FirstEnergy Corporation

USA, Electric Utilities

Accounting		Climate Assumptions		Audit		Date of analysis: April 26 2021
Judgements	Consistency with other reporting	Visibility	Paris alignment	Visibility in CAMs	Consistency check	Year end: December 2020 Report date: February 18 2021 AGM: May 18 2021
						CA 100+ company, so seen by investors as key to driving global net zero emissions
Significant concerns	Significant concerns	Significant concerns	Significant concerns	Significant concerns	Significant concerns	

Summary view:

- As an electric utility, almost all aspects of FirstEnergy's business are likely to be impacted by the energy transition and other climate risks. However, the continuing use of coal-fired generation in West Virginia stands out in terms of carbon footprint and the risks this presents to the company.
- The narrative reporting in the 10-K describes the multiple climate risks facing FirstEnergy but this does not appear to be reflected in any way in the assumptions used for the audited financial statements.
- FirstEnergy undertook a "2ºC global climate scenario" analysis in 2019, but this is not used for planning purposes.

Background

<u>The Business</u>

- First Energy Corp is an electric utility holding company, headquartered in Ohio and listed on the NYSE. It operates across transmission, distribution and generation of electricity, with 6 million customers in the American Midwest and Mid-Atlantic. Its Regulated Distribution segment accounts for around two-thirds of Income from Continuing Operations. This segment includes the generation assets, which account for approximately 40% of its revenues.
- FirstEnergy currently has generation capacity of 3790MW (including 210MW from the Yards Creek pump hydro asset, in the process of being sold). This capacity is primarily under its subsidiary in West Virginia, Monongahela Power Co. Coal, sourced from West Virginia and Pennsylvania, accounts for 82% of generation fuel (88% after the sale of Yards Creek).
- In 2020, FirstEnergy identified a Material Weakness in Internal Control over Financial Reporting, stating that certain former senior managers failed to set an appropriate tone at the top. A payment of approximately $4m in early 2019 was connected with the termination of a purported consulting agreement, the counterparty of which was an entity associated with an individual subsequently appointed to a full-time role as an Ohio government official directly involved in regulating FirstEnergy's Ohio subsidiaries. The company dismissed its CEO in October 2020 following an internal investigation. It states that this control deficiency did not result in a material misstatement in the annual or interim consolidated financial statements.

<u>Approach to climate change</u>

- The narrative reporting outlines several risks to FirstEnergy from climate change. These include: federal or state legislation could mandate the use of renewable or alternative fuel sources, which could significantly increase purchase costs or capex requirements; and there could be regulatory or legislative incentives to reduce peak demand and energy consumption.
- Concerning coal generation specifically, the narrative reporting mentions the potential for questions over the future viability of the use of coal, which would impact cash flows and profitability. Elsewhere, the narrative reporting raises the possibility of reductions to the useful life of coal generation assets and the impact this would have on depreciation and impairment. The Annual Report states that "we plan we plan to execute a thoughtful transition away from our two coal-fired plants in West Virginia by 2050".
- It is acknowledged that physical risks from climate change could have a number of effects on FirstEnergy including damage to capital assets, disruptions to supply chains and changes (increases or decreases) in end-user demand for energy.
- The company also notes the potential for investor aversion to coal assets, including divestment, having a negative impact on the stock price and access to capital markets. The

company's access to insurance underwriting may also be negatively impacted as insurance companies seek to reduce exposure to coal assets.

- However, while outlining these diverse risks to the company, FirstEnergy concludes it "cannot currently estimate the financial impact of climate change policies".
- In 2020, FirstEnergy issued a Climate Position and Strategy Statement including a pledge to be carbon neutral by 2050, with an interim goal of a 30% reduction in GHG Scope 1 emissions under direct operational control by 2030 (against a 2019 baseline). It also has a goal for electrification of its own vehicle fleet and is seeking approval to construct a 50MW solar asset. An earlier 2019 Climate Report outlined the significant risks and opportunities from a 2ºC global climate scenario, including regulatory risks, changes to the generation mix, increased electricity usage and the potential for utility-owned renewable regulated generation.

Accounting: judgements and consistency with other reporting

Accounting judgements		Significant concerns

- FirstEnergy reports using US GAAP for the financial statements.
- There is no reference in the notes to the financial statements that accounting judgements have been impacted by climate-related considerations.

Consistency with other reporting		Significant concerns

- There is a disconnect between the relatively extensive consideration of climate-related risks and issues in the narrative reporting and the apparent lack of consideration of the financial implications of these in the financial statements and notes.
- FirstEnergy published a Climate Report in 2019, which outlined risks and opportunities arising from a 2ºC global climate scenario by 2050, with emissions reductions goals updated in a 2020 Climate Statement. Such a scenario would require electricity generation from coal to be close to zero by 2035. However, management does not use this scenario for planning and the substantial financial implications are not reflected in the financial statements.

Climate assumptions in accounts: visibility and Paris alignment

Visibility of climate assumptions in accounts		Significant concerns

- There are no apparent climate-related assumptions. There is thus no sensitivity analysis.

Paris alignment		Significant concerns

- With no visibility, there can be no alignment with the goals of the Paris Agreement.
- Although the notes to the audited consolidated financial statements describe the shifting US politics concerning adoption of the Paris Agreement, First Energy asserts that it "cannot currently estimate the financial impact of climate change policies, although potential legislative or regulatory programs restricting CO2 emissions, or litigation alleging damages from GHG emissions, could require material capital and other expenditures or result in changes to its operations".
- Although the Climate Report, published in 2019, explored a 2C global climate scenario in some detail, the report stated that "this scenario is not used as a part of our current planning forecast" and does not feed through to the financial statements.

Audit: visibility in CAMs and consistency check

Audit firm: PwC	Responsible partner: Allan neil Crawford III
Audit standards: PCAOB standards	

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Visibility in Critical Audit Matters		Significant concerns

- There is no reference to climate change in the auditor's report.
- There is 1 CAM identified: recoverability of regulatory assets that do not have an order for recovery. Although this CAM is not directly related to climate risk, it is possible that climate-related considerations could increase the uncertainty over recoverability of regulatory assets if climate change leads to increased regulatory uncertainty or the passage of new legislation.

Consistency check		Significant concerns

- PCAOB audit standards require the auditor to read other information that is presented together with financial statements and the auditor's report thereon. The auditor's report is silent on the outcome of the review, which implies that no material inconsistency was identified in the other information within the 10-K.
- The apparent absence of climate considerations in the audited financial statements does not appear consistent with the description of the climate risks in the narrative reporting of the annual report.

The Climate Accounting Project is an independent investor-led project to reinforce the statements of the IASB and IAASB that material climate change issues are incorporated within their standards. This analysis seeks to understand the extent to which companies and auditors are delivering against this aspect of these standards and similar local standards.		**Key**
		Good practice
		Few concerns
		Some concerns
		Significant concerns

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