China Shenhua

China, Coal

Accounting		Climate Assumptions		Audit		Date of analysis: May 13 2021
Judgements	Consistency with other reporting	Visibility	Paris alignment	Visibility in KAMs	Consistency check	Year end: December 2020 Report date: March 26 2021 AGM: May 28 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 the world's largest coal miner, which also operates coal-fired power plants, China Shenhua faces very significant climate risks, especially since the Chinese government committed to carbon emissions targets last year. These risks cover policy risk from stricter emissions standards, transition risk as consumption shifts to alternative energy sources, and probably reduced access to capital markets.
- Although the narrative reporting of the Annual Report makes some high-level comments on carbon emissions, the discussion of climate risks is limited, with no mention of Scope 3 emissions. The risk of stranded assets must be considerable but is not addressed. There is no reference to any judgements or estimates in the audited financial statements having been affected by climate change considerations.
- Instead, China Shenhua continues to invest in coal mining and coal-fired power plants, with the latter accounting for 42% of the CAPEX budget for 2021. Inexplicably, the estimated useful lives for non-current assets have been lengthened.

Background

The Business

- China Shenhua Energy Co is the world's largest coal mining company. At end-2020, it had coal reserves of 29.7bn tonnes and recoverable reserves of 14.4bn tonnes under the PRC Standard, while the marketable coal reserve under the internationally recognised Australian JORC Standard was 7.7bn tonnes. In 2020, the company produced 292m tonnes of coal and sold 446m tonnes (it also purchases coal from third parties in areas surrounding its mines).
- China Shenhua also generates electricity in coal-fired power plants, operates coal-to-chemicals plants (producing polyethylene and polypropylene), and has an integrated railway network and port facility, which are primarily used for transporting the company's coal. The total installed capacity of China Shenhua's power generation was 32,279MW, of which 97% was from coal-fired plants in China, with the remainder in renewables in China and coal plants in Indonesia. A further 5,320MW of coal-fired generation is approved and under construction. Out of total CAPEX planned for 2021 of RMB355,820m, 42% is for the power segment (for construction of coal-fired generation, including some in Indonesia), 26% for transportation, 21% for the coal segment and 9% for coal chemicals.
- China Shenhua is a state-owned enterprise, incorporated in China and publicly listed with H shares on the Hong Kong Stock Exchange and A shares on the Shanghai Stock Exchange. The Chinese government owns 69.52% through parent company China Energy Investment Corporation, which is 100% owned by state holding company SASAC.
- According to its ESG Report, GHG emissions for 2020 totalled 135m tonnes of CO2 equivalent (127m tonnes Scope 1 and 8m tonnes Scope 2). These numbers do not include Scope 3 emissions, which will be much higher for a company operating in this sector. Carbon intensity of operations (again excluding Scope 3) declined by 30% between 2018 and 2020, which may reflect greater efficiency of coal consumption in power plants.
- The company faces substantial transition risks, particularly after the Chinese government's announcement in September 2020 that it will seek to contain carbon emissions in the medium-term (peak emissions 2030) and achieve carbon neutrality by 2060. These targets will require a significant reduction in coal-fired electricity generation, which will directly impact China Shenhua. The significant risk of stranded assets – especially given the multiple of reserves to current production – is not mentioned anywhere in China Shenhua's reporting.
- In addition, there could be physical climate risk to the company's mining operations and other assets from extreme weather events.

Approach to climate change

- Although the narrative reporting in the Annual Report includes a number of high-level references to carbon emissions, such as the reference in the chair's statement to "target tasks of peak carbon dioxide emissions and carbon neutrality", these comments are general in nature with little accompanying explanation. The coverage of climate-related risks is also brief, with some climate risks subsumed within other risks. For example, policy risk includes meeting the goal of "carbon peak and carbon neutrality" under the country's increased requirements for the energy industry. Similarly, risk of safety production and environmental protection notes the further tightening of national standards and the environmental tax, although the focus is primarily on pollutants, such as sulphur dioxide, nitrogen oxide and soot, with no explicit mention of carbon emissions or climate change.
- The ESG Report covers climate risks in somewhat more detail, splitting them into "strategy risk", including national policy risk and risk of transition away from coal consumption, and "operating risk", including technological risks, such as carbon capture costs, environmental licensing risk, and "disaster risk", which is essentially physical risk of weather events. The risk of reduced access to finance and capital markets is not mentioned.
- Going slightly beyond the Chinese government's commitment, China Shenhua has set a target of peak carbon emissions by 2025 and carbon neutrality by 2060. However, it is hard to reconcile this with the on-going CAPEX in coal-fired power plants and continuing investments in coal mining. Presumably these targets exclude Scope 3 emissions given that the company's emissions disclosures only address Scopes 1 & 2.
- In 2020, China Shenhua invested in what it terms a "demonstration project" of capture and storage of CO2, participated in the national carbon market and increased the use of forest carbon sinks. In early 2021, China Shenhua contributed RMB4bn to the Guoneng Fund to invest in renewable technologies including wind power, solar and hydrogen energy.

Accounting: judgements and consistency with other reporting

Accounting judgements		Significant concerns

- China Shenhua reports under IFRS as issued by the IASB.
- There is no reference in the notes to the financial statements that accounting judgements have been impacted by climate-related considerations.
- In 2020, China Shenhua made changes to its depreciation schedule, extending useful lives for certain assets. There is no explanation given for this change, nor how it is to be reconciled with the heightened risk of stranded assets. The changes to depreciation will only apply prospectively and the company says there is no material impact on the consolidated financial statements: mining-related machinery and equipment from 5-20 years to 5-40 years; and generator-related machinery and equipment from 5-20 years to 8-35 years.

Consistency with other reporting		Significant concerns

- The lack of any reference to climate considerations in the financials is inconsistent with the climate risks in the narrative reporting of the Annual Report (albeit the articulation of these climate risks is very limited). Nor does it sit comfortably with the high-level statements on the importance of carbon issues to the company.
- Moreover, China Shenhua produces an ESG Report, published around the same time as the Annual Report, which covers climate risks in more detail with some emissions disclosures.

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.

Audit: visibility in KAMs and consistency check

Audit firm: KPMG	Responsible partner: Guen Kin Shing
Audit standards: Hong Kong Standards on Auditing (HKSAs)	

Visibility in Key Audit Matters		Significant concerns

- There is no reference to climate change in the auditor's report.
- There are two KAMs identified: (i) Impairment assessment on coal mines related non-current assets; and (ii) Timing of revenue recognition from sale of coal.
- The first of these KAMs should relate closely to climate risk, given the potential for a decline in coal prices and resulting stranded assets, but there is no reference to these issues being considered even though the audit report refers to management making assumptions on "the future market supply and demand conditions".

Consistency check		Significant concerns

- The apparent absence of climate considerations in the audited financial statements is not consistent with the climate risks mentioned in the narrative reporting and described in the more detail in the ESG Report.
- The ESG Report was assured by KPMG Huazhen, which was the audit firm for the audit of the Chinese audited financials, rather than by Hong Kong's KPMG, which was the auditor for the IFRS accounts. However, the text of the assurance report refers simply to KPMG.

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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