Cummins Inc.

USA, Industrials

Accounting		Climate Assumptions		Audit		Date of analysis: Mar.15, 2021
Judgements	Consistency with other reporting	Visibility	Paris alignment	Visibility in KAMs	Consistency check	Year end: Dec. 31, 2020 Report date: Feb. 10, 2021 AGM: TBD
Significant concerns	Significant concerns	Significant concerns	Significant concerns	Significant concerns	Significant concerns	Climate Action 100+ company, so seen by investors as key to driving global net zero emissions.
Summary view: • The company's main product is diesel engine powertrains and components. Announced climate-related targets have not yet been integrated into business plans. Any consequences of steps that will be needed to achieve the goals have no visibility in the financial statements, nor is any statement made that such reassessments are in progress. • The climate and carbon-related assumptions currently used are not disclosed by the company or noted by the auditor.						

Background

The Business.

- Cummins designs, manufactures, distributes and services diesel, natural gas, electric and hybrid powertrains and related components. By far, the current business remains dominated by diesel. The company is organised into five operating segments: Engine, Distribution, Components (including emission solutions), Power Systems and New Power.
- The last of these is essentially development-stage, focusing on hydrogen production, and electrified power systems, batteries and fuel cells. Its operations consist mainly of a joint venture formed with L'Air Liquide, S.A., representing only 0.4% of consolidated revenue.

Approach to climate change.

- Cummins introduced a sustainability strategy in late 2019, with eight goals to be achieved by 2030, and targets for 2050 that are referred to as 'aspirational' and include carbon neutrality. None of these are articulated in the 10-K; they appear in the 2020 Sustainability Report (SR). Not yet integrated into business planning, progress is to be reported starting in 2022.
- Four of the 2030 goals are said to be science-based and Paris-aligned; these include:
    - 50% reduction: absolute GHG emissions from facilities and operations.
    - 25% reduction: scope 3 absolute lifetime GHG emissions from newly sold products.
    - 55 million metric ton reduction: scope 3 GHG emissions from products in the field.
    - 50% reduction: volatile organic compounds emissions from paint and coatings.
- A further four 2030 goals relate to re-use and recycling of materials, and reduced water usage.
- Given the focus on diesel, the potential for future bans or limitations on diesel is noted as a risk, as are legislative and regulatory responses to climate change more generally.
- Other risks include a weakness in commodity prices reducing mining industry demand, competition from new technologies and success of the company's own investment in new technologies. Also included is a risk that lower energy costs decrease demand for products that are designed for fuel economy. For all of these, the company is unable to predict potential impacts which could have material adverse effects.

Accounting: judgements and consistency with other reporting

Accounting judgements		Significant concerns

- There is no explicit reference to climate change in the notes to the US GAAP financials. It is not apparent that any consideration of climate has been built into the numbers.
- Useful lives of PP&E vary from 3-40 years (69% being machinery, equipment & fixtures at 3-15 years). 2020 depreciation roughly implies average lives of 16 years, and 7 remaining.
- No asset retirement obligations are noted.
- Quantitative goodwill impairment testing was performed on the automated transmission business, consisting of a joint venture with Eaton Corporation plc (Eaton Cummins Automated Transmission Technologies), acquired relatively recently (2017). No disclosure of specific assumptions is provided, and no impairment was recognised.

Consistency with other reporting		Significant concerns

- Having stated climate-related commitments, the 2020 financial statements lack any references to financial considerations that might be expected as plans become more concrete.
- The SR reports progress on previously set 2020 goals, including reduced energy intensity of facilities and greater use of electricity from renewable sources. While financial data for some of these initiatives is disclosed in the SR, it is not shown in the audited financial statements.

Climate assumptions: visibility and Paris alignment

Visibility of climate assumptions		Significant concerns

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

Paris alignment		Significant concerns

- With no visibility, there can be no alignment of assumptions with the goals of Paris.

Audit: visibility in CAMs and consistency check

Audit firm: PricewaterhouseCoopers LLP	Responsible partner: Jon Gerald Van Drisse
Audit standards: US standards (PCAOB)	

Visibility in Critical Audit Matters		Significant concerns

- There is no explicit reference to climate change in the auditor's report.
- The auditor identifies two Critical Audit Matters, the goodwill impairment assessment of the Automated Transmission reporting unit, and liabilities for warranty programs.
- Professionals with specialized skill and knowledge were used to assist in the evaluation of the appropriateness of the Company's discounted cash flow model and reasonableness of the discount rate assumption, but no mention is made of climate expertise.

Consistency check		Significant concerns

- The auditor makes no mention of procedures to ascertain consistency of other information included in the 10-K. As such a check is required by PCAOB standards, this implies that no material inconsistency was identified, but it is not possible to assess this or the procedures undertaken, from what is stated. Note also concerns over consistency of reporting (above).
- While the SR is not directly assured, the company states that more than 80% of the Environmental and Social Data has been reviewed by Bureau Veritas, referring to its Independent Assurance Statement included in the GRI Data Book, and that financial data comes from the 10-K, which is audited by PricewaterhouseCoopers LLP. This is not strictly accurate, as PwC's audit is of the financial statements, not the entirety of the 10-K.
- The 2020 Proxy makes no mention of climate change considerations by the Audit Committee.

Stripes image credit: Prof. Ed Hawkins www.showyourstripes.info

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

Terms, conditions and disclaimer

The information contained in this document is for general information and educational purposes only.

Nothing in this document constitutes investment, legal, accounting, tax or other professional advice, or any recommendation to buy, sell or hold any security or other financial instrument, nor to exercise voting rights in any particular way. The information contained in this document is not intended to form the basis of any investment or voting decision, it does not constitute any form of investment recommendation or investment research and has not been prepared in accordance with any legal requirements designed to promote independence or objectivity. The authors of this report are not regulated by the Financial Conduct Authority or any other financial regulatory authority. You should make your own independent assessment and seek your own professional advice.

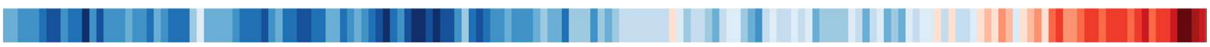
No representation or warranty is made that any of the information contained in this document is accurate or complete and no responsibility or duty of care of any kind is assumed by any person for errors or omissions in the contents or for the fairness of the opinions given. The authors do not accept any liability whatsoever for any direct or consequential loss howsoever arising, directly or indirectly, in connection with the use for any purpose of the information contained in this document.

You expressly agree that you use the information in this document at your own risk.

All information in this document is believed to be current as of the date of publication. Information may have been updated subsequently. The authors may make additions, deletions, or modifications to the contents at any time without prior notice.

This document reflects the authors' own interpretation and opinion of accounting and auditing standards and how companies and their auditors have applied those standards. No representation or warranty is made that any interpretation or opinion of International Financial Reporting Standards, International Standards for Auditing, other financial reporting and regulatory requirements or the application of these standards or requirements by individual companies or their auditors is correct, complete or fair, nor that they are incorrect, incomplete or unfair, or that the same views would or would not be arrived at by others. You should seek your own professional advice if making decisions that depend on the interpretation of any standards related to financial reporting or auditing, or other regulatory requirements.

The views expressed in this document reflect the personal opinions of the authors and not those of any other companies, organisations, committees or persons with which they may be associated.



Stripes image credit: Prof. Ed Hawkins   www.showyourstripes.info