PGE Polska Grupa Energetyczna SA

Poland, Electricity

Accounting		Climate Assumptions		Audit		Date of analysis: May 24 2021
Judgements	Consistency with other reporting	Visibility	Paris alignment	Visibility in KAMs	Consistency check	Year end: December 2020 Report date: March 23 2021 AGM: n.d.
Significant concerns	Significant concerns	Significant concerns	Significant concerns	Significant concerns	Significant concerns	CA 100+ company, so seen by investors as key to driving global net zero emissions

Summary view:

- Poland's main electricity generator and distributor, PGE has major climate change exposures because the bulk of its generation capacity is from fossil fuels, particularly hard coal and the especially carbon-intensive lignite.
- The discussion of its climate change ambitions, for 85% generation from low- or zero-emission sources by 2030, do not seem consistent with other discussions and reporting of company plans, let alone with the very limited coverage of climate-related matters in the financial statements.

Background

The Business

- PGE is Poland's state electricity generator and distributor. It remains 57% owned by the Polish state with the remaining free float listed on the Warsaw exchange. It provides around 41% of electricity in the country.
- It operates through 6 segments: conventional power generation, heat generation, renewable power generation, trade (as named in the financials; oddly, this is called 'supply' in the report on activities), distribution and other. Conventional power generation is powered mostly from coal, and the segment also includes lignite exploration and extraction activities. Renewables includes pumped storage hydro operations as well as renewables more strictly understood. Trade includes buying and selling electricity and gas on the wholesale markets and trading in emission allowances among other things.
- Conventional power is the largest segment by both assets and revenues (though the trade segment is of a similar scale in terms of revenues). It is also loss-making. Capex continues into this segment: a total of PLN2.4bn, the biggest single item being PLN504m into the lignite-fired 490MW unit 7 at the Turow Power Plant (total cost PLN3.6bn; expected life not disclosed). PGE is committed to a further PLN5.8bn in future capex in the conventional segment, in contrast to only PLN185m committed to the renewable segment. PLN4.2bn alone is committed to constructing 2 combined cycle gas turbine plants at Dolna Odra.
- The company discloses that the Czech Republic has launched a case against Poland's extension of the life of the Turow lignite mine to 2044, operated by PGE. The case is being heard by the European Court of Justice; on May 21 the court ordered the interim shuttering of the mine pending its decision on the case.

Approach to climate change

- PGE has a stated ambition to be climate neutral by 2050. By 2030 it aims to have around 85% of generation from zero- and low-emission sources, with renewables providing around 50% of the total. PGE plans for 2.5GW of offshore wind generation capacity by 2030 and 6.5GW by 2040. Onshore wind and solar are targeting 1GW and 3GW by 2030 respectively. 70% of heat generation capacity should be from low- and zero-emission sources by 2030. It predicts total capex of PLN75bn 2021-2030, about half of which will be on renewables. Some of its plans are dependent on the adoption of green hydrogen to substitute as fuel in gas plants.
- The company is subject to the EU emissions trading scheme (ETS). CO2 emission costs totalled PLN5.5bn in 2020, with the increase from 2019's PLN3.0bn arising from increased prices (PLN2.0bn) and reduced free allowances (PLN588m).
- The company is keen to emphasise a reduction in relative carbon intensity, to 0.85 tCO_2/MWh, from 0.98 in 2013/14. However, even its non-financial reporting provides only

limited insight into its absolute carbon footprint. CO2 emissions for 2020 from the power plants and heat plants are said to have been 59.5m. The unit is not stated, but presumably this is tCO2; it does not encompass all GHG emissions, and it is also not made clear, but this appears to be Scope 1 emissions only. Further, from the description this reported number entirely excludes the company's mining operations and other emissions sources.

- There is no apparent recognition of risks from the physical impacts of climate change for the company, in spite of, for example, the obvious rainfall dependencies of hydroelectric power production.

Accounting: judgements and consistency with other reporting

Accounting judgements		Significant concerns

- PGE reports in accordance with IFRS as adopted in the EU.
- By far the largest line balance sheet line item is the PLN61.7bn in PP&E, up 3.4% on 2019 (of PLN66.5bn total non-current assets and PLN81.6bn assets overall). There was an impairment during the year of PLN530m with regard to the conventional power generation segment. PP&E in the distribution segment is valued at PLN19bn; this valuation is largely dependent on the tariff permitted by the Energy Regulatory Office.
- Buildings, premises and civil engineering structures (totalling PLN24.6bn at year end) have 20-60 year depreciation periods and have stated average remaining such periods of 17 years; machinery and technical equipment (PLN26.3bn) is depreciated over 4-40 years with an average remaining life of 14 years; and while other PP&E (PLN6.5bn) is said to have 5-10 year lives for depreciation purposes, the stated average remaining is also 14 years.
- The company notes the government's February 2021 statement *Energy Policy of Poland until 2040*, which will require increases in renewables generation and reductions in coal-fired power. PGE states "in the opinion of the PGE Group, the assumptions adopted in the assessment of the recoverable value of generation assets are consistent with the Policy". It notes if its assumptions are wrong there would be significant implications for PGE's future financial position and reported results.
- PGE maintains a provision of PLN8.1bn for land rehabilitation, largely (PLN7.5bn) attributable to its lignite mines. This has a number of embedded assumptions about the lives of the mines, costs of rehabilitation and discount rates, all of which might be influenced by climate change scenarios. PLN1.2bn of the increase in the year arose from changes in assumptions. Current plans assume costs of rehabilitation start in 2030 for Belchatow and 2045 for Turow.
- The company recognises a PLN461m contingent liability for environmental funds, acknowledging an obligation to repay financing if the investments that they funded do not bring the (unspecified) intended environmental benefits.

Consistency with other reporting		Significant concerns

- The financial statements are published at the same time as management's report on activities and the supervisory board's assessment of both reports, together constituting the annual reporting suite. The non-financial report is published a short while thereafter.
- The scale of the climate change challenge faced by the company, as a lignite miner and a producer of electricity predominantly from coal and lignite, is only partly reflected in the narrative reporting and not appropriately in the financial statements. In particular, the goal of 85% of generation in 2030 being from low- or zero-emission generation does not seem consistent with the PP&E valuations and asset lives of existing assets.
- Furthermore, the various statements around plans for the lignite business in different elements of the company's reporting do not seem consistent with each other. The output levels when compared with existing resources in the two main lignite mines (Belchatow-Szczercow and Turow) seem largely consistent with the expected closure dates of 2040 and 2044, presuming much greater exploitation of the Turow resource once the new 490MW plant is completed,

but not with the illustrative indications of significant reductions in lignite extraction from 2030. It is certainly not consistent that the company highlights two strategic options of further lignite resources – Gubin near Turow and Belchatow-Zloczew. Exploitation of either of these would certainly not be consistent with the 2030 ambition.

Climate assumptions in accounts: visibility and Paris alignment

Visibility of climate assumptions in accounts		Significant concerns

- The discussion of the impairment of conventional power generation assets mentions assumptions regarding EU ETS prices: "CO2 emission allowance price forecasts provide for a dynamic growth of market prices in the subsequent years". It also states that the assumption for hard coal prices is for declines until 2026, followed by price increases of a "few" percentage points in subsequent years; gas prices are expected to jump 16% in 2021 and rise thereafter by around 3.5% a year. No more detail is provided on these items, and nowhere is there any discussion of the relevance of realistic climate scenarios for these assumptions.
- Regarding the heat generating segment, PGE assumes that free ETS allowances will be available for up to 30% of generation.
- There are no other apparent climate-related assumptions, and the only apparent sensitivity analyses relate to the heat generation and renewables segments, and include only sensitivities to the electricity price and the WACC, and solely to the WACC, respectively.

Paris alignment		Significant concerns

- Though visibility on the assumptions is limited, it does not seem that any of the modelled fossil fuel prices are in any way aligned with the goals of the Paris Agreement.

Audit: visibility in KAMs and consistency check

Audit firm: Deloitte Audyt	Responsible partner: Adrian Karas
Audit standards: Polish Standards on Auditing (PSAs), largely aligned with ISAs	

Visibility in Key Audit Matters		Significant concerns

- There is no explicit reference to climate change in the auditor's report.
- There is only one KAM identified – recoverability of the carrying amount of PP&E
- The KAM references the impairment testing and overall impairments for the year totalling PLN654m. The auditor reports testing the relevant assumptions as to future cash flows, identifying a number of key sensitivities, including macroeconomics, the discount rate and residual values, a number of which would potentially be impacted by climate change considerations, including additional CO2 emission constraints or costs. It is not apparent that climate change considerations were incorporated in the auditor's approach.
- Though PGE specifically notes that some of the assumptions in its impairment assessments are related to fossil fuel prices and ETS costs, the reference to the use of advice from specialists refers to valuation experts, not those expert in climate change or CO2 markets.

Consistency check		Significant concerns

- The main focus of the auditor's review of Other Information is management's report on the activities of the company. The auditor must highlight if it identifies any material misstatement, or inconsistency with the financial statements.
- The auditor makes a positive statement that the report on activities is consistent with the financial statements, and also notes that it has not identified any material misstatement in it.
- The auditor explicitly excludes expressing any assurance on non-financial reporting by PGE.

- The absence of detailed consideration of climate issues in the financials when compared with the substantial climate challenges faced by PGE, and as acknowledged in its narrative reporting, make it hard to see how there is consistency in reporting.

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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