Delta Air Lines

US, Transport

Accounting		Climate Assumptions		Audit		Date of analysis: May 12 2021
Judgements	Consistency with other reporting	Visibility	Paris alignment	Visibility in CAMs	Consistency check	Year end: December 2020 Report date: February 13 2021 AGM: June 17 2021
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:

- A leading airline with acknowledged clear exposures to climate change issues, both physical and transition. Because it operates an oil refinery business, these exposures are even greater for Delta than its peers.
- Despite an ambition to be net zero carbon in the aviation business, these climate-related issues do not appear to be reflected in the financials, even though they implicate a number of long-lived liabilities.

Background

The Business

- Delta is one of the US's leading airlines, operating a predominantly domestic US service with smaller operations across the Atlantic, in Latin America, and in the Pacific. It is a member of the SkyTeam alliance, one of the three global airline groupings. Delta also operates the Trainer oil refinery in Pennsylvania with the aim of reducing the cost of aviation fuel to the group; it supplies fuel directly to operations in the north-eastern US, including New York, exchanging its non-aviation fuel products for supplies from other producers. The refinery's revenues are thus all intercompany transactions but amount to more than 10% of Delta's total.
- Due to the COVID-19 pandemic, 2020 capacity fell by around 50% from 2019 levels. Despite significant government support (both grants and loans), this led to a net loss of $12.4bn.

Approach to climate change

- In February 2020, Delta announced plans to invest $1bn over the next 10 years to deliver on its aim of carbon neutrality. It recognises aviation fuel as its biggest exposure, and is supporting efforts to develop sustainable aviation fuels and make air traffic control more efficient. It also highlights the need for unspecified carbon removal technologies as part of delivering carbon neutrality.
- Delta references the airline industry's CORSIA initiative. CORSIA's central targets are that all growth in flights beyond 2020 (from a pre-pandemic 2019 baseline) should be carbon neutral, and that 2050 GHG emissions from the industry should be half of those in 2005 but these targets rely largely on offsetting emissions (and there are significant doubts about the programme[1]). It is not apparent how the additional costs inherent in CORSIA have been factored into company investment plans.
- The company has used the crisis as a moment to retire 227 older aircraft and so increase average fuel efficiency as well as remove complexity in its fleet.
- Delta acknowledges risks of additional costs arising from the physical impacts of climate change, specifically disruption from increasingly frequent severe weather events.

Accounting: judgements and consistency with other reporting

Accounting judgements		Significant concerns

- A US company so subject to US GAAP standards.

[1] See for example *The EU's assessment of the Corsia airline CO2 deal*, Transport & Environment, March 17 2021

- There appears to be no 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.
- Delta has significant long-term financial commitments which assume ongoing growth in air travel, including leases, firm commitments to buy aircraft and capacity purchase agreements with regional carriers. It does not appear that climate change issues have been taken into account with regard to these future expenditures. Aircraft lease terms run for up to 15 years, with operating leases averaging 12 remaining years, covering 353 aircraft (145 on finance leases, 208 under operating leases). Lease liabilities (also including property etc) total $7.6bn. Operating lease committed cashflows beyond 2025 total $4.4bn. Furthermore, Delta has firm commitments to buy 224 aircraft with a total financial commitment for purchases of $13.9bn; of this, $2.7bn is due in 2025 and $2.1bn due thereafter. Capacity purchase agreements total to liabilities of $7.7bn, with $837m due in 2025 and $1.7bn thereafter.
- Delta took $4.4bn in impairment-related charges on the retirements of 227 owned and leased aircraft. It also wrote off the entire $375m value of its 49% stake in Virgin Atlantic from its balance sheet as part of an overall $510m impairment (incorporating expected future losses) and wrote down the value of its 9% stake in Air France KLM by some $180m, to $235m. Delta retains some $9.7bn of goodwill on its balance sheet.
- Aircraft, spare engines and parts have estimated useful lives of 20-34 years and are amortised on a straight-line basis to a residual value of 5-10% of the original. Buildings have lives up to 40 years. The total value of all long-lived assets on the balance sheet is $26.5bn.
- The airline is unusual in operating an oil refinery. In normal years, this has produced (or the non-aviation fuel products have been exchanged for) some 200,000 barrels of aviation fuel a day, around 75% of Delta's total needs.

Consistency with other reporting		Significant concerns

- The company publishes its 10-K separately from other reporting. The proxy statement and 2020 ESG Report were produced around 12 weeks later.
- The 10-K narrative reporting incorporates the goal of carbon neutrality, but this is only set out in detail in the ESG Report. This makes it clear that from March 2020 the company aims to be net zero in its aviation operations. In practice this amounted to in 2020 a reduction of 1.1m metric tons of CO_2 through improved fuel efficiency and the fleet retirements, a 33 metric ton reduction through the limited use of sustainable aviation fuel, and fully 13m tons that were subject to offsetting – at a price of $30m. Delta is investing to foster the market to fulfil its a goal of 10% of its needs being supplied by sustainable aviation fuel by 2030, with dates specified for deliveries to start from new producers. It also references unproven carbon capture and sequestration technologies as being part of delivering its overall aim.
- The 10-K narrative reporting also acknowledges existing exposures to physical climate change risks, arising from weather-related disruption.
- The scale of these issues does not seem consistent with the absence of any consideration of climate change within the financial statements and notes.
- Even the ESG Report is incomplete: all the discussion on carbon neutrality in the ESG Report is in relation to the aviation business, and does not include the oil refinery operation. The disclosed Scope 1 emissions also state that they exclude those from the refinery.

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.

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Audit: visibility in CAMs and consistency check

Audit firm: Ernst & Young LLP	Responsible partner: Beau Barrett Bradley
Audit standards: PCAOB standards	

Visibility in Critical Audit Matters		Significant concerns

- There is no explicit reference to climate change in the auditor's report.
- There are 3 CAMs identified: (i) employee benefit plans; (ii) fair value of fleet assets; and (iii) deferred tax.
- The second and third CAMs depend in large part on estimates of future flying activity and profitability, and so are likely to be impacted by climate change and any carbon constraints or pricing that might be imposed. It is thus concerning that there is no appropriate reference to climate change issues in relation to these.
- The references to the use of advice from specialists refer to actuarial and tax specialists, not those expert in climate change or CO2 markets.

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 2020 10-K.
- The significant implications of carbon constraints for the airline industry, and Delta's aim of being net zero carbon in the aviation business, which are referenced in the 10-K narrative reporting, do not appear to be reflected in the financials, which include a significant weight of long-term financial commitments.

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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