Climate Accounting and CA100+

Why should investors look at accounting in addressing climate change?

Fuller financial disclosures enable investors to incorporate climate risks into their investment decision making, helping focus investment on those companies that are more likely to thrive in a carbon-constrained future.

At the moment, most companies assume business as usual in their financial statements, while at the same time in the annual report recognising that business as usual is something that the planet simply cannot sustain.

2020 saw a number oil companies write down the value of their asset bases (worth $billions), using oil price assumptions that are closer to those that might be consistent with the Paris Agreement.

Climate Accounting and CA100+

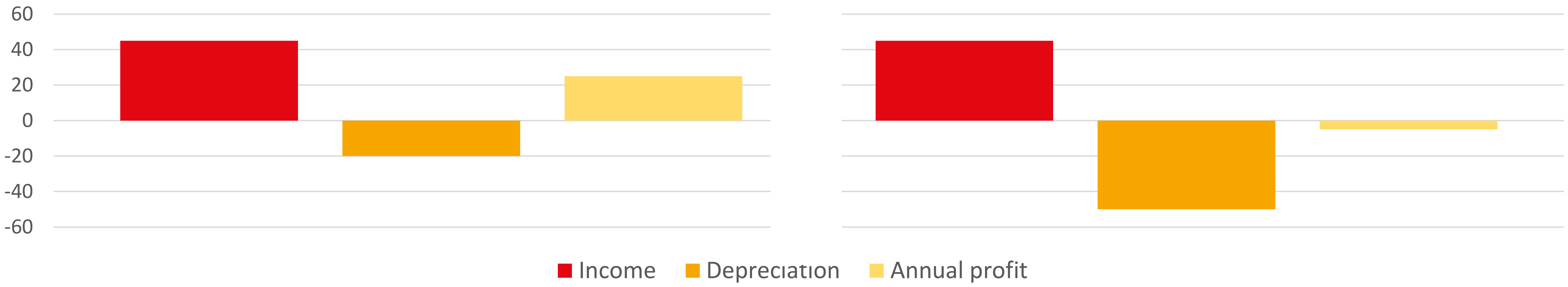
Financial accounting matters - example

Technical accounting requirements affect company profitability and asset values, which in turn can affect investment decisions by companies, remuneration of executives and investment decisions by investors. For example:

Coal-fired power station: $500M investment, output worth c$45M a year

Assumed useful life – 25 years

Assumed useful life – 10 years



$20M annual costs
$25M annual profit (pre financing)
Investment goes ahead

$50M annual costs
$5M annual loss (pre financing)
Investment does not proceed

What do the accounting standard-setters say?

The IASB, which sets accounting standards in the bulk of the world, has issued a paper making clear that material climate change risks must be incorporated in IFRS financial reporting. If properly followed it will have profound implications for the way companies are valued and the decisions made by investors.

The global auditing standard-setter, the IAASB, has also produced a paper highlighting the ways in which climate change is already embedded within its requirements, the ISAs. Furthermore, the IASB recently reinforced the message of the November 2019 paper through the publication of educational materials which confirm that material climate change issues should already be reflected in IFRS compliant accounts.

The ICAEW, which is the largest professional body of accountants outside the USA, has also written about the need to consider climate.

Climate Accounting and CA100+

IASB paper IFRS Standards and climate-related disclosures[1] (Nov 2019)

Applies to all companies subject to IFRS (140 countries globally):

- Materiality (threshold for disclosure in IFRS reporting) is driven by what matters to investors
- Climate change is a material consideration for investors and so should be reflected
- Climate change could be relevant for:
  - asset valuations and impairments;
  - useful lives of assets;
  - potentially unprofitable contracts;
  - provisions and liabilities arising from fines or penalties; and
  - credit losses for loans and other financial assets


November 2019

In Brief

IFRS® Standards and climate-related disclosures

Nick Anderson

Climate change is a topic on which investors and other stakeholders increasingly ask the International Accounting Standards Board (Board), why this is not mentioned explicitly in IFRS Standards.

In this update, Nick Anderson, a member of the Board, provides an overview intended to help investors understand what already exists in the current requirements and guidance on the application of materiality, and how it relates to climate and other emerging risks. While climate change risks and other emerging risks are not covered explicitly by IFRS Standards, the Standards do address issues that relate to them.

This article has been inspired by work from the Australian Accounting Standards Board (AASB) and Audit and Assurance Board (AUASB).

What is this publication about?

The International Accounting Standards Board (Board) is often asked why IFRS Standards don't mention climate change. While the phrase 'climate-change' does not feature in our requirements, IFRS Standards do address issues that relate to climate-change risks and other emerging

Taking inspiration from the joint AASB-AUASB bulletin, we have prepared this publication to help analysts and investors better understand our requirements and our guidance on the application of materiality.

In the rest of this document we discuss:

- Implications for many balance sheets, on profitability and broader performance disclosures
- Companies should disclose the assumptions underlying reported numbers
- Now reinforced by educational material[2], issued November 2020

(1) https://cdn.ifrs.org/-/media/feature/news/2019/november/in-brief-climate-change-nick-anderson.pdf?la=en
(2) https://cdn.ifrs.org/-/media/feature/supporting-implementation/documents/effects-of-climate-related-matters-on-financial-statements.pdf?la=en

Climate Accounting and CA100+

IAASB: Consideration of climate-related risks in an audit of financial statements[1]

Applies to all audits subject to ISAs (global):

- Climate change will be material for many companies and so should form part of audit planning and delivery
- Particular attention is drawn to:
  - whether approach to incoming law and regulation is appropriate;
  - linkage with disclosures elsewhere in annual reporting;
  - relevant estimates and assumptions; and
  - use of specialist advice and expertise as needed.
- Climate change disclosures must be assessed as part of auditor’s consistency check across all reporting
- Issues of climate change need to be built into auditor reports, including adequacy of disclosures
- December 2020 response from Big 6 audit firms committing to deliver on IASB and IAASB statements[2]

IAASB®

Staff Audit Practice Alert
October 2020

The Consideration of Climate-Related Risks in an Audit of Financial Statement

This publication has been prepared by staff of the International Auditing and Assurance Standards Board (IAASB) to highlight areas of focus related to the consideration of climate-related risks when conducting an audit of financial statements in accordance with the International Standards on Auditing™ (ISA™). This publication does not amend or override the ISAs, the texts of which alone are authoritative. Reading this publication is not a substitute for reading the ISAs.

What Is the Purpose of This Publication?

This Staff Audit Practice Alert is intended to help auditors understand what already exists in the ISAs today and how that material relates to the auditor's consideration of climate-related risks in an audit of financial statements.

Focus on Climate Change

(1) https://www.iaasb.org/publications/consideration-climate-related-risks-audit-financial-statement
(2) https://www.ifac.org/system/files/upload/gateway/GPPC%20Letter%20to%20IASB.pdf

Climate Accounting and CA100+

What is PRI doing on climate accounting?

In September 2020 the PRI, together with UNEP FI, UN-convened Net-Zero Asset Owner Alliance, IIGCC, IGCC and AIGCC, signed an open letter supporting the IASB opinion and calling for:

- *Companies to apply the IASB opinion in the letter and the spirit, including showing the key assumptions that have been made with regard to climate-related risks.*
- *The assumptions made by companies in preparing financial statements under International Financial Reporting Standards be compatible with the Paris Agreement.*
- *Auditors sign off financial statements which are consistent with the IASB opinion in the letter and the spirit, which include showing the key assumptions that have been made with regard to climate-related risks.*
- *Regulators and civil society support the implementation of the IASB opinion.*

If the investor group letter is followed, the effect would be to discourage companies from investing in projects that are only profitable because they do not pay the cost of the damage they do to the planet. Investors are encouraged to sign an investor statement to support the PRI's continued engagement with the audit industry, accounting bodies and regulators to support the implementation of the IASB opinion. See the PRI website for more details.

Climate Accounting and CA100+

What are other investor networks/groups doing on climate accounting?

- In November 2020, **IIGCC** published their Investor Expectations for Paris-aligned Accounts. This is being used as a basis to engage a number of European companies.
- In June 2021, **Ceres** published their investor expectations for Paris-aligned financial reporting in the U.S. oil and gas sector.
- **Carbon Tracker** are providing company-level analysis for investors to use in the engagements coordinated by IIGCC and Ceres.

What is CA100+ doing on accounting? Will it be added to the Benchmark?

Currently there is no formal CA100+ expectation that investors engage focus companies on climate accounting, however the topic is increasingly being raised and discussed in engagements with CA100+ companies. In addition, a number of shareholder resolutions filed at oil and gas companies include an ask to review and adjust critical accounting assumptions in line with the Paris agreement.

Companies are assessed on their climate performance using the Climate Action 100+ Net-Zero Company Benchmark, which was launched in March 2021. For its next iteration, CA100+ intends to develop an indicator to assess a company's climate accounting practices and related disclosures. This will be included as part of a broader consultation on the future development of the CA100+ framework. See here for more on the planned development of the Benchmark.

Company briefs for PRI and AIGCC coordinated companies

Climate Action 100+
Global Investors Driving Business Transition

Analysis of company accounts for CA100+ investors

To raise awareness, PRI had developed company-level analysis for 52 of the CA100+ companies coordinated by PRI and AIGCC (with 31 Dec year-ends and forthcoming company accounts). These 2-page briefs will assess companies against three basic criteria (derived from the investor network letter of September 2020):

- *Do the financial reports reflect climate change issues, and are they consistent with the narrative reporting in relation to climate change?*
- *Are the climate-relevant assumptions disclosed, and if so, are they consistent with the goals of the Paris Agreement?*
- *Does the work of the auditor appear to have incorporated climate change issues? In particular, are the financials consistent with the narrative reporting with respect to climate change, and is there a key (or critical) audit matter relating to climate change?*

The aim of these briefs is to inform engagement where useful/applicable, and were made available to CA100+ investors in batches from March-May (in advance of company AGMs).

Please contact livia.rossi@unpri.org for any additional questions.

PRI is coordinating with Ceres, IIGCC and Carbon Tracker who are providing analysis on companies separate to those coordinated by PRI/AIGCC.

PRI Principles for Responsible Investment

Company briefs for PRI and AIGCC coordinated companies

Briefs for the companies below are available as of 31st of May. Assessment of the remaining CA100+ PRI and AIGCC companies, as well as all other CA100+ companies, will be incorporated to the next iteration of the CA100+ Benchmark.

Companies covered by the analysis (1 of 2)	
Air France KLM SA	Colgate-Palmolive Company
American Airlines Group Inc.	Cummins Inc.
Aneka Tambang Tbk (ANTAM)	Dangote Cement PLC
Anhui Conch Cement	Danone SA
Boeing Company	Delta Air Lines Inc.
Bumi Resources	Dow Inc.
Bunge Limited	Ecopetrol Sa
Caterpillar Inc.	Firstenergy Corp.
Cemex SAB de CV	Formosa Petrochemical
China National Offshore Oil Corporation (CNOOC) Limited	Grupo Argos SA
China Petroleum & Chemical Corporation, China Petrochemical Corp (Sinopec)	International Paper Company
China Shenhua Energy	Koninklijke Philips NV
China Steel Corporation	Korea Electric Power Corp

Company briefs for PRI and AIGCC coordinated companies

Companies covered by the analysis (2 of 2)	
Lockheed Martin Corporation	Saudi Arabian Oil Company (Aramco)
Martin Marietta Materials Inc.	Siemens Energy
Nestlé	SK Innovation Co Ltd
Petrochina Company Limited	Suzano S.A.
Petróleo Brasileiro SA - Petrobras	Teck Resources Limited
Petróleos Mexicanos - PEMEX	Trane Technologies PLC
PGE – Posla Grupa Energetczna S.A.	Unilever PLC
POSCO	United Airlines Holdings, Inc.
Power Assets Holdings Limited	United Tractors
PPL Corporation	Vale S.A.
PTT	Vistra Energy Corp.
Raytheon Technologies	Walmart Inc.
Rolls-Royce	Weyerhaeuser Company

Company briefs for PRI and AIGCC coordinated companies

Illustrative example

Accounting		Climate Assumptions		Audit		Date of analysis: March 9 2021
Judgements	Consistency with other reporting	Visibility	Paris alignment	Visibility in CAMs	Consistency check	Year end: December 2020 Report date: February 8 2021 AGM: n/a
Significant concerns	Some concerns	Significant concerns	Significant concerns	Significant concerns	Some concerns	CA 100+ company, so seen by investors as key to driving global net zero emissions

Summary view:

- With a significant commercial aerospace business, including an aero engine business with long-term spares and servicing contracts, Raytheon faces material risk exposures in many climate change scenarios.
- The new company does not seem to have given any climate undertakings and makes no relevant disclosures in its 10-K.

Background

The Business

- Following the 2020 merger between United Technologies and Raytheon, and the spin-offs of the Otis elevator and Carrier air conditioner and refrigeration businesses, Raytheon Technologies is a pure aerospace and defence company.

Approach to climate change

- The new company does not seem to have made any public climate change commitment.
- Predecessor firms United Technologies and Raytheon both had absolute greenhouse gas emissions reduction targets (though progress towards delivering United Technologies' had reversed ahead of the merger).
- Raytheon Technologies faces exposures both as a major manufacturer, and procurer of heavily carbon-intensive materials, and because its products are largely currently powered by fossil fuels. The latter risk may be mitigated by the absence of alternative fuels from a power-to-weight ratio perspective and on the defence side the likelihood that governments will seek carbon reductions elsewhere, but the commercial aerospace business will face exposure.

Accounting: judgements and consistency with other reporting

Accounting judgements	Significant concerns

- A US company so subject to US GAAP standards.
- Much of the value of the Pratt & Whitney aero engine business consists of long-term service contracts. The estimated lives of associated intangibles run out for 25-30 years, suggesting significant assumptions about the lives and level of use of these engines. Yet the engines rely on carbon-intensive fuel and may be unsustainable in some climate scenarios.
- The estimated useful lives of property plant and equipment currently extend long into the future: buildings up to 45 years and plant up to 20. This creates a potential exposure should climate transition require operational changes within those time-horizons.
- The discussion of environmental matters in the notes to the financials is exclusively related to remediation of pollution at individual sites and the recoverability of such costs.

Consistency with other reporting	Some concerns

- As with most US companies, the 10-K annual report is issued independently of other

- There is thus little regarding climate change for the financial statements to be inconsistent with.

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 with the goals of the Paris Agreement.

Audit: visibility in CAMs and consistency check

Audit firm: PricewaterhouseCoopers LLP	Responsible partner: Laurie Roberts Schupmann
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 4 CAMs identified: (i) valuation of acquired intangibles; (ii) tax-free natures of spin-offs; (iii) revenue recognition; and (iv) goodwill impairment.
- Only the last of these 4 CAMs might be expected to include climate-related elements, but in practice the consideration of goodwill (and other intangible) impairment focuses on the Covid-19 pandemic impacts on airline customers of the aerospace business lines. There is no apparent consideration given to the risks to the commercial aerospace business from realistic climate change scenarios.
- The references to the use of advice from specialists do not refer to specialists in climate change or CO2 markets.

Consistency check	Some concerns

- The auditor expresses its role as extending to the financial statements only.
- The 10-K is largely internally consistent given the minimal discussion on climate change in the narrative reporting and the fact it is wholly ignored in the financial statements.

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

The experts who have prepared the analysis

David Pitt-Watson

David Pitt-Watson is a leading thinker, campaigner and practitioner in the field of responsible investment. He has been a leader in helping ensure accounting standards reflect the challenge of global warming. He was co-founder, and former CEO of Hermes Focus Funds and Equity Ownership Service, which became the largest responsible investment group of any institutional fund manager in the world.

During his career he has been deeply involved in policy and has led numerous initiatives to improve the performance of the financial system. For example, he chaired the UN Environment Programme's Finance Initiative in the run up to the Paris Climate Conference. He was Visiting Pembroke Professor, and now a Fellow at Cambridge University. His books have been translated into five languages.

He currently advises Sarasin fund managers and is advisory chair of Ownership Capital. He was an independent non-executive at KPMG, Treasurer of Oxfam and chaired the NESTA endowment fund. This year he was appointed a fellow of the CFA Institute in recognition of his contribution to the industry.

The experts who have prepared the analysis

Paul Lee

Paul Lee is an independent consultant on ESG and stewardship matters. Most recently he has advised both a major UK asset owner and a leading fund manager on their approach to ESG and made detailed recommendations for improvements to both an Indian and an Australian company. He is developing stewardship best practice documents and training for two leading investor representative bodies.

Until June 2018, Paul was the Head of Corporate Governance at Aberdeen Asset Management, where he was responsible globally for setting best practice and for stewardship activities. Until 2015 Paul worked at the UK's National Association of Pension Funds (NAPF) where he was Head of Investment Affairs, leading the association's work on all investment matters. Previously, Paul worked for more than a dozen years at Hermes Fund Managers, where he helped to create and build its Equity Ownership Services unit, leading asset owners in dialogue with companies globally and with policy-makers and regulators.

At the same time as these executive responsibilities, Paul has played a significant role in developing auditing and accounting standards and best practice. He was a member of the Auditing Practices Board (and then the Audit & Assurance Council of the FRC), during which time the Board created of the new standard for enhanced auditor reporting. He was a representative on the Investor Advisory Group for SASB, the Sustainability Accounting Standards Board, and was a member of the Enhanced Disclosure Task Force (fostered by the Financial Stability Board). Until the end of 2020, Paul was a member of the Capital Markets Advisory Committee of the International Accounting Standards Board – the main investor group inputting on the development of IFRS standards - and has just been appointed as a member of the inaugural UK Endorsement Board, which will approve accounting standards for the UK.