

June 11, 2021

Gary Gensler, Chair
U.S. Securities and Exchange Commission

Submitted via <https://www.sec.gov/cgi-bin/ruling-comments>

Dear Chair Gensler:

We welcome the opportunity to respond to the Securities and Exchange Commission's (SEC's) request for input on climate-related financial disclosure, issued by Acting Chair Allison Herren Lee on March 15, 2021.

We are writing as the Climate Accounting Project (CAP), an independent expert group working with a number of organisations representing investors in companies globally, including the Principles for Responsible Investment (PRI), the Institutional Investors Group on Climate Change (IIGCC) and the UN Environment Programme Finance Initiative (UNEP FI) – see <https://www.unpri.org/sustainability-issues>. This submission is the work of the CAP alone and is not made on behalf of any of the above-mentioned organisations. Each of these organisations may be submitting its own response to your call for input.

This paper focusses on what we believe is a simple reform, which can be quite quickly implemented, and have considerable impact. We believe it would have considerable support.

We have been working on the issue of climate and accounting for the past three years. The work arose from the observation that **there is an anomaly in the way accounts have been drawn up, in that climate risks have not been considered or assumptions shown**. As a result, material information has been, and remains, missing. It is almost as if climate has been granted a specific exclusion – a suspension of the normal requirements that apply to other topics involving risk and uncertainty. But we know this is not the case. What seems to have happened is that accounting and audit practice has been developed from year to year. A generation ago climate was hardly recognised as an issue. Today it is. But as climate risks have developed slowly, they have not been incorporated either in accounting or auditing practices.

The members of our team include people who have held very senior roles within the fields of investment, accounting and regulation. Our work to date has focused on IFRS. Partly as a result, **the IASB¹ and following them the IAASB², have provided clarity on their existing requirements for accounting and audit, noting that climate must be considered and material assumptions shown**. Their opinions have been welcomed in the investment community.

Over recent months, together with the Carbon Tracker Initiative (Carbon Tracker) we have been reviewing the financial reports of over 100 US/global companies that investors identified as being key to driving the net-zero emissions transition. Our full report is yet to be written. However, it is already clear that while much remains to be done, **the IASB/IAASB guidance seems to have made a considerable difference to company reporting in Europe**. Little improvement is seen in the USA however, where the anomaly remains; consideration of climate risks is not evident in financial statements or audits, and assumptions are not often shown.

This leads us to consider the following suggestions in relation to the US, in order to ensure that the current requirements function as they should, and that where material, like any other risk, climate is considered and material assumptions shown when drawing up and auditing the accounts. We suggest there is an immediate need in the US in relation to climate-related matters to:

- Confirm current US accounting requirements (building on the FASB Staff paper on ESG³);
- Confirm current US auditing requirements;
- Confirm current US disclosure requirements (business, legal proceedings, risk factors, MD&A);

¹ [Educational material: the effects of climate-related matters on financial statements prepared applying IFRS Standards.](#)

² [The Consideration of Climate-Related Risks in an Audit of Financial Statement | IFAC \(iaasb.org\).](#)

³ [FASB Staff Educational Paper—Intersection of Environmental, Social, and Governance Matters with Financial Accounting Standards.](#)

- Clarify the consistency expected across these items; and
- Reassert that these requirements will be enforced.

The SEC is ideally positioned to address these aspects collectively. We believe that this could be done quickly and effectively. Specifically, we suggest:

- **Confirming current requirements:** A Staff Accounting Bulletin (SAB) would likely be a clear and authoritative tool for confirming current accounting requirements to both companies and auditors - confirming that climate matters need to be considered in preparing the financial statements under US GAAP; other tools that would similarly articulate current requirements could also be considered.
- **Enforcing requirements:** Confirmation of current requirements would need to be followed by enforcement by the SEC and PCAOB in their respective capacities. Signalling this in advance could help to encourage widespread improvement.

It is important that any potential for ambiguity be removed for both companies and auditors, and that confirmation of requirements be comprehensive and specific as to where and how material issues should be taken into account, and assumptions disclosed. Specifically on accounting, and following the lead taken by the IASB, clarification should address aspects of recognition, measurement, presentation, and disaggregation of significant items, as well as other aspects of disclosing policies, assumptions, and estimates, and the result of applying them to reported amounts.

We believe that taking these two steps⁴ would represent an essential and meaningful action that is very much in line with the SEC's mission to: protect investors; maintain fair, orderly, and efficient markets; and facilitate capital formation. The current situation, where known risks and commitments made are not mentioned and accounting does not appear to reflect these elements, is not serving the markets in the manner required. It is, as we have mentioned, an anomaly which needs to be addressed; it is urgent that companies and auditors make-good on the current requirements.

These steps would also be compatible with, and could be done alongside, the consideration of potential new initiatives or requirements for climate-related (or even wider ESG) disclosure, without placing any constraints upon them. By focusing on existing requirements, these steps may also be achievable in the near term – ideally in time to support improvement in the upcoming 2021 reporting cycle. They would also help align US reporting practices with those in the rest of the world, on a topic that is very much global in nature. Such steps are also compatible with the initiative already under way for the SEC staff to evaluate disclosure rules and update the 2010 guidance on disclosure related to climate change, which we also support.

Finally there is one aspect in which the IASB guidance falls short of the requests of investors. Investor groups and investors themselves have asked that when accounts are prepared, they should be done on the basis of assumptions which the issuer believes are compatible with sustainability (in other words, aligned with objectives of the Paris Agreement, to achieve net zero emissions by 2050, and limit global warming to well below two degrees, ideally 1.5 degrees)⁵. This seems a reasonable request. It would be strange to encourage or allow companies to draw up financial statements on an 'unsustainable' basis, particularly when the nations in which they operate and trade are signed up to the Paris Agreement. We wonder whether in issuing the SAB, the SEC could guide companies to use sustainable assumptions, and thereby avoid flattering reported profitability and measures commonly used to evaluate solvency. We acknowledge this would involve substantial judgement, as do many topics associated with risk and estimation uncertainty. However, it would also provide a more realistic assessment of each company's own consideration of known risks, and the undertaking of commitments that aim to navigate transition to a more sustainable climate.

⁴ We note these two steps are also included in recommendations of the report [‘The Role of Accounting and Auditing in Addressing Climate Change’](#) published by the Center for American Progress.

⁵ For example, see [Investor groups call on companies to reflect climate-related risks in financial reporting \(unpri.org\)](#).

Our input in this letter is informed by the evidence we have gathered through the Climate Accounting Project to analyse recent company reports relative to current accounting and auditing requirements. We thought that the SEC might have an interest in the early results of that work which are summarised below.

We would be happy to discuss our work and input further, and can be reached to arrange this by email at [REDACTED], or [REDACTED].

Yours Sincerely,

David Pitt-Watson

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On behalf of the Climate Accounting Project

Company Analysis Work

We have recently completed analyses of over 50 Climate Action 100+ (CA100+)⁶ companies, and an additional 50+ companies are being reviewed by Carbon Tracker.

Our work focused on whether company financial statements and the audit reports thereon, demonstrated the attention to climate issues that investors have communicated they need and expect, in support of investment decisions and ongoing engagement between companies and their investors. The work also follows the explicit confirmations last year by the IASB and by the IAASB of their respective requirements for accounting and auditing to consider material climate issues.

We analysed the audited financial statements of companies reviewed together with the auditor's report, to identify evidence that current requirements had been met, including consistency across reporting. On consistency, our review was set in the context of other information reported by the company within its annual and other reporting and communications, as appropriate. This company-specific context can vary significantly by business sector and other factors. Our sample included a range of business sectors including chemicals; construction materials; food, beverages and forestry; industrials; metals and mining; oil and gas; transport; and utilities.

Given the similarities between US accounting and auditing requirements and their international counterparts, we considered it reasonable to include in our assessments the reports of companies applying US GAAP requirements and audit reports prepared under PCAOB requirements. We also note the FASB's Staff Educational Paper that similarly confirmed how an entity is to consider the effects of material ESG matters (including climate matters) when applying current US accounting standards. Additionally, auditors are required to make similar assessments of Critical Audit Matters under PCAOB standards as the ISAs require for Key Audit Matters.

Included in the 50+ companies reviewed were 18 US companies, and a further dozen non-US companies with audits having been performed under PCAOB standards

Specifically, we analysed the extent to which, in our view:

Financial Statements:

1. Accounting judgements demonstrated that material climate issues had been considered;
2. The financial statements were consistent with other company reporting of climate issues;
3. Climate assumptions (and sensitivity analysis) were visible within the accounts;

Audit Report:

4. The auditor demonstrated a focus on climate issues through discussion in the Critical/Key Audit Matters (CAMs/KAMs); and
5. Other information subject to the auditor's consistency check was consistent, or if not, this had been noted by the auditor (as applicable).

These are not the only (and not only) expectations that investors have for climate reporting by companies, but they are characteristics that the standard setters indicate are currently required: that accounting judgements take account of material climate-related considerations, assumptions be shown as appropriate, and that this should be assessed as part of the audit.

⁶ Climate Action 100+ is an investor-led initiative to ensure the world's largest corporate greenhouse gas emitters take necessary action on climate change. It has identified 167 companies globally as being key to driving the global net-zero emissions transition. In aggregate, these companies account for over 80 percent of corporate industrial greenhouse gas emissions and are globally significant emitters and/or companies that can play a strategically important role in the transition. For more information see www.climateaction100.org.

Early findings

Alarming these elements were, on-the-whole, not in evidence -- even for companies that investors have identified as CA100+ companies. For the majority of companies, neither the company's financial statements nor the auditor's report demonstrated that the requirements had been met, or for many, that there had been any consideration of climate matters at all.

We also looked at whether climate assumptions (if disclosed) were aligned with the goals of the Paris Agreement. Without disclosure, investors cannot be confident of the company's approach and whether the financials are based upon realistic, sustainable assumptions. Without alignment, the assumptions that are being made need to be understood as well as the reasons for their use. In either case, it is essential to understand whether the assumptions are also consistent with those used for planning and capital investment as would be expected. Sensitivity analysis can also be useful to investors for the purpose of developing alternative scenarios, informed by the company's own insight on its risk assessment and strategic positioning of the business.

Additional findings and collective observations from this work together with the analyses of an additional 50+ companies performed by Carbon Tracker, will be published in a forthcoming report.

Contrasting practices

In the meantime, we consider the UK to be a jurisdiction where progress has been tangible in a relatively short timeframe. We put this down to several deliberate steps that have been taken. First, IFRS and ISAs are wholly integrated into UK accounting and auditing requirements. In other words, the clarity provided by the IASB and IAASB applies currently and fully. The Financial Reporting Council, as the regulator responsible for enforcement of both the accounting and auditing requirements, made clear their support, and via publication of a thematic review in Nov. 2020 made clear that climate change would be topic of focus for upcoming reviews of accounts and audits.

To illustrate the difference at company level, it may be useful to consider the following preliminary analysis of Carbon Tracker's assessment of 2020 reporting by BP p.l.c. (BP) in the UK, and for comparison, Chevron Corporation (Chevron) in the US. Both companies have stated they support the aims of the Paris Agreement. Outside of their financial statements, both also discuss (to a degree) risks associated with, for example legislation, regulation and other government actions related to GHG emissions. Both also have some type of emissions targets (although BP's are more comprehensive). However, we note this is where the similarities end. When it comes to the consideration of climate-related matters being included in financial reporting judgements, the companies present very different pictures; their respective auditors also provide very different discussions within their reports.

2020 Financial statements:

Chevron:

Notes to the financial statements made no indication that the company considered the effects of climate change risks, for example when determining the significant assumptions or estimates related to impairment of PPE and goodwill, assessing asset lives or calculating asset retirement obligations in preparing the financial statements. While Chevron recorded a \$2.8bn impairment to upstream properties related to changes in price forecasts, and fully impaired its investments in Venezuelan oil activities, its notes did not indicate how it factored climate change issues (such as declines in commodity prices) into its impairment testing, or disclose the quantitative assumptions made.

BP:

The company disclosed in the notes to the financial statements that it considered climate change and the transition to a lower carbon economy in the preparation of the financial statements, especially related to the long-term prices used in assessing impairment. It recorded \$13.8bn in PPE impairments (of which \$12.9bn relate to upstream PPE) and approximately \$10bn in exploration and appraisal (E&A) asset write-offs, primarily due to revised price assumptions from the energy transition. Outside of the financial statements, it clearly indicated that, in the face of climate change, COVID and expectations of a lower carbon recovery, it significantly reduced the long-term prices it uses in

planning and impairment testing and extended them to 2050. It disclosed the quantitative amounts of forecasted Brent oil and Henry Hub gas prices used for impairment; these are the same as those used for planning. It also recorded downstream impairments of \$840m primarily due to portfolio changes in the fuels business. BP further noted that most of its reserves and resources that “support the carrying value of the group’s existing oil and gas properties are expected to be produced over the next 10 years”; a significant amount of those assets were expected to be fully depreciated during that timeframe.

Audit:

Chevron (audited by PwC):

The audit report identified two CAMs (the impact of proved crude oil and natural gas reserves on upstream PPE, and the acquisition of Noble Energy – valuation of crude oil and natural gas properties). While both of these topics appear to be exposed to the risk of climate change and steps to reduce emissions, the auditor did not refer to how climate matters had been considered.

BP (audited by Deloitte):

The auditor issued two reports, one in the UK annual report and the second in the US Form 20-F.

- UK: The audit report included 7 KAMs, the most relevant of which were on the impairment of upstream oil and gas PPE assets, the write-off of exploration and appraisal assets, and the potential impact of climate change and the energy transition. The first two of these provided a focus on how these assets were assessed for impairment (including consideration of the effects of material climate-related risks), and the third touched on impairment but also gave a wider assessment of climate issues considered, for example related to assessing the useful lives of assets and provisions.
- US: The audit report included as CAMs the two KAMs on impairment of PPE and write-offs of E&A assets, but omitted the KAM on climate change and the energy transition. US requirements differ from the ISAs on certain aspects of minimum disclosure and how CAMs/KAMs are addressed, but we were somewhat surprised to see the exclusion of some audit matters in the 20-F, while the audit reports reflected the same audit of the same financial statements by the same auditor, resulting in less information being provided to readers of the audit report in the 20-F.

On both accounting and auditing, the UK reports (BP/Deloitte) demonstrated greater progress on eliminating the anomaly we have referred to on climate. Regarding other companies analysed, we hesitate to single out further examples as most did not appear to provide the information required. We also note that steps on enforcement continue to develop internationally.

A further trend

There is a further trend emerging related to US companies in our sample, however. It was particularly noticeable that information suggesting significant climate risks to the company and where applicable, commitments made by the company (for example to reduce emissions), often appeared outside of the Form 10-K or 20-F. Only infrequently were company specific climate-related risks, commitments or steps being taken by the company to reduce emissions, mentioned anywhere within the annual SEC filing.

While the boundary used for the auditor’s consistency check was often limited to the annual report document containing the financial statements (corresponding to the PCAOB’s requirement), we expected greater consistency of the company itself across a broader range of its reporting, including for example sustainability reporting and other disclosure. This wider boundary often resulted in our assigning lower marks for company consistency than for the auditor’s consistency check. However, this reflects a worrying aspect of apparent consistency, where the absence of information in the financials and audit report was matched by a similar dearth of insight within the other sections of the annual filing.

As noted, additional findings and collective observations from our work on company analyses - together with the work of Carbon Tracker - will be published in a forthcoming report. The timing of this is likely to be over the summer. In the meantime, our individual company analyses can be made available on request.