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Comments from ACCA to the Climate Disclosure Standards Board (CDSB)

19 May 2014
Consultation on Proposals for reporting on Carbon Asset Stranding Risks

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ACCA (the Association of Chartered Certified Accountants) welcomes the opportunity to respond to the Climate Disclosure Standards Board (CDSB) on its proposals for reporting on carbon asset stranding risks.

In summary, ACCA believes that:

- As proposed in the joint ACCA / Carbon Tracker research report *Carbon Avoidance*, improvements in corporate disclosure around fossil fuel reserves are necessary to better inform investors and other stakeholders about potential carbon asset stranding risks (CASRs).
- A range of laws, standards and frameworks could be amended to require disclosure on CASRs, including financial reporting standards, stock exchange listing requirements and non-financial reporting standards.
- A multi-stakeholder approach will be necessary when looking to develop corporate reporting on CASRs, including businesses, reporting standard setters, stock exchanges and assurance practitioners among others.

Detailed answers are provided in Appendix I to this letter.

For further information on this consultation response, please contact Gordon Hewitt, Sustainability Adviser at ACCA via email at gordon.hewitt@accaglobal.com.

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Appendix I

Proposal 1:

1. **Which existing laws, standards or frameworks contain provisions that could be amended, supplemented or interpreted so as to require disclosure on aspects of Carbon Asset Stranding Risks (CASRs) (e.g. how risks are governed, the financial consequences associated with risks etc.)?**

A range of laws, standards and frameworks contain provisions that could be amended, supplemented or interpreted to require disclosure on aspects of CASRs.

These include:

- Financial reporting standards from international and local accounting standard setters (e.g. IASB or FASB) and specifically standards on the exploration and evaluation of mineral resources (IFRS 6), property plant and equipment (IAS 16) and the impairment of assets (IAS 36).
- Stock exchange listing requirements and stock market regulations from individual exchanges and from their regulatory bodies such as WFE and IOSCO.
- Reserves reporting standard-setters such as CRIRSCO and SPE-PRMS.
- Non-financial reporting standard-setters such as GRI, IIRC, CDSB and SASB.
- Company law and supporting guidance will generally mandate disclosure of information that is considered desirable for public policy reasons, whether or not it also falls to be disclosed for technical accounting purposes. UK company law, for example, requires directors to discuss in their annual report the principle risks and uncertainties facing the company, together with any information about the impact of their company's impacts on the environment that is relevant to an understanding of the company's business performance. In both cases the disclosures must explain how the matters reported on relate to directors' legal responsibilities, inter alia, manage their company's impacts on the environment and be mindful of the long-term consequences of their decisions.
- Laws and codes of practice that call upon institutional investors to monitor the performance of investee companies (such as those produced by the UNPRI and FRC).

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- Bodies with macro-economic responsibilities such as the Financial Stability Board.

2. **Do you agree with the objectives of reporting on CASRs as set out in the first paragraph of this section?**

We contend that the objectives of requirements on disclosure of CASRs (including the content requirements described in Proposal) should be to:

1. *Inform investors as to whether what the IASB calls "the main drivers of cash flows" – the fossil fuel energy resources - are at risk from the carbon budget identified by the IPCC and others (see introduction);*
2. *Provide an analysis of the risk, including a sensitivity analysis;*
3. *Describe any remedial and adaptive actions.*

Yes. It would be helpful to provide some further guidance on what should be considered in a risk analysis as a number of factors can drive asset stranding. These include new environmental regulations, developments in clean energy technology, resource constraints, evolving social norms and litigation. It would also be necessary for the disclosures to extend to information about what the companies are doing to mitigate the risks identified.

3. **What is the most effective approach for amending existing provisions or introducing new requirements to elicit information about CASRs in mainstream reports?**

Considering that extractives companies spend billions exploring for new fossil fuel reserves each year, they will likely be very resistant to any form of regulation or legislation requiring them to disclose the stranding risk associated with their reserves. As such, a voluntary approach would not be appropriate.

A large proportion of extractives companies are publically listed. Organisations that set regulations and standards for the securities sector (e.g. IOSCO or WFE) could use their position to influence their member exchanges and exchange regulators to introduce reporting requirements around CASRs. Beyond targeting global stock exchange and exchange regulator bodies, individual exchanges should incorporate disclosure on CASRs into their listing requirements. By introducing such legislation across global exchanges, 'safe havens' where companies would not need to report on such matters would be avoided.

If the above approach is not deemed feasible, a focus on particular stock exchanges that are carbon heavy e.g. the London Stock Exchange could be

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made. These exchanges could be targeted to introduce regulations for extractives companies to report on CASRs. This could be incorporated into the annual disclosure requirements of listed companies and initial public offering (IPO) disclosure requirements.

A focus on stock exchange regulations would be an effective way of influencing the disclosure requirements of listed companies, but would not have any impact on unlisted companies and state-owned enterprises. Considering that the fossil fuel reserves of state-owned enterprises such as Saudi Aramco are very significant, it would be necessary to develop an approach that encompasses such entities.

The governments of countries with significant fossil fuel reserves could be lobbied to introduce laws and regulations around disclosing CASRs. This could be done at a bilateral level, or through international processes such as the UNFCCC COP process. The top 10 countries for each of the three fossil fuel reserves account for 82.9% of oil, 76.8% of gas and 91.5% of coal (as of 2010). As there are a number of countries that appear in the top 10 for more than one fossil fuel, the total list of fossil fuel rich countries amounts to 22. Although many of these countries are very powerful on the international stage (e.g. Russia, China, the US) they represent a significant minority, so unilateral action from the remaining countries should be effective (although this is far easier said than done).

Proposal 2:

1. What definitions and language should be used to communicate fossil fuel energy resources in mainstream corporate reports?

Internationally recognised definitions from organisations such as the UNFCCC should be used and applied by companies around the world. The harmonisation of definitions and language is key the success of future disclosure requirements on CASRs. Ultimately investors and other stakeholders are looking for comparability when assessing the carbon asset stranding risks of the companies they hold, so it is critical that they are able to make meaningful comparisons between companies.

It would also be necessary to get multi-stakeholder agreement over the definitions and language used to communicate fossil fuel energy resources to ensure widespread acceptance and use.

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2. **Which approaches to classification of fossil fuel energy resources are most consistent with the needs of and existing approaches to mainstream corporate reporting?**

Most major mineral companies conform to the Combined Reserves International Reporting Standards Committee's (CRIRSCO) prescriptions on fossil fuel reserves reporting, so these standards would be a good place for initial focus. The CRIRSCO approach requires companies to judge whether or not their identified mineral resources are economically recoverable, which involves a consideration of the economic, legal, environmental, social and governmental factors among other things. These 'modifying factors' are similar to the potential drivers of asset stranding noted in proposal 1, question 2. If the resources are deemed to be economically viable, they can be classified as reserves.

In terms of determining the potential greenhouse gas emissions associated with reserves, it would be necessary to apply greenhouse gas emission factors. The UNFCCC maintains an emission factor database, which could be applied to known reserves and generate statistics around potential greenhouse gas emissions.

3. **Do certain industry classification approaches preclude recognition and reporting of CASRs, for example, because they are based only on internal forecasts of future conditions?**

N/A

Proposal 3:

1. **What is the scope of information that needs to be reported about fossil fuel energy resources in order to satisfy the objectives of CASRs reporting (proposal 1)? Should the scope of information in mainstream reports be restricted to commercially recoverable / exploitable / developed resources or extended to known but non-commercial / undeveloped deposits?**

Using the CRIRSCO terminology, companies can have inferred, indicated and measured mineral resources (depending on the level of geological knowledge and confidence associated with said resources). Depending on a number of 'modifying factors', these resources can be classified as reserves. For example, indicated resources would be considered probable reserves if they considered

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economically recoverable. Only once these reserves are measured are they considered proved reserves.

To assess CASRs, it would be necessary to quantify a company's proved and probable reserves at a minimum (as proved reserves could be reclassified as probable reserves due to changes in the 'modifying factors'). Information about indicated resources would also be worth disclosing as this would provide investors and other stakeholders with an idea of the potential scale of the company's future fossil fuel reserves.

Common accounting practices under IFRS 6 – Exploration and Evaluation of Mineral Resources allow companies to capitalise the costs associated with exploring for fossil fuel reserves. Much of the fixed assets of extractives companies are also related to extraction of fossil fuel reserves. In terms of value at risk, it would be important for companies to quantify and communicate, in monetary terms, which assets are associated with their reserves. This would allow investors and other stakeholders to see what proportion of the company's balance sheet is exposed to CASRs. As oil and gas companies are often invested in a wide range of projects in different geographical locations and focussed on different forms of fossil fuel, a high level of granularity (perhaps at the site level) would allow investors to get a detailed picture of which assets are potentially at risk.

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2. How should the scope of information that needs to be reported be expressed?

See table below for potential way to express information on CASRs.

Fossil Fuel	Source	Quantity of proved and probable reserves	Potential associated greenhouse gas emissions	Potential future revenues associated with reserves	Value of balance sheet assets associated with reserves (goodwill, intangible assets, fixed assets)
Oil	Off-shore deep water oil	X	X	X	X
	Off-shore shallow water oil	X	X	X	X
	On-shore oil	X	X	X	X
	Oil sands	X	X	X	X
Gas	Off-shore deep water gas	X	X	X	X
	Off-shore shallow water gas	X	X	X	X
	On-shore gas	X	X	X	X
	Shale gas	X	X	X	X
Coal	Strip mined coal	X	X	X	X
	Contour mined coal	X	X	X	X
	Underground mined coal	X	X	X	X
Total			X	X	X

Note – it would also be possible to factor in carbon offset costs associated with potential emissions and investment in non-fossil fuel energy technologies, perhaps as a ratio with investment in exploration for new fossil fuel reserves.

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3. **Should the same requirements apply to all companies involved in the extraction and production of fossil fuel energy resources?**

Yes – this would be necessary to ensure consistency and comparability.

Proposal 4:

1. **Do you think that resources should be valued by the reporting entity in their corporate mainstream report as an indication of financial risk relating to CASRs? If so**

    I. **Should all resources within the scope identified in your response to Proposal 3 be valued or just certain classifications (e.g. economically viable resources);**

Yes – companies should provide investors and other stakeholders with an estimate of the potential future revenues associated with their reserves. This figure will be an estimate, based on future prices, production capacity and demand, so transparency over the assumptions applied over these variables will be necessary. Due to the level of uncertainty associated with these future earnings, this value should not appear in the company's financial statements, but it should be included within a company's mainstream report as an indication of the future earning potential / future revenues that may be at risk due to CASRs.

Including this information in a report that accompanies the financial statements will mean that it will be read by the auditor and considered for consistency purposes. While the auditor will not perform checks on the reliability of the figure disclosed, the information will be assessed for consistency with the information in the accounts and it may cause the auditor to question their understanding of the business and the environment within which it operates.

Providing a monetary value of the resources of the company would also be beneficial, although a less precise figure should be sufficient, as resources have not been proved economically viable.

Such disclosure requirements may take some time to come to pass, so in the meantime, we encourage NGOs and research bodies to use publically available

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information from fossil fuel companies to calculate and disclose their own reserves valuations.

II. **How should resources be valued? How (if at all) would the financial reporting concept of fair value be applied?**

See 1. I above.

2. **If not, is disclosure of the quantity of fossil fuel energy resources in units of barrels of oil equivalent (BOE) sufficient to enable users to determine their value?**

See Proposal 3 Q2. Companies should disclose both the quantity of fossil fuel energy reserves and an estimate of the monetary value of said reserves (including the key assumptions applied when calculating their value). This will provide investors and other stakeholders with sufficient information to form their own estimate of the value, whilst also providing a monetary value to those that may not have a detailed understanding of fossil fuel commodity markets. Including this calculation in a company's annual audit will provide comfort that sensible estimates have been applied by the company.

3. **What further information (if any) is required for users to assess organizations' mitigation and adaptation plans and activities?**

Investors and other stakeholders would benefit through an understanding of how a company considers CASRs and whether or not asset stranding is considered a material risk by the business. Requiring companies to report on material risks would be a potential way of achieving this. Listed companies in the US are required to report on 'risk factors' in their 10k forms, so a similar approach could be taken.

4. **Is there merit in developing a system and language for recognizing mitigation and adaptation activity as assets along the lines proposed by Terrafiniti?**

Yes – understanding whether or not assets contribute to the 'green' economy or the 'brown' economy would be beneficial.

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5. **Are any other future-looking indicators necessary for the assessment of CASRs?**

No – although company may not want to disclose too much forward looking data (especially around capital expenditure etc.) due to the sensitive nature of such information.

6. **Would disclosure of the proposed future-looking indicators present particular challenges for extractive industries?**

Yes. Due to the fact that their business models and vast amounts of their assets are totally reliant on the extraction of fossil fuels, it is difficult to reconcile many of the low carbon future scenarios with their ability to create value in the long term.

Proposal 5:

1. **Do you agree that impairment testing should take account of CASRs and carbon budgets?**

Yes. Carbon budgets and other drivers of asset stranding (see proposal 1 question 2) should certainly be considered when calculating the economic viability of fossil fuel reserves and should factor into the risk assessments of companies. This would impact on whether or not evaluation and exploration expenditure can be capitalized under IFRS 6. The should also be considered when performing impairment testing on evaluation and exploration expenditure that has already been capitalised and on fixed assets associated with proven reserves and fields that are already operational.

Proposal 6:

ACCA believes that the approach included in the IASB Conceptual Framework is of value.

Proposal 7:

1. **Are there any other activities or initiatives that could support the development of CASR reporting?**

When dealing with the issue of CASRs, it is important to take a multi-stakeholder / multi-pronged approach. Stakeholders that should be included are

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businesses, reporting standard setters, stock exchanges and assurance practitioners among others.

Initiatives such as the 350.org fossil free campaign could also be a good means to pressure the development of CASR reporting from a grass roots level.

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