June 17, 2022

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

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

Re: File Number S7-10-22: Input on Proposed Rule on Climate Change Disclosures

Dear Chair Gensler:

We welcome the opportunity to respond to the Securities and Exchange Commission's (SEC's) request for input on proposed rules contained in Release Nos. 33-11042; 34-94478, "The Enhancement and Standardization of Climate-Related Disclosures for Investors".

We are writing as the Climate Accounting & Audit Project (CAAP), an independent expert group which has included senior regulators, standard setters, investors, and auditors. We are commissioned by the Principles for Responsible Investment (PRI) and are working with a number of organisations representing investors in companies globally– see https://www.unpri.org/sustainability-issues. This submission is the work of the CAAP alone and is not made on behalf of any of the above-mentioned organisations, each of which may be submitting its own response to your call for input.

Primacy of Existing Financial Reporting Requirements

This submission focuses primarily on what we consider to be an important aspect of the context into which the proposed new reporting requirements will be introduced. Critically, this context already includes existing financial statement requirements that address how material climate risk should be taken into account in the preparing the financial statements, and their audit. As we trust this note makes clear, we believe the SEC should urgently both emphasise these existing requirements and enforce them, ideally in time to influence 2022 year-end reporting and audit.

Under the SEC's proposals, the existing accounting and disclosure requirements will remain, and provide a key part of the overall suite of reporting information. They are set to be complimented by new requirements for 1. improved business and financial risk reporting outside of the financial statements and 2. detailed requirements for line-by-line disaggregation of climate related amounts in the financial statements, and information on climate-related assumptions and estimates. We believe these proposals will only work effectively if the existing financial reporting standards are followed.

The proposals address new disclosure, not aspects of accounting recognition or measurement; these rely on existing requirements, which also already address various aspects of presentation and disclosure. We would caution that the approach to assumptions and estimates included in the proposed regulations may seem to concern itself with providing disclosure that is in large part already required. We welcome the new disclose requirements which we note will ensure information is shown in a more consistent and detailed manner. However, it is critical that the SEC also makes it clear, as the FASB Staff has already done, that existing rules treat climate like any other financial risk, and that where material it needs to be considered and material information on assumptions shown.

We also note that the new regulations may take time to become finalised and implemented. In the meantime, we are concerned that existing requirements be both re-emphasised and enforced by the SEC. This is so that the information already required by them is delivered upon, both in the interim before the new regulations come into effect, as well as once they are implemented. We suggest below how this might be done in time to influence 2022 year-end reporting.

Existing financial statement requirements – a critical link and underpinning to the proposed disclosures

We view the information required under existing financial statement reporting requirements as providing a critical link between business and financial risk associated with climate change and the response to it, and how this is reflected in the financial statements. Requirements address both the amounts reported and accompanying footnote disclosures. We also believe that business and financial risk information is most useful when it can be seen how, or the extent to which, a company's current assessment of climate is manifested in the current financial statements.

Additionally, any disaggregation of financial statement line-item amounts attributed to climate requires the existing financial statement requirements to have been applied in relation to climate matters in the first place. Thus, robust application of the financial statement requirements as they exist currently, is an essential underpinning to the proposed structured disclosures, as well as already being required.

Material Climate Risk and Financial Statement Risk – emerging consensus

Climate risk represents both a business and financial risk for many companies, with some also benefitting from new opportunities emerging from the transition to a low-carbon economy. Financial statements of companies impacted by such risks and opportunities may also present reporting challenges in the form of uncertainties and risk to the financial statements of material misstatement (financial statement risk).

Both the FASB and the IASB have confirmed that their existing standards already apply to climate risk, requiring both accounting adjustments where criteria is met, along with disclosure of material information such as climate-related assumptions and estimates. The IAASB has also published guidance confirming that the International Standards on Auditing (ISAs) already require consideration of financial statement risk relating to climate, including requirements for the auditor to perform and report on consistency of financial statement information with information elsewhere in the annual report.

Additionally, regulators outside the US have also identified financial statement reporting on climate as a significant priority for their enforcement activities. We note for example steps taken by the UK's Financial Reporting Council (FRC) to publish insight on current practices in the form of a 'Climate Thematic' report (2020) and to include in its 2021/22 priorities for routine monitoring of annual reports and accounts, a focus on climate-related risks and new disclosures, including how these are appropriately reflected in the financial statements. Additionally in the European Union, the European Securities and Markets Authority (ESMA) included in its enforcement priorities for the 2021 annual financial reports of listed companies, climate-related matters including the consideration of climate and consistency of between financial and non-financial information.

Investors too have a strong interest in company-specific information on climate risk when it is material to a company's business. Climate risk is increasingly identified as representing investment risk. Investors and investor groups representing over US$103 trillion in assets under management globally have made clear their interest in financial statements and audits that consider, in accordance with existing requirements, the impact of climate risk[1]. Such information is critical to decisions on investment, engagement with companies, and shareholder voting. [2]

Evidence of current reporting

However, and in spite of all of this, evidence suggests that even for companies identified by investors where climate risk is clearly material -- such as oil and gas companies -- the existing financial statement requirements are not being properly followed by companies, and auditors have not addressed this oversight. If they were, it would make a significant contribution in providing the material information which has been asked for by investors[3] and would help them align capital markets with the climate challenge.

For example, the report by Carbon Tracker 'Flying blind: The glaring absence of climate risks in financial reporting' shows that over 70% of some of world's largest corporate emitters failed to demonstrate how the effects of climate risk were considered in preparing their 2020 financial statements, and 80% of the related audit reports showed no evidence of how climate risk was assessed. Building on this, the Climate Action 100+ (CA100+) Net Zero Company Benchmark assessment of Climate Accounting & Audit also showed very limited demonstration of meeting requirements. Across seven separately assessed categories, the highest score reflected only 3% of the 164 company reports studied (year-ends Dec. 2020 through Sept. 2021) having met the requirements in a comprehensive manner.

Furthermore, the initial reviews of year-end 2021 reporting does not suggest significant progress. Though more analysis is needed, this suggests a step change is needed to dramatically increase the visibility of how existing requirements are met and ensure that they are. See Appendix I for further information relating to this company-specific analysis work.

Recommendations to the SEC

For all of the reasons cited above, we believe it is crucial that year-end 2022 reports reflect current requirements functioning as they should. We therefore urge the SEC to:

- Issue a Staff Accounting Bulletin (or similar authoritative communication) to emphasize the need under existing rules to account for, and provide disclosure on, how material climate-related risks have been considered; and
- Enforce the existing financial reporting requirements rigorously.

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[1] See Investor groups call on companies to reflect climate-related risks in financial reporting | PRI Web Page | PRI (unpri.org).
[2] A full discussion of IFRS standards, of investor requests to companies and auditors as regards financial reporting, and of the apparent failure to meet standards can be found on the website of the Principles for Responsible Investment. See https://www.unpri.org/sustainability-issues/accounting-for-climate-change.
[3] See Investor groups call on companies to reflect climate-related risks in financial reporting | PRI Web Page | PRI (unpri.org).

We believe that taking these two steps[4] would represent 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. These steps would also help bring US reporting practices into alignment with international requirements, on a topic that is very much global in nature.

Such steps, as they focus on existing rather than new requirements, could be taken more quickly, have significant impact, and as we have described, provide a stronger foundation for linking the disclosure proposed under the new regulations to their financial statement consequences. This link once established, should subsequently be maintained, for example as climate risk is reassessed over time and transitional steps are potentially reassessed and ultimately undertaken, the financial statement consequences of considering such new information should be updated, with corresponding accounting adjustments and updated financial statement and other disclosure as needed.

Updating requirements for climate risk and other disclosure outside of the financial statements (as is proposed) will be helpful, but if the underlying financials presented alongside this information are deficient in not showing any related financial impact (or consideration of potential impact), these deficiencies will only become more apparent, and questions over the consistency of such information with the financial statements could be exacerbated. For example, the information on a company's strategy including its stated targets to reduce emissions may appear to lack substance, if steps to meet these targets involving early replacement of assets with low-carbon alternatives do not appear to have been considered in the accounts (for example in determining remaining lives for depreciation, the amount or timing of asset retirement obligations, and considering impairment indicators and assessing the recoverable amounts of assets, etc.).

Steps need to be taken in an authoritative manner that is likely to deliver the insight expected under current requirements (i.e., removing any residual uncertainty as to whether material climate risks must be considered and assumptions disclosed). It is fortunate therefore that this aspect of reporting can be advanced without involving any new requirements[5]. The improved financial statement and audit reporting that should result could be highly impactful for investors seeking to make decisions on the basis of better information, as they might reasonably expect if the requirements were to be applied in spirit and in the letter.

2022 Reporting Cycle

We encourage the SEC to provide confirmation of the requirements via the issuance of a SAB in order to get these existing requirements on the agenda for companies and their auditors in time to generate substantial progress in reporting this year. It is important that any potential for ambiguity be removed for both companies and auditors, and that confirmation of requirements be

[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] A focus on existing requirements not only avoids the prospect of legal challenge that might be faced in introducing new requirements, but also may serve to remove the costs of compliance with existing requirements from the cost-benefit analysis required of new requirements.

comprehensive and specific as to when and how material issues should be taken into account, and information on material considerations and assumptions disclosed. We suggest that the clarification 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 under current requirements.

It would also be helpful to address through illustration, the application of some of the more typical issues that may arise, for example how to consider depreciation and impairment of high emissions-related assets that are to be retired early under plans to meet emissions targets, consideration of impairment indicators and the estimation of cash flows used in impairment testing (for example including revenues forecasted by oil/gas/coal companies, etc.) and associated disclosures that would provide material information to investors.

Additionally, it is important that it be made clear that any proposed new disclosures not be used as an excuse for delaying action on the existing requirements. The current situation, where it is at least unclear whether or how financial statements reflect known risks and climate-related commitments made, is not serving the markets in the manner needed and expected. As such, it is urgent that companies and auditors make-good on the current requirements so that investment decisions can be made on the basis of the full set of required information.

Furthermore, without disclosure of climate-sensitive assumptions, it is hardly reassuring that impairments are not being taken. For example, if there is significant headroom in impairment testing because an oil company has assumed future revenues continuing at the current volumes and pricing, this is material information to investors. Contrast this with a situation where a company in the same circumstances has updated their assessment for pricing and volumes for consistency with expectations published by the IEA[6]. Impairment may or may not result from these assumptions depending on how resilient the company is to such assumptions, but without disclosure of the assumptions used, the two situations may be indistinguishable to investors.

Confirmation of current requirements would not only set the stage for company compliance and audit risk assessment, but also for increased enforcement by both the SEC and PCAOB in their respective capacities. Signalling this in advance could help to encourage widespread improvement and strengthen the basis for enforcement.

Investor interest in sustainable assumptions

There is also one aspect in which the accounting guidance falls short of the requests of investors. Investor groups and investors themselves have asked that when accounts are prepared, this should be done on the basis of assumptions which the company believes are 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)[7], in other words using sustainable assumptions. This seems a reasonable request. It would be strange to encourage or allow companies to prepare financial statements on an 'unsustainable' basis, particularly when the nations in which they operate and trade are signed up to the Paris Agreement.

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[6] IEA's Net Zero Emissions by 2050 (IEA NZE) scenario.
[7] For example, see [Investor groups call on companies to reflect climate-related risks in financial reporting (unpri.org)](unpri.org).

In this regard, we note that there should at least be limits to the range of assumptions considered to be reasonably supportable, for example on impairment and expectations of future fossil fuel volume and price assumptions for forecasted revenue, given the global drive to a low-carbon economy. This is not unlike other assumptions and estimates used in preparing the financial statements that require judgement.

However, if the assumptions used do not align with Net Zero by 2050 and 1.5 degrees, for example if a company's risk assessment and its climate strategy and plans are not aligned with this and the company uses other assumptions, then supplemental information focusing on scenario analysis or at least analysis of certain key assumptions that are aligned (fossil fuel commodity prices, carbon prices, for example) and their impact on the financial statements, could be required to be disclosed. We recommend that the SEC consider a new requirement for such information. We acknowledge this would involve substantial judgement, as do many topics associated with risk and estimation uncertainty. However, the additional disclosures on this basis would also provide a more realistic and practical 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.

Process benefits of delineating new and existing requirements

A focus on existing requirements not only avoids the prospect of legal challenge that might be faced in introducing new requirements, but also may serve to remove the costs of compliance with existing requirements from the cost-benefit analysis required of new requirements.

Specific SEC questions

We provide further comments in response to the detailed questions posed in the request for comment, in Appendix II. This includes a recommendation that the PCAOB also take steps to:

1. Issue guidance in the form of a Staff Audit Practice Alert confirming existing audit requirements, to encourage compliance and support audit inspections
2. Address in Audit Inspection Reports, how the auditor considered climate risk as appropriate to the performance of the audit and to the reporting on the audit.

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

Yours Sincerely,

David Pitt-Watson

Sue Harding

Peter Taylor

On behalf of the Climate Accounting & Audit Project

Appendix I: Company-specific Analysis

We have been working on the issue of climate and accounting for the past several years, with input from senior standard setters, investors and auditors. Over recent months and together with the Carbon Tracker Initiative (Carbon Tracker), we have been reviewing the financial reports of US/global companies that investors identified as being key to driving the net-zero emissions transition, and generally highly exposed to transition risk.

Flying Blind

Last year, together with the Carbon Tracker we reviewed the financial reports of over 100 US/global companies that investors identified as being exposed to climate risk. This work was published in the report Flying blind: The glaring absence of climate risks in financial reporting - Carbon Tracker Initiative. [8] The report shows that over 70% of some of world's largest corporate emitters failed to demonstrate how the effects of climate risk were considered in preparing their 2020 financial statements, and 80% of the related audit reports showed no evidence of how climate risk was assessed. It also highlights that for 72% of the companies, the treatment of climate matters within their financial statements appeared to be inconsistent with their disclosures of climate-related risks (and commitments, when relevant) in their other reporting. This included instances where the company had highlighted financially material climate risks.

CA100+ Net Zero Company Benchmark – Accounting and Audit assessment

In addition, starting in 2021 Climate Action 100+[9], produces a Net Zero Company Benchmark (the Benchmark), which assesses the progress of companies that are key to driving the global net-zero emissions transition. The 2022 Benchmark was extended to include specific consideration of Climate Accounting and Audit, addressing how (or whether) the financial statements and audit report demonstrate consideration of climate, including company disclosure of significant climate-related financial statement assumptions, as appropriate. It also looked at consistency of company reported information in the financial statements versus climate related information outside of the financial statements, and the auditors required review of 'other information' for consistency.

The overall assessment was split into three areas: Accounting (financial statement reporting), Audit (reporting in the auditor's report), and a third aspect of looking at alignment of financial statement assumptions with Net Zero by 2050 or sooner. Further information can be found in the CAAA methodology. The financial statement and audit report assessments are grounded in the existing requirements of the relevant accounting and audit standard setters, with the alignment

[8] The assessment approach in the Flying Blind analysis used a four-level rating system (significant concerns, some concerns, few concerns and good practice). The ratings statistics cited represent the percentage of reports that were scored at the lowest level of 'significant concerns'.

[9] The Climate Action 100+ represents over 600 global investors who are responsible for more than $60 trillion in assets under management. It has selected 167 focus companies, accounting for over 80 percent of corporate industrial greenhouse gas emissions, for engagement on climate matters covering three high-level goals: emissions reduction, governance, and disclosure. For more information see https://www.climateaction100.org.

element being based on the further request by investor groups. Seven specific aspects of reporting were assessed under the following ‘Metrics’:

1. **Financial Statements**
   - Metric 1a. The financial statements demonstrate how material climate-related matters are incorporated.
   - Metric 1b. The financial statements disclose the quantitative climate-related assumptions and estimates.
   - Metric 1c. The financial statements are consistent with the company’s other reporting.
2. **Audit Report**
   - Metric 2a. The audit report identifies how the auditor has assessed the material impacts of climate-related matters.
   - Metric 2b. The audit report identifies (any significant) inconsistencies between the financial statements and ‘other information’.
3. **Alignment with net zero by 2050 (or sooner)**
   - Metric 3a. The financial statements use, or disclose a sensitivity to, assumptions and estimates that are aligned with achieving net-zero GHG emissions by 2050 (or sooner).
   - Metric 3b. The audit report identifies that the assumptions and estimates that the company used were aligned with achieving net zero GHG emissions by 2050 (or sooner) or provides a sensitivity analysis on the potential implications.

The methodology formally adopted the analysis of Flying Blind into a published set of criteria, which was then applied to the full list of 164 CA100+ focus company reports, predominantly for year ends from 31 Dec 2020 through 30 Sept 2021.[10] The assessment results reflect extremely limited achievement (none higher than 3%) by companies and auditors:

- Only three companies achieved a positive score on having met one of the three financial statement metrics (BHP and bp on their consideration of climate and National Grid on the disclosure of quantitative assumptions); and
- On audit reports, one achieved positive scores on both metrics (audit of Royal Dutch Shell), and four achieved a positive score on one of the two metrics (auditors of bp, Glencore, National Grid on their consideration of climate risk, and the auditor of Rio Tinto in relation to calling attention to work-in-process to assess the financial statement implications of emissions targets and steps to achieve them).

All six of these company reports were of UK listed companies (several with dual headquarters or headquarters elsewhere in Europe or Australia). While the achievements were limited across the CA100+ population of climate-exposed companies, the reporting of these companies/auditors that did meet the requirements, demonstrate that this can be achieved.

[10] Some reports had already been reviewed as part of the Flying Blind analysis, and those scores were translated from the four-level rating system that had been used, into the binary approach used in the Benchmark to indicates whether the requirements of a metric have been met or not.

2021 reporting

Thus far in 2022, CAAP together with CTI have reviewed and published reports on the Climate Accounting & Audit of 15 CA100+ focus companies for year-end 2021. These can be found on the CTI website . These reports provide both update results under the CA100+ Net Zero Benchmark assessment for Accounting & Audit, and further analysis. These assessments continue to evidence limited progress, with very few metric requirements having been met by companies or their auditors. While there were some positive moves noted, for example Equinor and its auditor took steps to provide insight on Net Zero assumptions, there were also backward steps, where the auditors of Shell and Rio Tinto had previously drawn attention to the status of incorporating emissions targets into the financial statement assumptions, and this was less clear in the 2021 reporting.

The full set of year end 2021 (and subsequent) reports of CA100+ focus companies will be reviewed over the coming months, and results are to be included in an updated CA100+ Net Zero Benchmark expected to be published in the autumn of 2022.

While the analysis of 2021 reporting by companies and their auditors is currently limited, there are potential trends that appear to be emerging. Some companies have added what we would characterise as assertions of climate having been considered and addressed in preparing the financial statements, without providing further demonstration of how this was done and, in some cases, why it was reasonable that there were no apparent adjustments made or other consequences for the company's reporting. Disclosure of assumptions also remains limited, denying investors the opportunity to understand how the company specifically incorporated consideration of climate into the financial statements, and to consider whether this is aligned with their own view of climate risk.

Additional concerns remain over the consistency of information within the financial statements and other information outside of the financial statements. Unexplained inconsistencies raise legitimate questions of whether there is a material misstatement of information in one or both of these components of reporting, for example whether targets and plans lack substance or have actually been ignored in the company's accounting estimates.

APPENDIX II: Responses to selected questions

Questions 53, 58 - Financial Statement Metrics.

We view the proposed Financial Impact and Expenditure Metrics as calling for disaggregated elements of amounts reported in the consolidated financial statements. This gives important continuity and consistency to such financial information, the logical extension of which is that the tabular information is also included in the notes to the financial statements and be subject to the audit process. As a result, we strongly believe that the basis of the information should be the same as exists in the consolidated financial statements, albeit with a need for definitions relating to how specific attribution is to be made for the purpose of disaggregating individual components. See also our recommendations that the SEC provide guidance on the existing financial statement requirements, for example by issuing a Staff Accounting Bulletin.

Questions 81, 86 – Financial Estimates and Assumptions.

Information on significant assumptions and estimates, including quantified disclosures, can represent material information for investors whether or not an adjustment to the amounts assumed and/or the reported financial statement amounts, has resulted. It is the consideration of climate-exposed assumptions and estimates that is the first key step to be made clear through disclosure, followed by disclosure that provides and understanding of any consequential adjustments (or rationale for none). We recommend that the existing requirements, for example on disclosure of assumptions and estimates and changes made in the period, be made clear through guidance, and that new expectations under the proposal also be distinguished.

Question 91 - PCAOB auditing standards.

The evidence from company reporting analysis suggests much more is needed from auditors as well, both in relation to the existing requirements as well as how these will interact with the new financial statement disclosure requirements. During 2021 and continuing into 2022, it seems likely that the understanding of climate risks, as well as company commitments on emissions, for example, will also have developed – and so should consideration of these matters within the financial statements and the audit thereof.

Steps need to be taken in an authoritative manner that is likely to deliver the insight expected under current requirements (i.e., removing any residual uncertainty as to whether material climate risks must be considered in the audit). The improved audit reporting that should result could be highly impactful for investors seeking to make decisions on the basis of better information, as they might expect if the requirements were to be applied in spirit and in the letter.

Recommendations to the PCAOB include two complimentary steps to confirm requirements and then follow this up within the audit inspection process.

1. **Issue guidance in the form of a Staff Audit Practice Alert confirming existing audit requirements, to encourage compliance and support audit inspections**
   While the audit reports considered in the company specific analysis evidenced little regard for climate generally, the results for US audit reports generally demonstrate little if any consideration of climate. In fact, for some audits of foreign private issuers, discussion of

climate that appeared in the ISA-based audit report was absent altogether from the report on the same audit, presented under PCAOB requirements. We are unaware of any reason for removing such information under US requirements.

Confirmation of current requirements in the form of a Staff Audit Practice Alert would put auditors too on notice of the need to ensure they have complied with relevant audit requirements. Signalling this would help to encourage widespread improvement in both audit performance and reporting. In this respect it would be most helpful if the Audit Practice Alert were to address climate-related consideration of risk, reporting of Critical Audit Matters (CAMs), the use of specialists, and obligations for the auditor to read ‘other information’ and consider consistency across reporting.

2. **Address in Audit Inspection Reports, how the auditor considered climate risk as appropriate to the performance of the audit and to the reporting on the audit.**

Increasing business and financial risk related to climate, as well as the growing number of company commitments to curb emissions and take other steps to address climate-related risks, all point to potentially increased risk for the audit of the financial statements. A greater focus on this within the audit inspection process and the related inspection reports, would also encourage compliance with requirements for the audit.