asa

Accountancy South Africa

AUGUST 2019

TALITA FERREIRA

EVOLVING INTO THE AUTHENTIC SELF

HOW DO SUCCESSFUL CEOs

MANAGE THEIR MIDDLE ACT

GENDER INEQUALITY

IT'S STILL A MAN'S WORLD

MEET THE 2019

TOP 35-UNDER-35 FINALISTS

SAICA
THE SOUTH AFRICAN INSTITUTE OF CHARTERED ACCOUNTANTS
develop.influence.lead.

CPD
30 MIN

THE NEXT BIG THING IN FINANCIAL REPORTING?

The world is already in transition to a low-carbon economy, driven by climate change and technical development. This presents a set of climate-related risks which business should address through the recommendations of the Task Force on Climate-related Financial Disclosures (TCFD)

Words Dave Collins

Global climate policy is moving slowly but relentlessly, with the 2015 Paris Agreement setting the rules but not the extent of greenhouse gas emission reduction. Many companies, cities and US states are setting their own quicker pace. The awareness of climate change and the pressure to address it are increasing, with mass protests in many countries, divestment away from coal and growing investor demand for climate risk reporting. At the same time, technical development is accelerating in materials science, digitalisation, connectivity and processing power, leading to cleaner and cheaper energy options.

This transition to the low-carbon economy will require significant and, in some cases, disruptive changes across economic sectors and industries. There are implications for the global financial system, especially in terms of avoiding financial dislocations and sudden losses in asset values. Given such concerns, the G20 Finance Ministers and Central Bank Governors asked the Financial Stability Board (FSB) IN 2015 to review how the financial sector can take account of climate-related issues. The FSB established the Task Force on Climate-related Financial Disclosures (TCFD) to develop consistent climate-related financial disclosures that would be useful to investors, lenders, and insurance underwriters in understanding material risks. TCFD is currently voluntary but there are expectations that it may become regulated in the future.

In June 2017 TCFD issued recommendations for companies on:

- *Governance* around climate-related risks and opportunities
- *Strategy:* Actual and potential impacts of climate-related risks and opportunities on businesses, strategy and financial planning
- *Risk management:* How climate-related risks are identified, assessed and managed
- *Metrics and targets* used to manage climate-related risks and opportunities, and
- *Scenarios:* Describe the resilience of the organisation's strategy taking into consideration different climate-related scenarios, including a 2 °C or lower scenario (that is one in which the global average temperature rise above pre-industrial times will be 2 °C or less).

There are certainly risks in getting through the transition:

- Because the world is not moving quickly enough on GHG emissions reduction, physical impacts are inevitable from changed weather patterns – heat waves, floods and droughts. Countries, companies and communities will have to adapt to new conditions.
- Companies need to worry about reputational risk – are they perceived to be doing enough to facilitate the transition, be this directly in their own operations or in the case of a bank, indirectly through their loans to emissions-intensive operations? This could extend to legal risk – there are hundreds of current climate-related liability cases around the world.
- Companies also need to worry about market risk. Will a demand for their current products or services even exist in a low-carbon economy?
- Regulatory risk arises from policy actions to constrain adverse effects of climate change, such as carbon pricing, or to promote adaptation.
- Further transition risks arise for companies by moving too quickly, or too slowly, relative to their markets and customers.

In addition to the TCFD risk categories, socio-economic risk should be considered in a country such as South Africa, which has high social inequality, energy poverty and is particularly vulnerable to climate-related physical impacts. In a low mitigation scenario, there will be risks from community disruption and unrest: in a high mitigation scenario, there will be risks from unrest stemming for mass job losses.

The TCFD recommends that organisations should use scenario analysis to assess the potential business, strategic, and financial implications of climate-related risks and opportunities and disclose those, as appropriate, in their annual financial filings. Some organisations are affected by risks associated with climate change today. However, for many organisations, the most significant effects of climate change are likely to emerge over the medium to longer term, and their timing and magnitude are uncertain. Organisations need to consider how their climate-related risks and opportunities may evolve and the potential implications under different conditions. Scenario analysis is a well-established method for developing strategic plans that are more flexible or robust to a range of plausible future states.

In September 2018 TCFD announced that the number of companies supporting the recommendations was over 500, including Anglo American, Sasol, Gold Fields, Glencore, Rio Tinto, South32, ArcelorMittal, and the South African Institute of Chartered Accountants (SAICA). The total list represented market capitalisations of more than $7,9 trillion, including financial firms responsible for assets of nearly $100 trillion. TCFD will publish a further status report in June 2019 which will allow for analysis of disclosures made in 2018 financial reports.

WHAT CAN A COMPANY DO TO MANAGE THE TRANSITION?

- First and foremost, a company must be constantly aware of what is happening on climate change and technological innovation; the various political, regulatory and technical responses; and the amplifying factors such as public perception, and fossil fuel divestment campaigns. This is an existential business sustainability risk, not a 'compliance' or an 'environmental' issue with a focus on physical impacts.
- It should identify all the relevant business sustainability risks and incorporate them into its risk governance process. The TCFD framework is a useful tool for this.
- Opportunities are always much more difficult to identify than risks. But if a company does not find new opportunities, it risks its business being disrupted by others.
- A company should at minimum report its GHG emissions and reduction plans annually to the Carbon Disclosure Project (CDP). This is a good basic framework for managing current and future emissions.
- In the light of the many uncertainties, forecasting how the future world and business environment will look is futile. A company should rather generate some plausible scenarios which cover the range of possible outcomes.

The need to disclose all these climate-related risks is becoming a mainstream issue, and the question has now become not whether to manage climate risk, but how to do it.

With all the uncertainties – including the impact of climate change, the pace of technical development, public perceptions and development of global carbon policy – the low-carbon future might arrive as early as 2040, or as late as the end of the century. But arrive it will.

THE QUESTION HAS NOW BECOME NOT WHETHER TO MANAGE CLIMATE RISK, BUT HOW TO DO IT

AUTHOR I Dave Collins, Executive at MAC Consulting