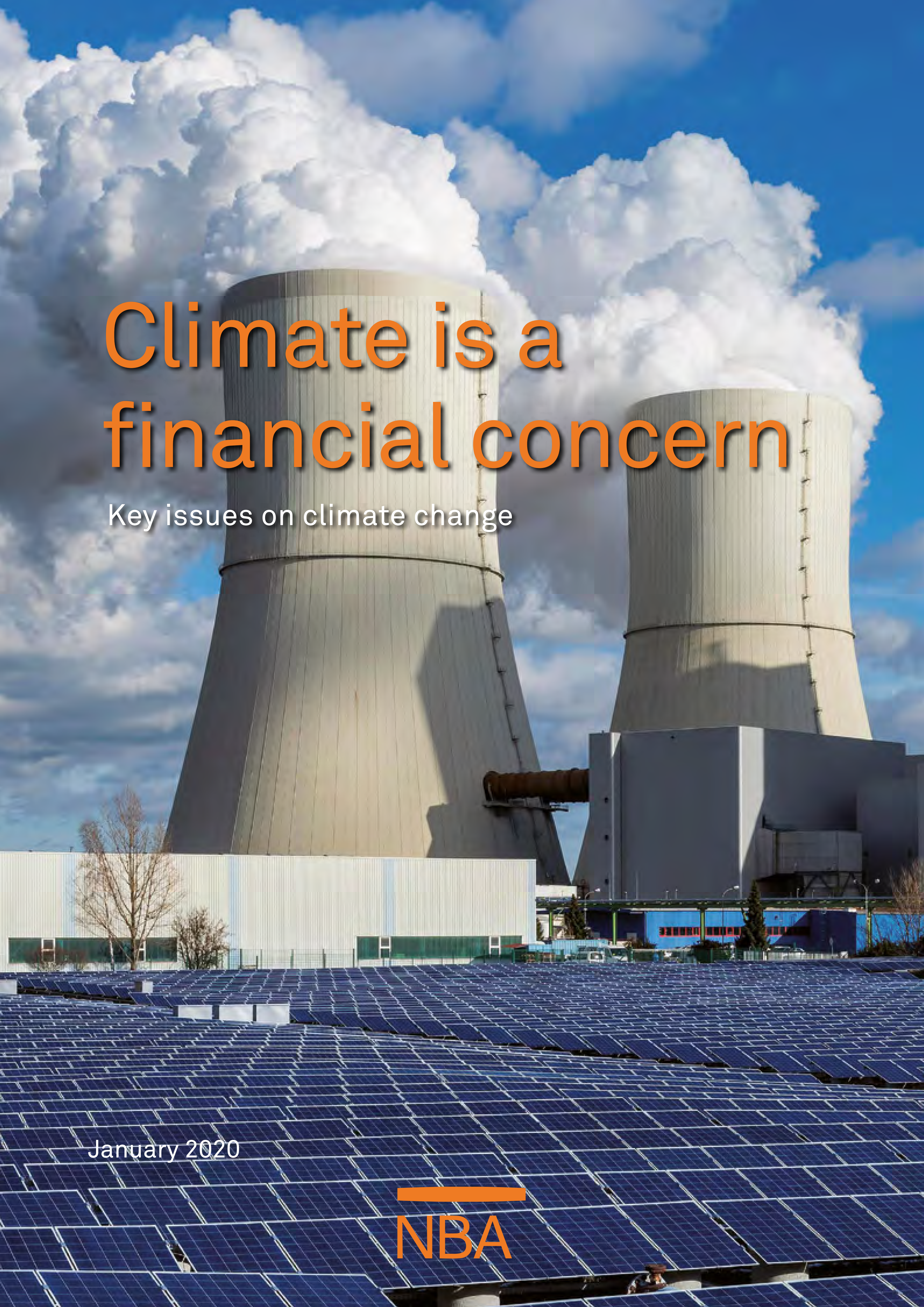

Climate is a financial concern

Key issues on climate change

January 2020

NBA

Royal Netherlands
Institute of Chartered
Accountants

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The NBA's membership comprises a broad, diverse occupational group of over 22,000 professionals working in public accountancy practice, at government agencies, as internal accountants or in organisational management. Integrity, objectivity, professional competence and due care, confidentiality and professional behaviour are fundamental principles for every accountant. The NBA assists accountants to fulfil their crucial role in society, now and in the future.

To directors, supervisory bodies and other interested parties

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Date
January 2020

Dear Sir/Madam,

Sustainability and climate are the primary issues of our time. The media are full of reports about making the economy more sustainable, global warming, reducing fossil fuels and CO2 emissions. Actually, these are not new topics, because almost 50 years ago the Club of Rome reported on the limits of economic growth and its impact on the environment.

The fact that the climate is changing is not a subject for discussion, except perhaps for a few persistent climate deniers. However, the question can be asked whether public organisations and companies are sufficiently aware of the need to take action too. Numerous national and international agreements have been made to halt climate change, but is this really effective? It is already known that several climate targets are not being met and that CO2 emissions are still increasing worldwide. Governments, too, are reluctant to take decisive climate measures.

Much has been written about sustainability, climate and the call to action. This Public Management Letter (PML) approaches the problem from a different perspective: that of accountants. Climate and climate change are at the heart of this, as specific themes with regard to sustainability. The principal message of the PML is simple: climate is a financial concern. Not paying attention to the effects of climate change creates financial risks. These can take on all kinds of shapes, such as fines, a decrease in market share, reputational damage or a new government policy that threatens the continuity of the organisation. It can also happen very quickly: when the ultra-modern coal-fired power station on the Maasvlakte was built, no one knew that it would have to be closed again within 15 years. On the other hand, the climate also provides numerous opportunities: in the form of new products and markets, or the acceleration of all kinds of innovations, for example.

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In short, the climate provides financial risks, costs and opportunities: the field of expertise of the accountant par excellence. The PML focuses on four signals in this context:

1. Climate is not part of the strategy
2. Climate is not embedded in the organisation
3. Accountability for climate performance falls short
4. Accountants need to be more aware of climate change

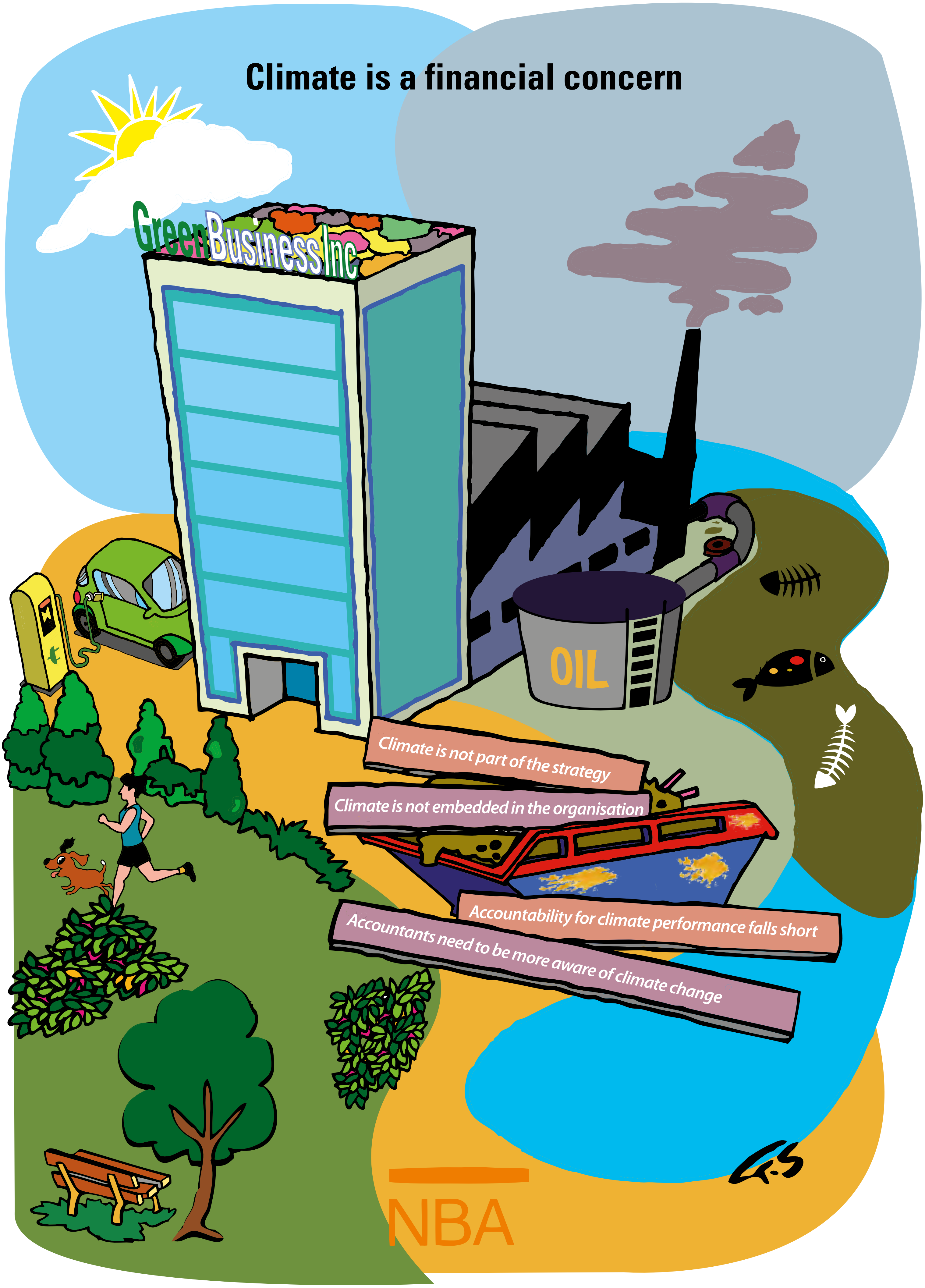
In order to ensure their continuity, organisations must incorporate the climate into their strategy; it must become part of their DNA. It also means that they must be transparent about their performance in terms of the climate in their annual report. From the perspective of their social function, accountants are in the perfect position to play a pioneering role in this.

The signals are based on the observations of an expert group of accountants, supplemented by research. Various stakeholders, including the Dutch Central Bank (DNB), Eumedion, Impact Institute, MVO Nederland (CRS Netherlands) and the stockholders' association Vereniging van Effectenbezitters (VEB), have submitted their comments to us by letter or otherwise. We are grateful to them all for their contributions.

Yours faithfully,

Marco van der Vegte RA
Chairman of the NBA

Karin Hubert RA
Member of the NBA Identification Board



Climate is a financial concern
GreenBusiness Inc
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Climate is not part of the strategy
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Climate is a financial concern

There is a growing awareness all over the world that sustainability is not a choice, but a necessity. Particularly climate and climate change are the major issues of our era. This PML focuses on the consequences of the climate change for the continuity of government bodies and businesses (referred to hereinafter as: organisations). Primarily, this concerns the emission of greenhouse gases such as CO_2.

Climate change and what we can do to counter this (climate action) not only presents risks, but also opportunities. In this PML, the umbrella term 'climate' is used for this purpose. Taking the effects of the climate into account is also called climate adaptation. Conversely, organisations themselves influence the climate through their economic activities.

Climate action also has a social dimension: making a conscious contribution to reducing greenhouse gases in order to keep the world a place that is worth living in for future generations.

Climate agreements

The vast majority of scientific reports on the climate shows that there is no time to lose for climate action[1]. Recent reports by the IPCC[2], the United Nations (UN) climate panel, warn us of the far-reaching consequences of climate change. The Paris Climate Agreement, concluded in December 2015, was signed by 195 countries. In September 2015, the UN adopted the 17 Sustainable Development Goals (SDGs), including SDG 13: Climate Action. There are Dutch objectives in line with this, often agreed at European level or in a UN context. A concrete example of this is the European Emissions Trading System (EU ETS), through which the EU aims to reduce greenhouse gas emissions.

President of the European Commission Ursula von der Leyen and European Climate Commissioner Frans Timmermans presented the European Green Deal at the end of last year. According to this ambitious plan, Europe should be a climate-neutral continent by 2050. Virtually all European legislation is being reconsidered; in March 2020, the European Commission is presenting a legislative proposal to make the climate target mandatory for all member states. By 2030, CO_2 emissions must be reduced by at least 50 per cent. The plan contains various measures, including an end to the subsidy for fossil fuels and CO_2 tax at the EU border.

National agreements are also laid down in, for example, the Energy Agreement, the Climate Agreement (with a proposed CO_2 tax for companies) and the Climate Act.

It is questionable whether all these agreements will be sufficient to limit climate change and it is unclear whether and how the agreements will be met. The ruling on nitrogen of the Council of State already has consequences for the agricultural sector and the construction industry, among others. And although this issue is not about greenhouse gases, it shows what the consequences are if emission standards are exceeded and maintained. The government is struggling to formulate and implement a concrete and coherent policy on these themes.

In 2030, the Netherlands aims to emit 49 percent less CO_2 in comparison to 1990. By 2050 emissions should even be reduced by as far as 95 per cent. The intention behind this is to limit global warming to below 2 degrees Celsius in this century in order to prevent flooding, desertification, food shortages and massive climate migration.

1 https://www.reuters.com/article/us-climatechange-temperatures/evidence-for-man-made-global-warming-hits-gold-standard-scientists-idUSKCN1QE1ZU
2 Intergovernmental panel on climate change, IPCC diverse rapporten: https://www.ipcc.ch/reports

However, according to the November 2019 audit by the Netherlands Environmental Assessment Agency (Planbureau voor de leefomgeving, PBL), current climate policy is insufficient to meet the agreed climate targets[3]. The PBL notes that, due to the latest climate measures, organisations will be faced with higher cost increases than citizens. At present, the measures from the Dutch Climate Agreement of June 2019 have not yet been adopted, by imposing a CO_2 tax on the manufacturing industry, for example.

Circular Economy

The transition to a circular economy, which the Netherlands aims to achieve by 2050, will reduce dependence on primary raw materials. A circular strategy aimed at the smarter and more efficient use of raw materials and energy also leads to lower CO_2[4] emissions. Organisations benefit from responding to this. On the one hand, because raw materials may become scarcer and therefore more expensive and, on the other hand, in the interest of their long-term continuity, also referred to as long-term value creation. Banks have set themselves the objective of providing more financing to companies that do circular business. In addition to this, purchasing and tendering are increasingly subject to requirements with regard to circularity.

Climate risks

According to the World Economic Forum, climate risks will be among the top ten global risks in 2019[5]. Extreme weather conditions, natural disasters and inadequate adaptation to the climate are paramount due to the high probability of their occurrence and the high impact they can create. According to the Forum, underestimating climate risks can have significant financial consequences for organisations in both the short and long term.

A global[6] survey of the five hundred largest listed organizations shows that they estimate the cost of climate risk at around one trillion (a thousand billion) dollars. However, the five hundred organisations estimate the climate opportunities even higher: at two trillion dollars, in the short to medium term. Opportunities refers to the need for services and products aimed at reducing CO_2 emissions. The question remains how much can really be achieved. Moreover, the amounts are not balanced uniformly across all sectors.

The disruptive consequences of climate change are difficult to predict. They can have a huge effect on business results and models.

Financial consequences

Many organisations find it difficult to implement their climate targets in concrete terms and embed them in their DNA. Often, they do not get any further than formulating good intentions; concrete actions are lacking. Everyone talks about the urgency of taking action with regard to the climate, but somehow it is difficult to get started. As with any major change, climate change requires a clear definition and implementation of strategies and an internal organisation that has been brought in line with this. It takes time, persistence and above all the will to change. Change is best done in small steps; continuous steps that lead to measurable results. Perseverance and transparency, and not wanting to achieve everything at once and also accepting failures are of paramount importance. In any case, standing still when it comes to climate is not an option.

Climate is a financial concern. Climate risks and opportunities have a financial dimension and are therefore important for the continuity of an organisation. This may involve competing in tenders that impose requirements in terms of climate, loss of turnover and a decrease in market share because products are not climate-proof, reputational damage due to changing public opinion, new government policy, or investment in product innovation that opens up new markets. Risks can also occur in the supply chain, in the form of a growing scarcity in raw materials, for example.

Large, international organisations have often made more progress in this than small SME organisations, but there are of course exceptions. The Crystal Award and the Transparency Benchmark show that in the field of sustainability reporting there is a small group of frontrunners[7], a larger peloton and a very big group of laggards. It is therefore a question of persuading those left behind that climate awareness is not a choice, but an important condition for future survival.

That climate change will impact every organisation is inevitable, but the extent to which this is the case will vary from organisation to organisation. Every organisation must therefore give some thought to the way in which it will be impacted by the climate in its specific situation.

3 https://www.pbl.nl/nieuws/2019/klimaatakkoord-steviger-beleidspakket-maar-doel-van-49-emissiereductie-naar-verwachting-niet-gehaald
4 https://unfccc.int/news/circular-economy-crucial-for-paris-climate-goals
5 The Global Risks Report 2019, The World Economic Forum consists of CEOs and politicians worldwide
6 Major Risk or Rosy Opportunity: are companies ready for climate change? Carbon Disclosure Project (CDP), 2019
7 See the jury report compiled by the Ministry of Economic Affairs and Climate in cooperation with NBA: Transparantiebenchmark 2019 De Kristal 2019.

The role of the accountant

The core function of the accountant is to add trust to the accountability information of organisations. In this capacity, he/she[8] comes into contact with the business operations, policy and strategy of numerous organisations. In the execution of his job, the accountant focuses on the financial health - and therefore stability and future resilience - of the organisation. The climate is an important risk and opportunity factor here, meaning that it will inevitably be addressed by the accountant.

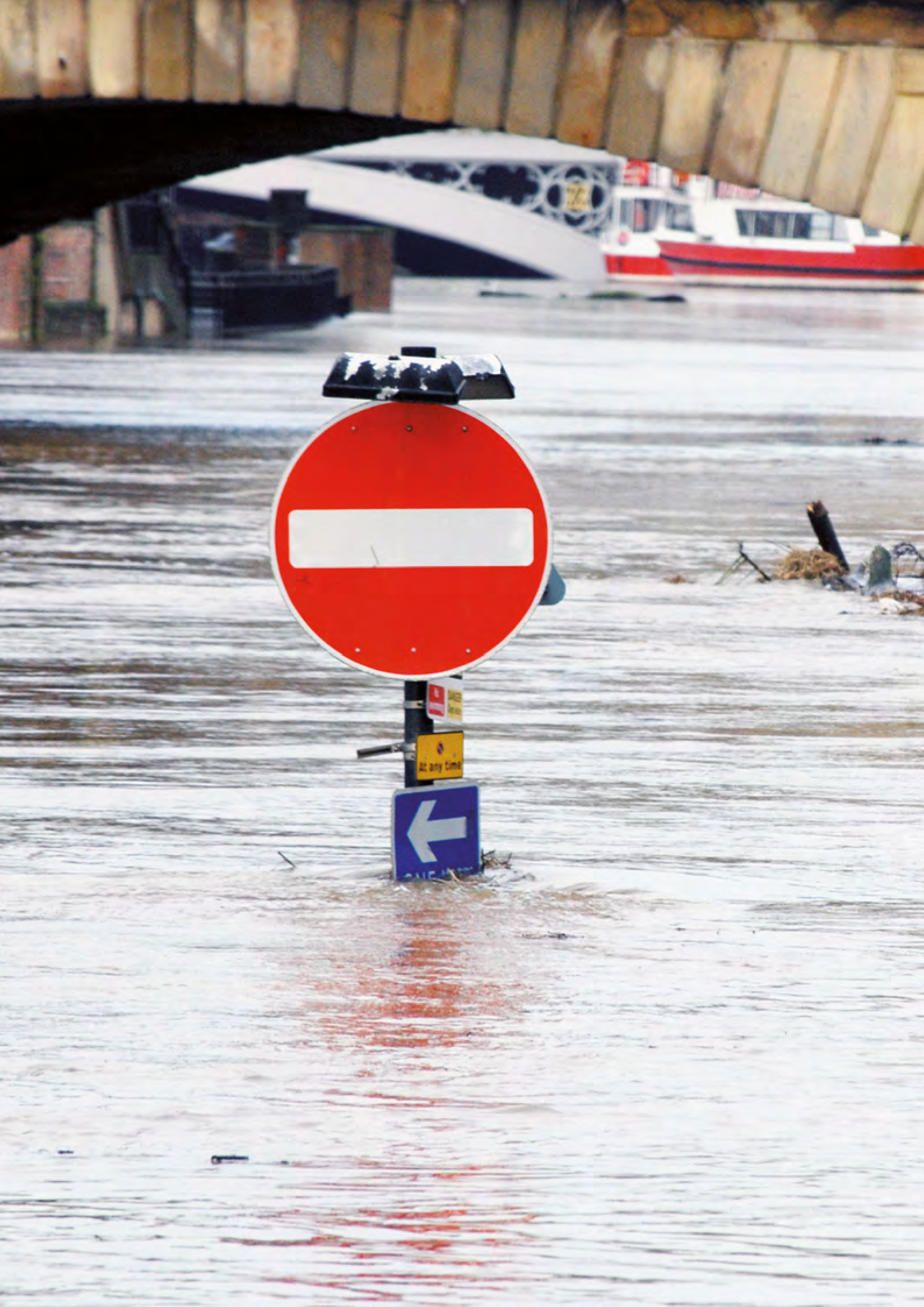
This concerns not only accountants in their capacity of statutory auditors, but also accountants in another role, such as internal auditors or accountants in a financial position. Climate awareness starts within the organisation itself, which is why accountants in a financial position and internal auditors will often play a greater role than the accountant as an auditor, who after all is at the end of the accountability chain. Within SMEs, the accountant can and should play an important role, particularly as a trusted advisor.

Even though climate risks and opportunities inevitably have a financial dimension, in the near or distant future, many accountants are still not at all concerned with our climate. Of course, there are frontrunners here too, but this is a limited group. That is why this PML has been written not only for organisations, but also for their accountants. Climate is a financial concern: it is time for concrete action.

Structure of this PML

The PML follows the four steps an organisation goes through when implementing a new strategy. The first step starts with formulating the strategic goals. During the second step, the internal organisation is adjusted in line with these goals. The third step concerns accountability for the realisation of the strategic goals. In the final step, the accountability is tested for reliability by an accountant. The PML formulates a suitable signal and recommendation for each step.

8 Throughout this publication, the use of the masculine gender is intended to mean he/she.


At any time

Signal 1 | Climate is not part of the strategy

Many organisations pay little concrete attention to the climate and its impact on their results. Climate is hardly a part of their vision and strategy; let alone that concrete goals have been formulated in that area. This inevitably creates continuity risks.

Many organisations lack a strategy that takes climate[9] into account. Directors and internal supervisors, such as a supervisory board, generally do not give sufficient consideration to how they can incorporate climate into their reason for existence ('purpose'). Climate risks can have financial consequences for organisations in various ways. The risks can be subdivided into physical risks and transition risks[10]. Physical risks include rising sea levels, hot and dry summers, extreme rainfall or violent storms. Transition risks in the transition to an economy with lower CO_2 emissions consist of the risks that occur in an organisation's economic environment. These include policy and legal risks, technological risks, market risks and reputational risks.

Government climate policy can have a major impact on the future results of organisations in particular. Imposing a CO_2 tax would have major consequences for the manufacturing industry and the transport sector, among others. The phasing out of coal and gas affects the energy sector. The government does not always show itself to be a stable partner, as was evident when the ultramodern coal-fired power station at the Maasvlakte was commissioned.

There are currently a number of major court cases in progress in the area of climate, potentially leading to substantial fines, damages and reputational damage for the organisations[11] involved. At present, this concerns primarily oil companies, but there is a good chance that other organisations will also have to deal with this. A prime example is the Urgenda case, in which the Dutch government has an obligation to reduce greenhouse gas emissions by at least 25 per cent by 2020, in comparison to 1990. Because of the wide reach of social media, public opinion can quickly turn against an organisation if it is portrayed negatively, especially if an organisation presents itself in a more sustainable way than it actually is. This is referred to as 'greenwashing'[12].

Climate developments can also cause the financing costs of an organisation to rise. Dutch financial institutions will be reporting on the climate impact of their financing and investments from the 2020 financial year onwards. Financiers, investors and external regulators, such as DNB and AFM, increasingly expect organisations to take climate risks into account[13]. Climatic effects can also lead to the write-down of assets or provisions being made for anticipate costs and restructuring.

Larger organisations have often made more progress in this than SMEs, although there are of course exceptions. This is often due to pressure from outside - from suppliers, customers, financiers or interest groups in the field of sustainability and climate change. However, SMEs have enough to achieve in terms of climate change, if only in terms of energy savings and waste separation[14].

9 See, among others, a report by the SER: Kansen pakken en risicobeheersing, September 2019, and a study by KPMG: Are Dutch companies addressing the right climate-related risks?, July 2019.

10 Final Report Recommendations of the Task Force on Climate-related Financial Disclosures (TCFD), June 2019 and Signal 1: Energy transition changes business model, from the PML for the Energy Sector (NBA), May 2016

11 For example: https://milieudefensie.nl/actueel/klimaatrechtszaken-wereldwijd-een-overzicht and https://www.houthoff.com/expertise/Topics/Climate-Change?sc_lang=nl-NL

12 https://www.researchgate.net/publication/283039649_Does_Greenwashing_Pay_Off_Understanding_the_Relationship_Between_Environmental_Actions_and_Environmental_Legitimacy

13 De Nederlandse financiële sector veilig achter de dijken?, DNB 2017 and A call for action: climate change as a source of financial risk, Network Greening Financial System, April 2019

14 Duurzaam ondernemen, Chamber of Commerce, December 2018

Negative example

Hidden costs, real costs?

Airline A does not take climate effects into account. Its tickets are cheap because aviation currently does not have to pay CO_2 taxes, VAT or excise duties on the kerosene it uses. If the government believes that aviation should still contribute financially to the damage flying causes to the climate, this might mean the end of its exceptional position and A's tickets would become much more expensive. If the consumer is not willing to pay more, A's profit margin would evaporate, and its continuity be called into question.

Positive example

Climate included in the strategy

Food Group B has included climate in its strategy, in which it expects to be able to take advantage of all kinds of climate-related opportunities. The aim is to reduce the CO_2 footprint of its production process by 50 per cent by 2030. For each product it made, the amount of CO_2 emitted was identified. Annually, B compiles a report to show the extent to which CO_2 emissions have been reduced during the production process, including in the value chain associated with this.

RECOMMENDATION 1: Give climate the highest priority

Directors and entrepreneurs

- Incorporate climate risks and opportunities into the organisation's vision and strategy in both the short and long term. The most important points of attention in regard of this are as follows:
  - What climate risks are the organisation and the sector exposed to?
  - What are the possible financial consequences of these risks?
  - Which emission sources are the greatest in the organisation and in the value chain?
  - What is the impact of new regulations (including new taxes and charges)?
  - What are the possible opportunities brought about by climate change?
- Risk management should then be adjusted in line with this. Quantify the risks and opportunities with models[15] and scenario analyses where possible or provide a qualitative explanation if this is not possible. Determine the sensitivities in the assumptions and their influence on them (see also Recommendation 3):
  - Valuations (depreciation of oil or gas fields, for example)
  - Results (higher costs due to production breakdowns in the event of storms, for example)
  - Information about this in risk and financial reports
- Decision on what the organisation will focus on in concrete terms: (e.g. housing, behaviour and culture, primary business (and other) processes, circularity, purchasing or possibly stimulating stakeholders to take climate effects into account).
- Communicate with key stakeholders, including investors and financiers.

Supervisory bodies and internal auditors

- Establish how the management can identify climate and integrates it into the strategy. Consider the risks and opportunities identified by the management and how it has integrated these into the business model and its day-to-day decision-making procedure.
- Ask each other how often it is necessary to discuss climate issues at meetings, how the discussions can become more productive and what information is needed for this.

15 For example: models of the non-profit organisation. Use True Price to compile a list of the actual prices and costs of products. See: https://trueprice.org/about-us/.

Signal 2 | Climate is not embedded in the organisation

In many organisations, climate is not embedded in the internal organisation. Climate is not yet a factor that is incorporated into business processes and internal reporting as a standard. Internal auditors and accountants in financial positions can play an important role in this.

Many organisations find it difficult to embed climate in the core of their internal control mechanism. Their organisational culture and behaviour, business processes and systems are not designed for this and it is no specific focus on this in terms of establishing the company's direction. There is also insufficient knowledge available. It is important that the management or the entrepreneur himself sets a good example and promotes climate as an important theme that deserves an integrated approach. Many organisations are still working on separate projects and sometimes have a separate department for sustainability, but do not integrate climate into their culture, daily operations, internal (or external) reporting and financial decision-making[16] processes. Organisations often feel compelled to pay attention to the climate from outside, through legislation or the actions taken by an interest group in the field of sustainability, for example. It is precisely the intrinsic motivation of both the top management and the employees that is indispensable to embed climate awareness into the 'DNA' of the organisation.

Internal auditors and accountants in a financial position can help organisations embed climate into their business processes, systems and internal reports. Accountants in a financial position can help develop targets, climate-related performance indicators and benchmarks and reporting systems. Internal auditors can review or advise on the systems, data and reports.

An important indicator for dealing with climate is an internal report. CO_2 reports are a concrete example in which there is still much room for improvement. This depends, among other things, on the sector in which an organisation operates. So far, CO_2 is barely on the financial agenda[17]. Emissions are actually calculated, and internal CO_2 pricing is performed at only a limited number of organisations. Particularly SMEs are lagging behind in this.

To the extent that CO_2 emissions nevertheless are calculated, the reports on these are neither detailed nor standardised sufficiently. Also, hardly any use is made of international standards such as the Greenhouse Gas Protocol[18]. An alternative in the Netherlands is the CO_2 Performance Ladder[19]. The Partnership for Carbon Accounting Financials (PCAF) has developed a measurement method for financial institutions that shows the carbon footprint of investments and financing[20].

16 See, for example: https://www.compact.nl/articles/een-sleutelrol-voor-internal-audit-in-sustainability/ and the study Culture eats sustainability for breakfast, Rotterdam School of Management, March 2019
17 A study by the NBA and the University of Groningen: CO_2 staat nauwelijks op de financiële agenda, February 2018
18 This protocol is an international standard that provides organisations with tools for direct as well as indirect reporting on greenhouse gas emissions. See: http://ghgprotocol.org/standards
19 This is an instrument used mainly for purchasing by organisations to gain insight into and reduce their CO_2 emissions. See: http://www.co2-prestatieladder.info/
20 https://carbonaccountingfinancials.com/global-carbon-accounting-standard

Negative example

Corporate culture is not climate oriented

Car manufacturer C had its diesel cars emit fewer polluting gases on paper by modifying the test software. Thanks to this software, the cars were able to meet the environmental requirements at the time of testing but were in reality a much more polluting. Apparently, there was not enough room to question this method internally. The primary focus of C's corporate culture and organisation was on profitability - and not on the company's impact on the climate. This came to light and C is now facing huge fines.

Positive example

Climate embedded into the 'DNA' of an organisation

Bank D has embedded sustainability into its internal organisation and business processes. Sustainability is an integral part of its business operations. This means that D only finances organisations that operate sustainably according to a list of criteria. The mortgages granted by D stimulates homeowners to enhance the sustainability of their homes. Additionally, D invests in sustainable projects through its funds. D also aims to be a learning organisation and promotes the ongoing improvement of its sustainability processes.

RECOMMENDATION 2: Integrate climate into day-to-day operations

Directors or entrepreneurs

- Make climate and climate awareness not only part of the strategy, but also anchor it into the internal control systems. Don't forget the soft controls, which focus on the culture and behaviour within the organisation.
- Give employees enough room for experiments in the field of climate:
  - Conduct research into whether climate objectives can become part of the organisation's assessment, remuneration and hiring policies.
  - Provide an environment with room for new ideas and in which making mistakes is not frowned upon.
  - Inspire employees through a programme with concrete climate targets, in which their role is essential for achieving the desired, joint result.

Accountants in a financial position

- Provide relevant, measurable performance indicators in line with strategy and policy. Consider linking up with existing sector and/or industry-specific indicators. Find out if there is also a financial component within non-financial indicators. Specific focus areas for SMEs:
  - Housing: energy label, solar panels, LED lighting, insulation, heating
  - Purchasing: eco-labels, using appliances longer
  - Production: CO_2 emissions, carbon footprint, the reuse of materials and recycling of waste
  - Design: long service life, reparability
  - Employees: compensation for air travel, lease bicycles, electric cars, travel by public transport, working from home
- Opt for CO_2 registration and reduction through concrete targets and measurement methods. Use existing methodologies, such as the Greenhouse Gas Protocol or the CO_2 Performance Ladder.

Internal auditors

- Provide advice on the design of internal processes and reports on climate performance and pay attention to this during operational audits in the organisation.

Signal 3 |
Accountability for climate performance falls short

Organisations pay little attention to climate performance in their annual reports, in which the lack of a uniform reporting standard does not make things easier. Depending on their effect, climate risks should be included in the annual accounts or the management report.

Organisations often do not know how to deal with climate and accountability. A limiting factor here is the lack of a globally recognised standard for reporting on corporate social responsibility, sustainability and climate[21]. Although there are initiatives for harmonisation[22], this will take some time. However, this should not prevent organisations from reporting on their climate performance. It is, above all, a matter of making choices and being transparent about them. The recommendations of the Task Force on Climate-related Financial Disclosures (TCFD)[23] are currently the most authoritative guideline for reporting specifically on financial climate risks.

Research shows that few Dutch organisations report on climate impact[24]. More than half of the 200 organisations surveyed provide a minimal level of information, even though some of them are subject to the EU Non-Financial Information Directive[25], which requires large organisations to include relevant information on sustainability in their management reports. It is often not clear whether there are major climate risks, let alone what their effect is. A limited number of organisations provide concrete and detailed information on the impact of climate change on their business operations and on future plans to mitigate this. The climate reports of large organisations contain general explanations in the areas of strategy and policy, corporate governance and reporting.

Usually there is no adequate planning and control cycle for CO_2 emissions, so no concrete figures can be reported.

When organisations report on climate risks, they usually do so outside the management report or the annual accounts in the form of individual sustainability reports. This often involves fewer good supporting processes than financial reporting. However, it should not be forgotten that climate risks with a financial impact simply belong in an annual report. Depending on the likelihood of occurrence, they must be disclosed in the annual accounts or the management report. Therefore, integrating sustainability reports into regular annual reporting, by means of an 'integrated report' is a far more obvious alternative. More and more organisations are doing so, but studies[26] have shown that there is room for improvement in terms of translating policy into concrete risks, performance indicators and results. Integrated reporting involves more than just reporting on climate performance but focusing on this is an important first step. Organisations could, for example, report on progress in the area of the aforementioned SDG 13 Climate Action.

Because of their key position within organisations, accountants in financial positions can be an important catalyst for realising integrated reporting and the integrated policy required for this, which is referred to as 'integrated thinking'. Internal auditors primarily have an advisory role at the start of the integrated reporting process. At a later stage, this can develop into a reporting and certifying role.

21 At present, the following global reporting systems, among others, exist for different organisations: Carbon Disclosure Project (CDP), Climate Disclosure Standards Board (CDSB), Global Reporting Initiative (GRI), and Sustainability Accounting Standards Board (SASB).
22 E.g: the Better Alignment Project of the Corporate Reporting Dialogue (CRD)
23 The Recommendations of the Task Force on Climate-related Financial Disclosures
24 Report by the University of Groningen: Transparant over klimaatimpact, June 2019
25 EU Directive 2014-95 applicable to large public-interest entities with at least 500 employees
26 Themed study by the AFM: In Balans 2018 deel A and Trendzicht 2019, pp. 34.-35

Negative example

No information about climate impact

Oil Group E is being sued for failing to provide information in its annual report on the dangers of the greenhouse effect and the impact on its earnings model. Neither does E indicate how it intends to mitigate the negative effects it produces on the climate. The outcome of the current legal procedures may lead to the payment of substantial compensation by E and also large-scale reputational damage.

Positive example

Impact of climate risks presented

Company F is active worldwide in the storage and transhipment of chemical and oil products. F reports on climate risks due to extreme weather such as hurricanes and rising sea levels which can result in damage to terminals. It has therefore invested in raising the dikes at a number of locations. The company has also reported that the energy transition could have negative financial consequences. F would, for example, not be able to make as much storage space available for hire or might have to make changes to its offering of services.

RECOMMENDATION 3: Report on climate performance in the annual report

Directors or entrepreneurs

- Report the material (significant) financial effects of climate risks that are likely to occur in your financial statements. Report them in the management report if the financial effects are uncertain. Always provide a good explanation. Use scenario analyses and work towards integrated reporting. When determining financial securities, take the following into account (among others):
  - Possible depreciation or accelerated depreciation of assets (e.g. due to a shorter service life as in the case of coal-fired power stations). Investigate whether this involves reduced future cash flows;
  - Provisions for items such as litigation, possible claims and other costs in accordance with RJ Guideline 252;
  - Lower profits (a decreasing demand for polluting products, for example;
  - Higher operational costs, such as CO_2 taxes or other government measures (energy labels, for example), higher financing costs and more expensive raw materials;
  - Information backing assumptions about climate change and their impact on valuations, results and cash flows (sensitivity analyses on the expected life cycle of assets and uncertainty in determining provisions, for example);
  - Potential impact on continuity (with substantiation).

Accountants in a financial position

- Support the management in drawing up external reports on climate performance and pay attention to the points mentioned above.

Internal auditors

- Make concrete agreements with the public accountant so that he can make use of the work of the internal auditors during his audit.

Signal 4 |

Accountants need to be more aware of climate change

Public accountants should pay more attention to climate in relation to their clients' organisations. When performing audits, they should insist that significant climate risks are included in annual reporting. In regard to his role in society, it is fitting for the accountant to draw attention to climate issues in his other activities too.

In the case of an audit assignment, the public accountant's task is to check whether the financial statements give a true and fair view of the organisation's financial position and results and whether the management report contains any significant inaccuracies. The impact of climate risks should also be included, depending on the probability of occurrence. This must be disclosed in the annual accounts or the management report. Organisations need to realise that the climate has a financial dimension, which can have a direct effect on continuity. Climate is not an isolated factor, but should be a part of every risk analysis.

However, many accountants - just like organisations - still pay little attention to climate as a theme in annual reporting.[27] Perhaps this is because the theme is generally abstract and focused on the medium and long term. Nevertheless, given the financial dimension of climate risks and opportunities, it is a key subject that falls within the financial expertise of the accountant. His knowledge in the field of administrative organisation, internal control, reporting and control also makes him a significant player in the field of climate. Of course, If an accountant does not have sufficient expertise in parts, he can always call on the expertise of specialists.

In his role as an auditor, reviewer or compiler of financial statements, the auditor should ensure that climate risks are adequately disclosed in annual reports. Depending on the degree of certainty of its financial effects, this should be included in the financial statements or in the management report. The accountant will also have to take into account any effects this may have on the continuity of the company in the short and long term. He will also have to express an opinion on the reporting system used and the choices made for reporting, valuation and disclosure. Climate change can lead to impairment of assets and can also affect results and cash flows. A prime example of this involves the valuation of factories that emit a lot of CO_2. If a separate sustainability report is issued or integrated reporting is used, the accountant may choose to provide assurance in this respect as well. The auditor will have to find a balance between the increasing expectations imposed by society and the extent to which certainty can be provided (in order to prevent greenwashing).

In his role as financial advisor to SMEs, the accountant is often involved in drawing up strategic analyses, assessing investment plans and elaborating internal risk management. Based on this expertise, he can also play a role in the field of climate, by advising on climate strategy, climate awareness in the organisation and possible forms of internal and external reporting, for example.

The accountant can also simply provide information, particularly in the SME sector on such topics as the information obligation to report on energy savings or on existing and new subsidy possibilities for sustainable investments.

27 See an article in the Dutch Financial Times (FD) of 3 December 2019: Accountants moeten oog hebben voor impact klimaatverandering.

Negative example

Accountants called to account

In the United Kingdom, a law firm has called both companies and several accountancy firms to account. They are asked to explain why they have not insisted on processing and explaining climate risks to audited organisations. The organisations in question had a material exposure to climate change which should be included in the annual accounts.

Positive example

Insisting on showing the consequences of climate risks

Company G is a company in the manufacturing industry that has invested heavily in plants and systems. The auditor notes that G has an increased risk that certain assets will lose their value in the distant future as a result of climate risks. The accountant insists that the climate risks should be clearly explained in the management report. Company G revises its risk analysis and explains the climate risks transparently in the management report.

RECOMMENDATION 4: Educate organisations on climate risks and opportunities

Accountants

- Insist that organisations include climate risks in their financial accounts, particularly if they have a significant financial effect and possible impact on continuity (impairment of assets and impact on results and cash flows). If the financial effect is uncertain, insist on including climate risks in the management report. Take the impact of the following into account when determining financial securities (see also Recommendation 3):
  - Valuations including a possible influence on cash flows (damage to property due to extreme weather conditions, for example);
  - Results (higher costs due to necessary investments in new low-carbon technologies, for example);
  - Substantiation of the above (a sensitivity analysis of the impact of severe drought on crops, for example).
- Discuss the subject with the management and supervisors or the entrepreneur. Discuss the future resilience of the strategy, the embedding of climate awareness into the organisation and the benchmarking and justification of climate performance. Inform them about opportunities and risks in relation to climate, also taking into account new or changing grant schemes or procurement requirements in tender procedures.
- Consider the climate at every stage of the audit, assessment or composition assignment: in planning, implementation and reporting.
- Ensure that the team has sufficient knowledge and expertise on climate issues, including the relevant legislation and regulations. Call in specialists if necessary.
- See how an advisory role can be fulfilled in the field of climate. This applies particularly to SMEs. Possible roles are:
  - furthering the discussion by putting climate on the agenda (in the context of annual accounts or investments, for example);
  - raising awareness within the organisation by drawing attention to developments and initiatives in the field of climate within the sector; and
  - advising on the strategic, organisational and financial implications of climate risks and opportunities.

NBA

- Ensure that knowledge is increased and shared about climate issues via a focused community, publications, meetings, stakeholder dialogue and mandatory or voluntary training courses.

Summary of stakeholders' responses

At the request of the NBA, the following stakeholders have responded to the public management letter. Their responses are summarised in this chapter.

The Dutch Central Bank

The Dutch Central Bank (DNB) endorses the PML's most significant message that paying no attention to the effects of climate change poses financial risks. Improving the quality and quantity of climate data is crucial to the financial sector's ability to manage climate risks. To this end, climate information needs to be better disclosed throughout the reporting chain. The DNB considers the role of the accountant to be of paramount importance in this respect.

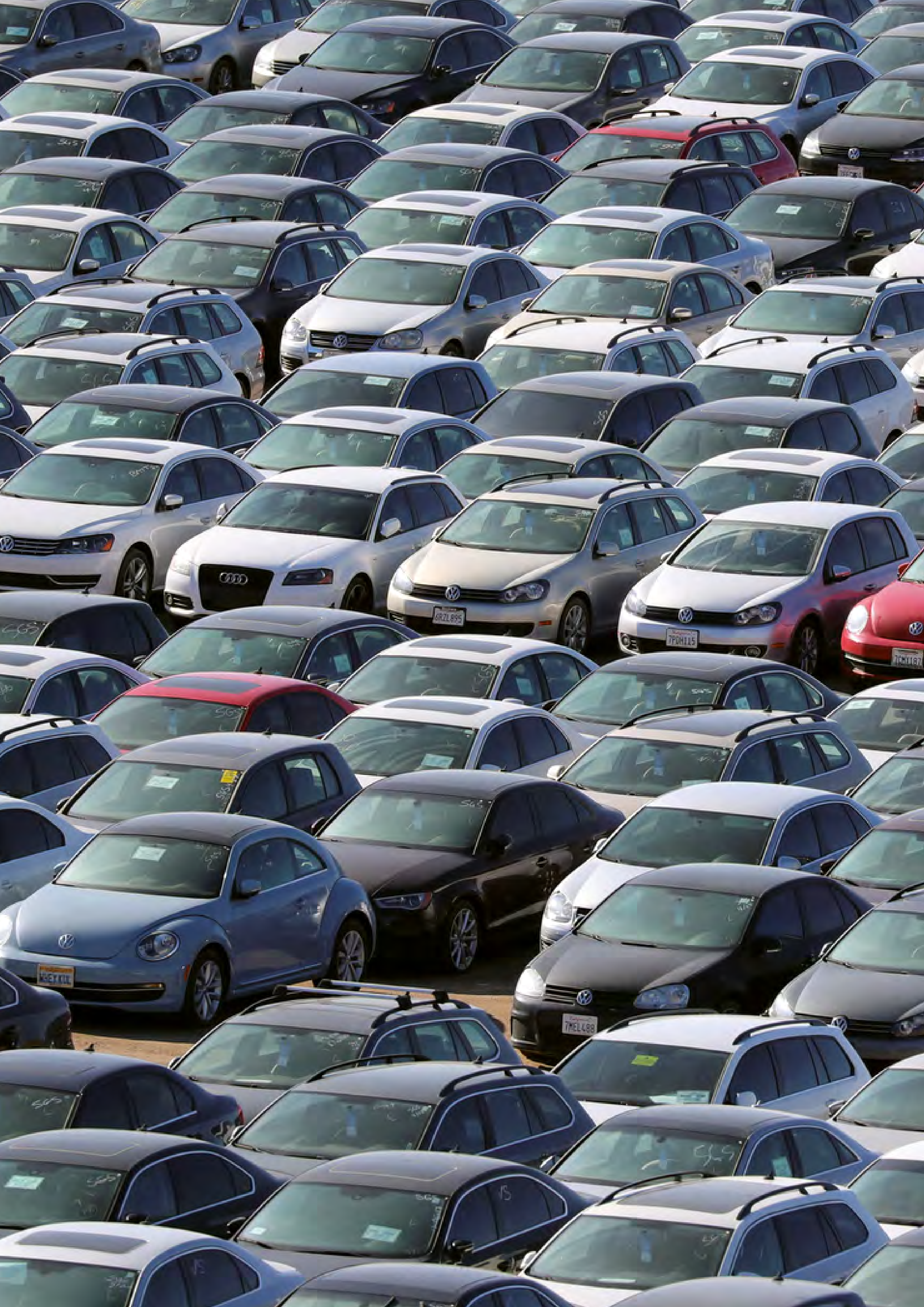
The DNB also endorses the recommendation to promote integrated reporting, in which unambiguous definitions and standards are of the essence. In the area of non-financial information, there is still some work to be done in terms of harmonisation. Accountants and the NBA can contribute to this by pleading for this with the bodies that draw up reporting standards.

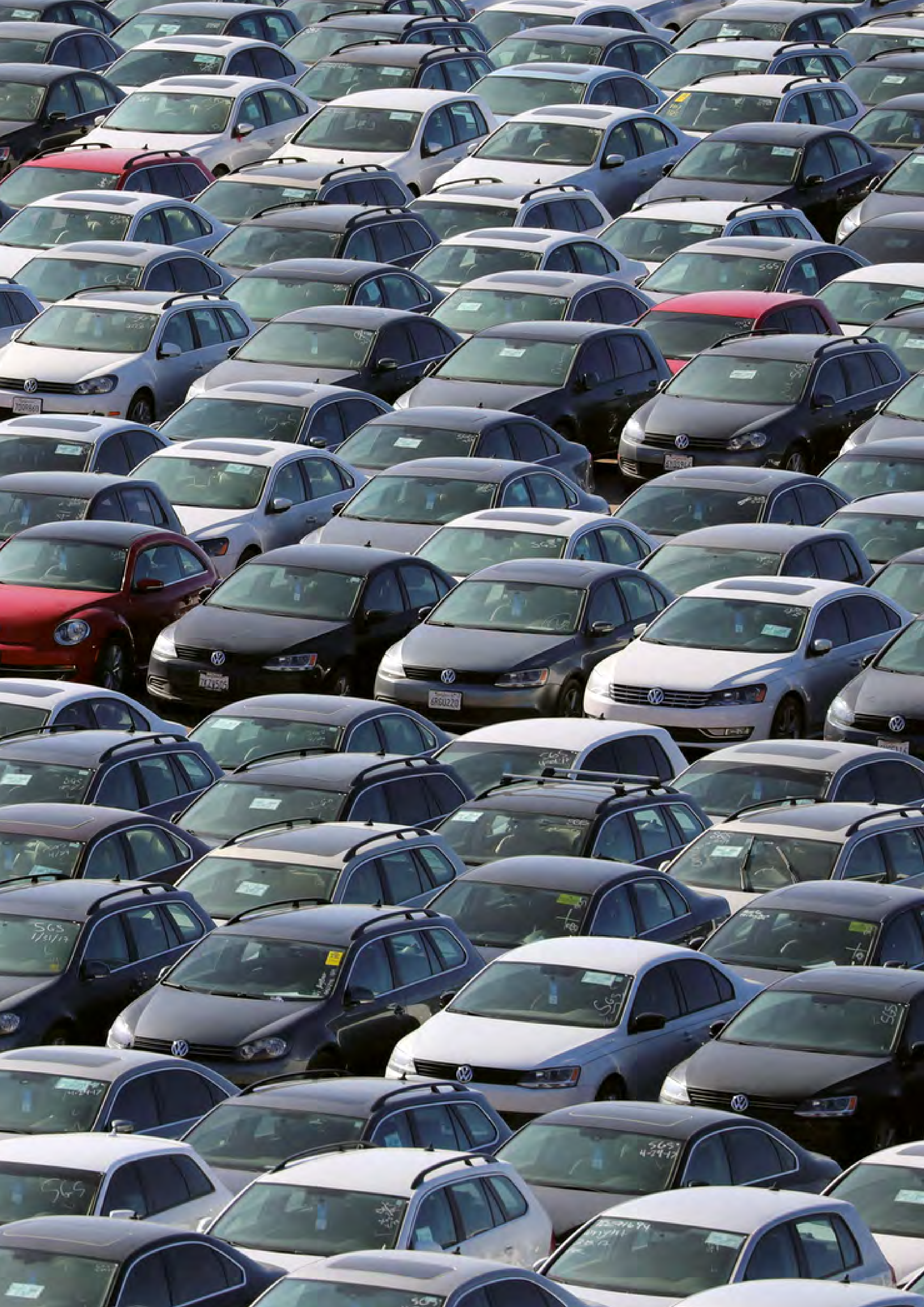
Data quality is an important aspect of accessing data in the reporting chain. Data users want to know the degree of reliability. Accountants are ideal parties for determining the quality of data and to clarify the requirements that need to be met. Consideration could be given to whether a broad set of climate definitions is desirable. Not only for green economic activities, but also for grey and brown ones, for example. Standard frameworks are also needed for the correct valuation of assets.

MVO Nederland (CRS Netherlands)

MVO Nederland is the movement for entrepreneurs in the new economy, which is climate-neutral, circular and inclusive, with fair trade chains. Solid management information and transparency are crucial preconditions for the transition to this new economy.

MVO Nederland is therefore pleased with the NBA's initiative to publish this PML. The PML offers entrepreneurs and accountants both clear insights into why professional reporting and management of climate data is crucial and how other companies can benefit from this. It also clearly describes in each signal what both accountants and entrepreneurs can do in concrete terms to capitalise on these opportunities. After all, working successfully to prevent and adapt to climate change is also a huge opportunity towards making your company future-proof. This is exactly what doing business in the new economy is all about.





Credits

Sharing Knowledge

In the NBA Sharing Knowledge policy programme the expertise of accountants is collectively applied to signal risks early in social sectors or relevant themes. In doing so the emphasis is on governance, operations, reporting and auditing. The NBA has used this public management letter (PML) to present four recommendations concerning climate change. This subject is the 24th topic to be selected by the Identification Board of the NBA. A working group of accountants and advisors gathered anonymised findings and translated them into a concept publication. This was then discussed at a meeting with stakeholders. The Identification Board gauged the signals from a social perspective and applied a social assessment to the signals. Stakeholders in the sector were willing to respond in writing to the PML. Coordination and final editing was provided by the Sharing Knowledge programme team.

Further Information

A public management letter is one of the publications issued by the Sharing Knowledge policy programme. Open letters and discussion reports are also released. The NBA has released the following publications:

- 2019: Professional Football Organisations and Notarial Profession
- 2018: Commercial Real Estate and Trust Offices
- 2017: Housing Associations
- 2016: Cyber Security, Energy Sector and Introducing New Laws
- 2015: Curative Healthcare and Hospitality
- 2014: Life Sciences and Banks
- 2013: VET Colleges, Risk Management and Transport & Logistics
- 2012: Municipalities, Tone at the Top and Charities
- 2011: Commercial Real Estate, Pensions and Greenhouse Horticulture
- 2010: Insurance and Long-Term Care

All publications are publicly accessible and are intended for a wide audience.

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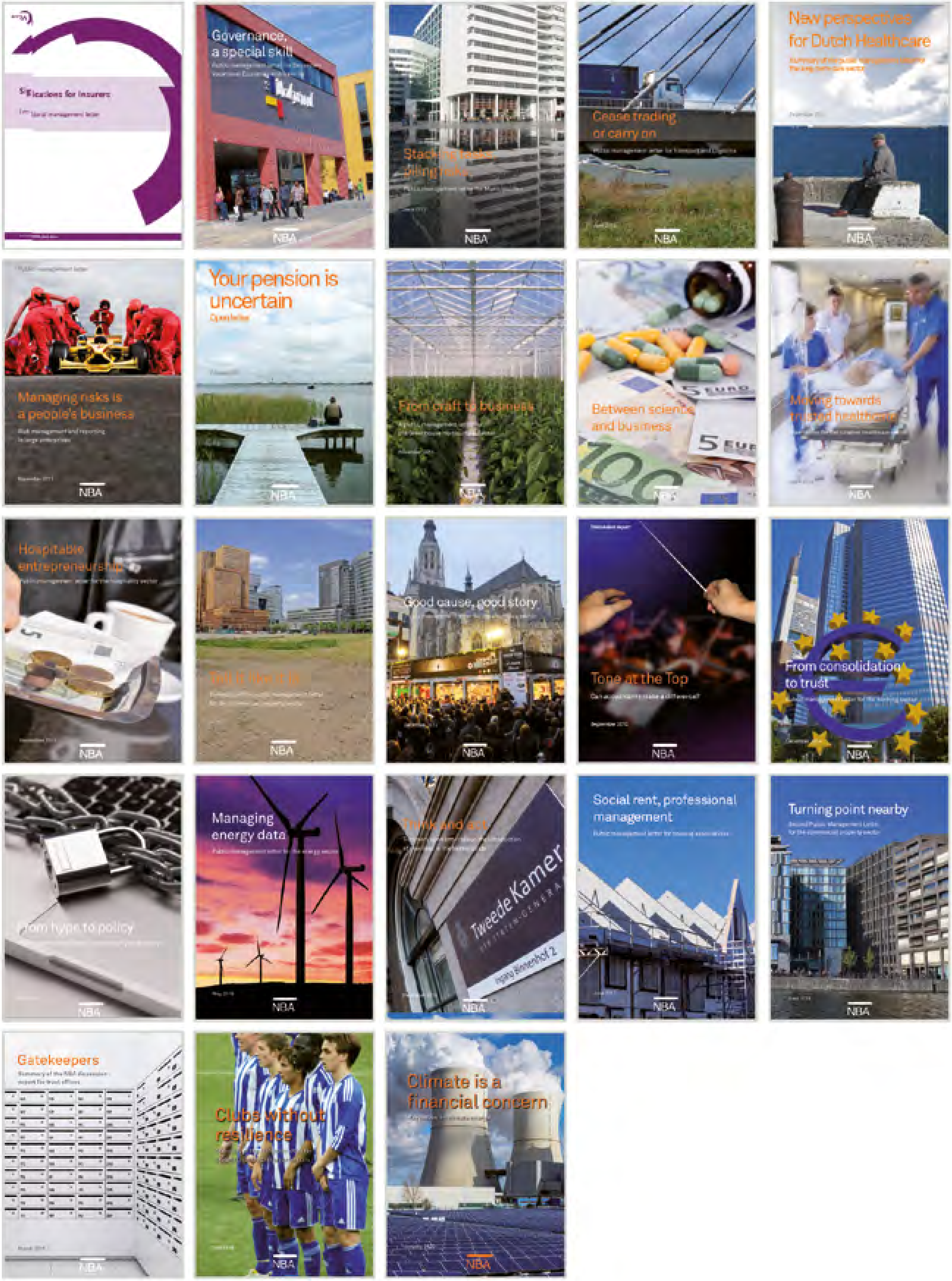
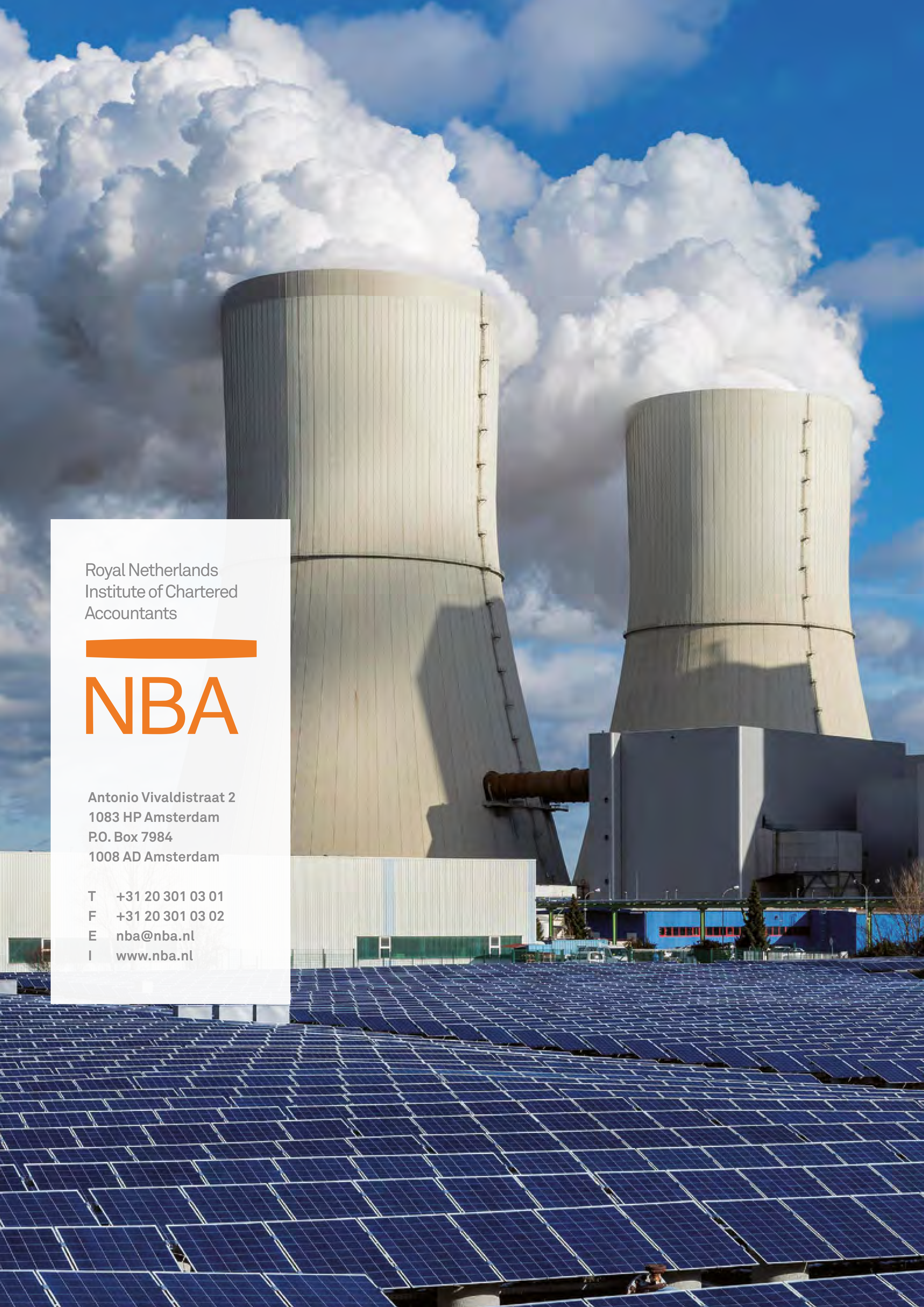
Public Management Letters (PMLs) published in 2010-2020





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