Considerations for reporting and disclosure in a carbon-constrained world

Carbon Tracker Initiative

CDSB Climate Disclosure Standards Board

The world is now agreed that significant action is needed to address climate change. The Paris Agreement, which was the outcome of the 21st session of the Conference of the Parties (COP 21) under the United Nations Framework Convention on Climate Change (UNFCCC) commits to keeping the average rise in temperatures for this century to below 2° C. This creates clear constraints for the burning of fossil fuels. The involvement of, innovations by and financing from the private sector are acknowledged as being crucial to implementing the agreement.

So what should private sector coal, oil and gas companies report to stakeholders about the transition to the post fossil fuel era?

The Paris Agreement, together with the creation of the Financial Stability Board's (FSB) Climate Disclosure Task Force (CDTF), highlight the need to establish clear requirements about what a fossil fuel company is expected to report to its stakeholders about climate change risks and opportunities. We are therefore revisiting and updating our previous proposals (see below) in order to stimulate discussion on the reporting infrastructure needed for the transition to the post fossil fuel era.

A number of assumptions underlie the discussion below:

1 Reporting infrastructure cannot be developed in isolation from activities that seek to influence, supervise and regulate the behaviour of fossil fuel companies. Reporting should reflect the actions taken to create change.

2 The Paris Agreement and the launch of the CDTF confirm climate change as a mainstream business issue. Few sectors are as directly impacted as the fossil fuel sector. Stakeholders should therefore expect to see information about climate change targets and their implications for the business in fossil fuel companies' mainstream reports.

3 In the absence of a global company-specific allocation mechanism for a 2° C carbon 'budget', the role of disclosure becomes paramount in addressing the various information needs of various stakeholders, including:

- Informing capital market participants of fossil fuel company-specific risks, expectations and business plans;
- Monitoring global progress towards the 2° C constraint.

4 To promote the adoption and success of reporting requirements, regulatory monitoring and oversight may be needed. Regulators can only act on matters within their jurisdiction and any changes to regulation are likely to be subject to consultation.

5 Achieving the buy-in of key stakeholders can help achieve changes to disclosure regimes.

Below, we aim to break through the complexity of reporting on carbon asset stranding risk (CASR) and other issues by asking four questions and offering some initial thoughts in response:

1 What should resource companies report on climate change and CASRs?

2 Who should set the reporting requirements and how should the information be used?

3 What are the challenges ahead?

4 What are the opportunities for developing reporting infrastructure?

1 What should resource companies report on climate change and CASRs?

Much excellent work has already been done to work out what fossil fuel companies should report on. In particular, the following approaches by CDP, Carbon Tracker, SASB and WRI define the type of narrative discussion and quantitative information that companies should report.

- CDP's "Climate Change Information Request" for the Oil and Gas sector;
- Carbon Tracker's "The Fossil Fuel Transition Blueprint;"
- SASB's "Oil and Gas Exploration and Production Provisional Accounting Standard;"
- WRI's "Calculating and reporting the potential greenhouse gas emissions from fossil fuel reserves".

In addition, reporting content is informed by a number of corporate finance and listings regimes (the US SEC and EU Prospectus Directive, UK AIM market and Australian Securities Exchange are examples) and an IASB Discussion Paper.

Although an in-depth comparison has not been conducted for the purposes of this paper, there seems to be much agreement between stakeholders on what should be reported. At a very high level, some of the shared reporting themes include:

- **Disclosures regarding proven and probable reserves**

Using reasonable future assumptions to quantify proven and probable reserves and production assets under current recognised standards;

- **Factoring the carbon budget into accounting and decision-making**

Consider carbon budget implications for reserves accounting and what attributes of resource base need to be discussed to reflect carbon risks;

- **Strategic development**
  - o Report the company specific risks arising from CASR and operation in a climate-secure environment;
  - o Analysis of how climate regulation impacts the demand for, and price of hydrocarbons, as well as capital expenditure strategies for exploration, acquisition and development;

- **Scenario analysis and stress testing**
  - o Scenario analysis and stress testing consistent with a low carbon energy transition, including sensitivity of reserve levels to future price projection scenarios that account for a price on carbon emissions;

- **Linking to mineral competent persons reporting**
  - o To ensure that there is a consistent approach taken to evaluation of mineral assets assumptions, CASR and asset valuation;

- **Embedded metrics**
  - o GHG emissions from fossil fuel companies, particularly carbon dioxide emissions embedded in their reserve and resource base;
  - o Segmentation of capital expenditure plans.

The material in documents issued by CDP, Carbon Tracker, SASB, WRI and others also provides calculation approaches, estimation methodologies, and cross-references to third-party materials such as the Committee for Mineral Reserves International Reporting Standards, the Petroleum Resources Management System and others.
We believe that much has already been achieved to determine what should be reported on. Now we need fossil fuel companies to act on it. Endorsement of the requirements by authoritative bodies (eg: the IASB, the OECD or national regulators) would provide the certainty, authority and agreement on what should be reported.

2 Who should set the reporting requirements and how should the information be used?

The CDTF has been established as an 'industry-led' task force to develop a reporting approach that elicits information to be used for the management of financial stability-related climate risks, including the 'transition risk' to a lower carbon economy. It is right that financial markets participants – regulated financial institutions and other investors – are able to contribute to this process as it is they, in a financial stability context, who may be best placed to manage their individual risks.

Regulated financial institutions	To manage their investment risk in a regulatory context. In addition, to determine key fossil fuel investment strategies, including: • Divestment where appropriate; • Engagement with fossil fuel companies on matters of strategy and business planning and investment risk, whether because of risks to company or the institutions' overall portfolio.
Other investors	As above, excluding the regulatory risk management context.
Accounting, corporate reporting agencies and listings regulators.	To ensure that intended disclosures do not conflict with existing regulatory disclosure obligations and, possibly alongside legislators, can be incorporated into regulatory regimes.
Energy and climate regulators and departments	To be able to access, understand and act on data that illustrates whether the transition to a carbon constrained world remains on track and consider implications in context of industry/sector.
Fossil fuel industry	To provide information in a feasible, cost- effective manner and demonstrate appropriate management of enterprise risks to investors. At an industry level, further disclosure information may help create agreed pathways towards managing the 2° C carbon 'budget'.

3 What are the challenges ahead?

There are inevitably many challenges ahead, as there have been with the development of financial reporting. However, one of the main challenges will be co-ordinating all of the activity currently underway to support or require resource companies to report on climate and CASRs. Co-ordination is required to:

- Ensure coalescence around objectives,
- Encourage standardization of reporting terminology, compliance with reporting requirements and placement of information;
- Secure agreement on the type of professionals competent to assure reported information and which institution(s), if any, will have or can create the authority to monitor progress against reporting requirements and take action to enforce where appropriate;
- Manage the overall disclosure burden for issuers and investors, accounting for any commitments to reduce the overall volume of disclosure;
- Account for and correlate with complementary initiatives such as the Extractives Industry Transparency Initiative;
- Address concerns from fossil fuel companies regarding disclosure (particularly regarding financial and operational projections) that is both commercially sensitive and also possibly highly variable over time;
- Consider technical issues regarding accounting, such as:
  - o Balancing carbon-focused treatments of reserves and resources with limitations on resource-based reporting intended to prevent inflated reserve estimates;
  - o Characterising actual and embedded GHG emissions from proven and probable reserves within a reporting system that distinguishes activities and outcomes over which the reporting organisation has ownership, control and influence, respectively.

4 What are the opportunities?

The recent Paris Agreement has created significant public and political support for the steps needed to monitor and enforce the transition to a lower carbon economy. Alongside this, the CDTF mandate has achieved considerable profile. As well as using existing climate reporting practice developed by CDP and others to advance its work, there are a number of complementary activities and opportunities that could be pursued by the CDTF to enhance climate reporting further:

- Practical guidance on how information on CASRs (see 1 above) could be integrated into the existing reporting model, including financial statements prepared according to IFRS. The IASB's role as a member institution of the FSB presents a unique opportunity for greater alignment of financial and climate reporting;
- CASRs and reporting could be considered in the broader corporate finance and listings regulatory context. For instance, regulation requires fossil fuel companies to seek "mineral experts'" opinions on certain carbon asset valuations, but not necessarily on CASRs. Several regulatory initiatives underway in 2016 within the EU may provide opportunities to promote a consistency of approach here.
- France's Energy and Ecology transition Law (2015-992), with its requirements for companies to report climate-related information and investors to disclose the carbon exposure of their assets may provide a blueprint for wider adoption.
- The recent Shell prospectus issued in connection with a UK takeover transaction contains a risk disclosure showing that, post-Paris Agreement, carbon and climate risk is on the minds of fossil fuel companies and serves as a reminder that principal risks need to be disclosed to investors—for fossil fuel companies this likely includes CASRs. The Paris Agreement gives greater certainty to companies so that they can factor CASR into planning assumptions and disclosures.

About Carbon Tracker

Carbon Tracker is a team of financial, energy and legal experts with a ground breaking approach to limiting future greenhouse gas emissions. We have the technical knowledge, connections and reach to get inside the mind-set of the global financial community and effect change on a global scale. We are a non-profit, independent think-tank, free from the commercial constraints of mainstream analysts and able to set our own research agenda.
Carbon Tracker produces its research working with a number of former financial analysts and advisors, and by subscribing to industry databases giving the latest project economics for oil gas and coal.

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About CDSB

The Climate Disclosure Standards Board (CDSB) is an international consortium of business and environmental NGOs. We are committed to advancing and aligning the global mainstream corporate reporting model to equate natural capital with financial capital.

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