Intelligence MEMOS

From: Robert Siddall

To: Canadian accountants

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Re: **With a Little Help From Our Friends**

Are you sad because you're on your own? No, I get by with a little help from my friends.

The famous Lennon/McCartney lyrics might not seem to apply to accountants. But continuing to ensure that financial information is free of material misstatement in an era of continued climate change means that accountants will need to rely on experts in environmental science, engineering, asset management, law, and economics. The profession has taken steps in the right direction, but more is needed.

Most climate-related focus has been on improving the quality of disclosure of the its impacts on a company's operations, finances and financial results. A number of frameworks have been developed to support better climate-related disclosures and accountants will play a big part in developing and improving these disclosures.

But existing accounting and auditing standards require accountants to ensure, for example, that there hasn't been a permanent impairment of company's assets as a result of physical or transaction risks associated with climate change. And how do we ensure the estimates of the useful life of these assets is reasonable in a world of changing climate conditions? Both scenarios require significant professional judgement in estimating financial impact, now and in the future.

Continuing to amortize assets on a straight-line basis over 50 to 70 years may no longer be appropriate when either acute or chronic climate change may significantly reduce the useful lives of these assets. And assets that, when built, were not susceptible to flooding risk, might now find themselves significantly susceptible to flooding 20 years out, as water levels rise, or flooding occurs regularly. Other assets, like hydro lines, that were susceptible to severe ice storms occurring every 10 to 20 years, may now find these storms occurring every other year, having a permanent impairment on the lines or reducing the expected useful life of these assets.

Accountants should be able to identify these risks to a business's assets. However, assigning a new value to these assets or determining the timing, value and extent of any permanent impairments will likely require reliance on experts in environmental, engineering, asset management and science fields. Indeed, one of the recommendations coming out of Ottawa's Final Report on the Expert Panel on Sustainable Finance specifically argues for the development of "a climate lens for accounting, auditing, and assurance standards in Canada." Mark Carney, Bank of England Governor recently reinforced the link between standards and climate, when he noted "CPAs working as auditors help ensure that climate change impacts, risk and opportunities are appropriately disclosed."

Relying on experts is not a new concept for accountants. They currently rely on experts for pension liabilities (actuaries) or in some cases for valuation of certain assets (real estate assessors). In these circumstances, these experts usually have a body of evidence to turn to and a set of commonly accepted practices used by them in arriving at their conclusions.

When it comes to assessing the impact of climate change on the carrying value or useful life of an asset, environment and asset management specialists do not have the same body of empirical evidence or body of practice to rely on. The science of climate change is, by its very nature, constantly changing and estimating climate change impacts out 25 to 50 years is almost impossible to do accurately at this time. This would not be a problem if these impacts were not material to a company's financial position, but in a lot of cases, they are. For example, if more than 10 percent of an asset's useful life is at risk as a result of climate change impacts, then for companies that are capital intensive this could be a material financial impact.

To be able to effectively address this dilemma will require accountants to explain their needs for appropriate evidence to climate change experts and asset managers, and to work effectively with them over time to develop a database of empirical evidence to support the impact climate change on financial information.

With a little help from our friends, we can meet this challenge together.

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