

Accounting for Environmental Change: the Corporate Acco..

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The Corporate Accountability Network is launching a new report today, which includes a draft Financial Reporting Standard for Accounting for Environmental Change. This embraces the ideas previously described in sustainable cost accounting.

The [draft standard and supporting paper is here](#). The introductory note is as follows, with the references being available within the report.

It is now widely acknowledged that there is a climate crisis (G20 2021, UN PRI 2021).

Accounting initiatives have been made in response to this crisis, including those from the Task Force on Climate-related Financial Disclosures (TCFD) (TCFD 2017) and the International Financial Reporting Standards Foundation (IFRS) linked International Sustainability Standards Board (ISSB 2021), both of which seek to provide data on the scale of this crisis. The EU is taking a slightly broader approach (EFRAG 2021a) in its accounting response. In addition, wider recognition of the need for enhanced sustainability reporting has also emerged indirectly through the UK government's Brydon review's recommendation for new resilience statements (Brydon 2019).

This paper will argue that these proposals are useful steps forward but are fundamentally limited in scope, meaning that they fail to deliver the accounting reforms required in response to the environmental crisis. There are three reasons for this.

First, none of the above proposals require properly integrated reporting (Flower 2015, Dumay et al 2016). Integrated reporting would require that the accounting consequences of environmental change would be reflected on the balance sheet of a reporting entity. This is not envisaged by any currently proposed climate accounting standard. That is because none of the currently proposed standards break down the silos between sustainability reporting and financial reporting (Unerman et al, 2018).

The IFRS Foundation's ISSB will instead likely steer the TCFD towards 'front end' rather

than 'back end' financial reporting^[1]. In addition, the IFRS's implicit endorsement of the Australian Accounting Standards Board (AASB 2019) approach requires no change to general purpose financial statements whereas this paper argues that this is precisely the change that is required. The same is also true of the IFRS's own statement on this issue (Anderson 2019).

First, this unwillingness to integrate climate and financial reporting means that the latter will misrepresent the risk inherent in many public interest entities (PIEs) arising from climate change. Serious investment errors are likely to result as a consequence, whilst essential climate change responses may also be deferred, which is a risk that society cannot afford to take.

Second, these proposals avoid any suggestion that changes be made in those who are considered to be the primary users of what the IFRS calls general purpose financial statements, which definition currently excludes most in society (IFRS 2018, para 1.2) by focusing solely on the needs of shareholders and other suppliers of capital to a company. Nor is any such change likely to result from the UK government review of audit (BEIS 2021). As a result, only a small sub-section of the potential users of accounting data remain the focus of this proposed reporting on climate change (Young 2006), which means that the proposed climate reporting now on offer does not meet public need, by design.

Third, whilst the proposals might create a new emphasis within financial reporting, effectively delivering a form of natural capital reporting (Wackernagel et al 1999), the result is that an artificial asset (carbon emissions as defined by regulation) is promoted as another financialised asset for disclosure purposes (Perry and Nolke 2006). We argue that this form of accounting does not meet user needs, even by the IFRS Foundation's definition of decision usefulness.

This paper presents an alternative model of climate reporting by arguing that accounting for environmental change is not an addition to existing financial reporting or a mere variant to it, but fundamentally changes the focus and purpose of financial statements. This change can be achieved through adoption of a new Financial Reporting Standard on Accounting for Environmental Change, a draft of which with explanatory notes is attached to the paper. The resulting changes to the conceptual framework of accounting are the focus of this explanatory paper.

At its core the proposed Financial Reporting Standard makes a straightforward demand. Rather than require a reporting entity to disclose its emissions and its progress in reducing them, which is the focus of most existing climate change accounting proposals, the draft Financial Reporting Standard requires the reporting entity to estimate the cost of eliminating those emissions in order to align its activities with the goal of achieving a 1.50 Celsius global temperature change (IGCC 2021). This cost, plus the cost of any new investment required to achieve this goal if the reporting entity is to continue to be considered a going concern, must be provided on the balance sheet of

the reporting entity, with that liability being matched by what is deemed to be a realised reserve that reduces the capacity of the reporting entity to pay dividends until the goal of sustainability is achieved.

This paper notes that these changes are possible, but that delivering them will require changes in the IFRS conceptual framework for accounting (IFRS 2018). These changes primarily relate to a reappraisal as to who the users of accounts are, with a range of stakeholders being suggested in place of the existing focus that is solely upon shareholders and other suppliers of capital, and a reappraisal of what form of capital has priority when it comes to accounting, with environmental capital taking priority over financial capital.

We argue that accounting for these provisions for the cost of adapting to environmental change on an ongoing basis will provide users of financial statements with the data they need to monitor the reporting entity's success in becoming net-zero compliant. In the process we turn issues relating to environmental change into hard accounting data capable of being recorded within the audited books and records of any PIE. As a result the Board of any such PIE will have to focus its attention on this issue since it has direct impact on its financial reporting.

Notes:

[\[1\]](#) *The 'front end' of financial reporting is largely narrative-based data. The 'back end' comprises the financial statements drawn from the general ledger of the reporting entity.*