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Climate change and accountancy: when government action falls short

5 May 2020: Dr Roland Kupers a researcher at the Institute for Advanced Studies – University of Amsterdam, advises on complexity, resilience and energy transition. He describes to ICAEW Insights why climate change most definitely matters to accountancy.

"We generally count on top-down measures to fix the climate," says Kupers, "but the reality is that in most jurisdictions, governments have failed to pass measures commensurate with the problem."

One example is the scarcity of regulation around accounting for climate risk. "You would hope regulation would complement climate policy," he continues, "but the rules are just not there yet. For Kupers, accountants play a really important role, providing a formal interpretation of reality. However, he also believes that many accountants do not yet know they are intrinsic to addressing climate change.

"Climate change matters to accountancy. It matters both directly through the adoption of new rules and regulations that impact companies and their accounts, but also indirectly through the great uncertainties generated from the very lack of adequate rules and regulations," Kupers insists. "There is no doubt that current regulatory frameworks fall well short of the scale and urgency of the climate crisis."

"This is recognised, for example, in the Paris agreement that envisages a so-called ratcheting mechanism, where country targets are tightened every five years. This process starts with 2020 COP26 meeting in Glasgow."

In his 2020 book, A Climate Policy Revolution: What the Science of Complexity Reveals about Saving the Planet, Kupers describes one example of how system change might occur outside the usual top-down government model. It concerns the impairment decisions around fossil fuel assets.

He writes: "Every year the management of every firm is called upon by their accountants to state the value of their assets. The accountants ask questions, audit, and then certify the logic with which the assets were valued. But what is the remaining value of a coal plant? Basically, it is determined by how much money it will make over its remaining useful life. But how long is its useful life? Under any realistic climate scenario, coal plants will either be closed in a more or less congenial way today, or more brutally in the future as the urgency further grows. Either way, there is a huge range of uncertainty over the value of these plants.

"Depreciate too fast and you decimate short-term profit and shareholder value. Depreciate too slowly and you are liable for cooking the books. In Europe $75bn worth of coal plants have been depreciated early."

Assisting management with climate-related impairment decisions requires accountants to be familiar with the dynamics of climate policy (or the lack thereof). This applies to coal assets, but also to other assets such as fossil-fuelled cars, whose resale value will plausibly plummet as demand shifts to electric cars.

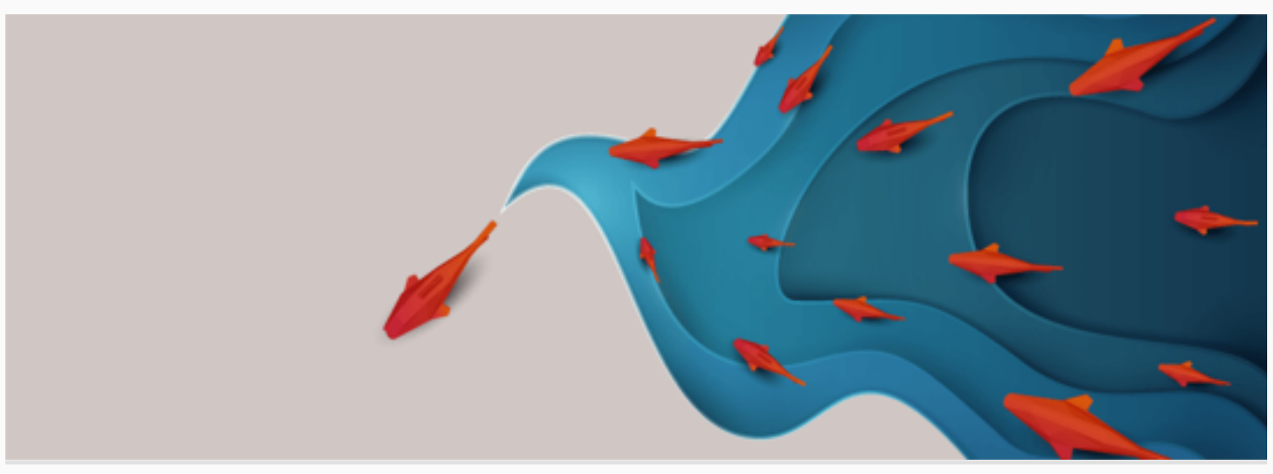
The book is fundamentally optimistic and focuses on how change might happen, not only what changes should happen. Kuper demonstrates how we have already broken the dependencies that make fundamental change so daunting.

"Consider the mid-2000s, when, against all predictions, the United States rapidly switched from a reliance on coal to natural gas," he says. "The change required targeted regulations, a few lone investors, independent researchers and generous technology subsidies. But in a stunningly short period of time, shale oil nudged out coal, and carbon dioxide emissions dropped by 10%."

Kupers shows how to replicate such patterns such as the one above in order to improve transit, reduce plastics consumption, and temper the environmental impact of middle-class diets.

For more resources on climate change, please see ICAEW's sustainability hub page

ICAEW Climate Hub



Climate change poses serious risks to businesses and investors. Find resources, information and inspiration on the ICAEW Climate Hub.

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