Ceres
Ceres Accelerator
for Sustainable Capital Markets

October 28, 2022

Dear Mr./Madam Secretary:

We are writing in response to the PCAOB Staff's Request for Information and Comment on the Application and Use of the PCAOB's Interim Attestation Standards.

We have the same concern about this document as we did about the PCAOB's Draft Strategic Plan, and we are attaching a copy of our comment letter submitted in connection with that draft. In both instances the PCAOB has omitted any reference or discussion of the need for action by the PCAOB on standard-setting relating to third-party assurance of climate change matters. As we stated previous letter, we believe it is important that the PCAOB address this matter as soon as possible.

Respectfully submitted,

Steven M. Rothstein

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Managing Director
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Office of the Secretary September 15, 2022
Public Company Accounting Oversight Board
1666 K Street, N.W.
Washington, DC. 20006-2803

Re: PCAOB Strategic Plan, 2022-2026 Draft for Comment

Dear Sir/Madam Secretary:

The Ceres Accelerator for Sustainable Capital Markets appreciates this opportunity to comment on the PCAOB's Draft Strategic Plan ("the Plan"). This is a welcome and much-valued occasion for Ceres and other interested stakeholders to comment on the vitally important work being performed, and planned to be performed, by the PCAOB.

Ceres is a nonprofit organization working with the most influential capital market leaders to solve the world's greatest sustainability challenges. Through our networks and global collaborations of investors, companies and nonprofits, we seek equitable market-based and policy solutions throughout the economy to build a just and sustainable future. The Ceres Investor Network is composed of more than 220 members collectively managing over $60 trillion in assets, and the Ceres company network. The Ceres Company Network includes more than 55 corporations, 70% of which are among the Fortune 500.

The Ceres Accelerator for Sustainable Capital Markets is a center within Ceres that aims to transform the practices and policies that govern capital markets to reduce the worst financial impacts of the climate crisis. It spurs action on climate change as a systemic financial risk—driving the large-scale behavior and systems change needed to achieve a net zero emissions economy through key financial actors including investors, banks, and insurers. The Ceres Accelerator also works with corporate boards of directors on improving governance of climate change and other sustainability issues.

We are submitting this comment letter because of our significant interest in the role of auditors in connection with climate change disclosures. Ceres has long been outspoken on the need for SEC-mandated climate disclosures, first raising the issue with the SEC 20 years ago. Further, because of our view of the important investor-protection role of auditors, we have urged that climate disclosures be subject to independent third-party assurance. Thus, in 2021, in response to the SEC's Request for Information relating to climate change, Ceres stated: "The SEC should require that GHG emissions disclosure be in a supplemental schedule to the financial statements and be audited according to rigorous standards established by the Public Company Accounting Oversight Board at the reasonable assurance level."[1] More recently, in our comment letter on the SEC's landmark climate disclosure proposal that is now pending, we reiterated our support for

[1] Mindy Lubber, Ceres response *Re: Public Input on Climate Change Disclosures* at 10 (June 10, 2021).

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the SEC's proposal that issuers obtain limited assurance of certain GHG emissions, known as Scopes 1 and 2, with a phase-in to reasonable assurance.[2]

Given the SEC's proposal and the widespread attention being given to ESG information more generally, we had hoped to see mention of the PCAOB's plans with respect to climate change in the Plan, but there is none. We describe below why the PCAOB should reconsider its approach to this issue.

1. *Longstanding Climate Disclosure Issues:* We believe that even without the SEC's pending proposal there should be better disclosure of climate impacts in audited financial statements and, hence, greater scrutiny of this matter in PCAOB inspections. We also recommend that the PCAOB issue guidance relating to how climate change should be addressed in financial statement audits.

a. *Financial Statements:* The potential impact of climate change on financial reporting has been widely researched and discussed. For example, the FASB Staff's March 2021 Educational Paper, *Intersection of ESG Matters with Financial Accounting Standards,* described the many accounting standards that are relevant to ESG or climate change: going concern; risks and uncertainties; inventory, goodwill and other intangibles; property, plant, and equipment; asset retirement and environment obligations; loss and gain contingencies; income taxes; fair value measurement; and various industry guidance.[3] The International Accounting Standards Board issued its own guidance in November 2020, making many of the same points.[4.] Risks related to climate change and the energy transition can affect current financial statements in many ways, including through the numerous estimates and assumptions about future prices, future use of long-lived assets, future cash flows, and so on.

Notwithstanding these accounting and disclosure standards, research by Ceres and others has found that the audited financial statements rarely include any reference to climate change concerns. Last year Ceres issued a report, *Lifting the Veil: Investor Expectations for Paris-aligned Financial Reporting at Oil and Gas Companies*.[5] The report discussed the lack of financial statement information relating to climate change, particularly among oil and gas companies, stating: "The extreme uncertainty and disruption of climate change, and global efforts to arrest it, call historic estimates and estimation processes into question in a way that

[2] Mindy Lubber, Ceres response *Re: The Enhancement and Standardization of Climate-Related Disclosures for Investors* *[File Number. S7-10-22]* (June 17, 2022).
[3] *FASB Staff Educational Paper: Intersection of Environmental, Social, and Governance Matters with Financial Accounting Standards*, Financial Accounting Standards Board (March 19, 2021).
[4] International Accounting Standards Board, *Effects of climate related matters on financial statements* at 1 (November 2020).
[5] *Lifting the Veil: Investor Expectations for Paris-aligned Financial Reporting at Oil and Gas Companies*, Ceres (June 17, 2021). Also see March 2021 webinar *Lifting the Veil: Transparency in Accounting*.

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demands transparency about the assumptions and estimates that underlie accounts." The report cited various items in the financial statements as to which disclosure might be expected.[6]

Likewise, a report issued last year by CarbonTracker, *Flying blind: The glaring absence of climate risks in financial reporting*, found that over 70% of the reviewed 107 public companies failed to disclose climate-related risks in their audited financial statements.[7] (Carbon Tracker will be releasing its updated report shortly. We would be happy to forward this under separate cover.)

Given the impact of climate change, disclosures on this topic should be increasingly common. There is evidence that climate risk is growing in significance. For example, the National Oceanic and Atmospheric Administration (NOAA) has reported an increasing frequency and severity of extreme weather events. Since 1980, the agency has tracked 232 such events with damage amounting to $1 billion or more.[8] 2020 marked a historic record of billion-dollar weather climate disasters with a total count of 22, followed closely by 2021 with 20 such events and a $145 billion price tag.[9]

One area that Ceres has examined closely is the risks to financial institutions. We have published two reports analyzing the exposure that the 28 largest U.S. banks faced from a slice of bank lending, that is, syndicated loan portfolios. Our 2020 report found that more than 50% of U.S. syndicated bank lending, or around $500 billion, is exposed to climate-related transition risk, that is the economic and financial risks arising from the policy, regulatory, consumer preference, and reputational impacts of a transition to a net zero economy.[10] Our 2021 report found that value-at-risk from physical risk factors for the same asset class to be an additional $250 billion in exposure by 2080 (or 10% of portfolio value).[11] We are currently drafting another report, focusing on climate-related financial risks stemming from derivative transactions.

Hence, our view is quite straightforward and is widely accepted by experts and regulators: climate change can significantly impact financial reporting, the impact is increasing, and financial statement disclosures need to better reflect this impact. This should be a matter of concern to the PCAOB.

b. *Auditor's Reports on Financial Statements:* The CarbonTracker report "Flying blind" also found that auditors have not generally examined the impact of climate change on financial reports. The report stated: "There was little evidence that auditors considered the effects of

[6] Ceres hosted a webinar on this topic with CarbonTracker in April 2022 and another with PRI, IIGCC, and Carbon Tracker in November 2021. *See Webinar: Accounting for Climate (US/UK)*, Ceres (April 12, 2022), and *Dialogue Meeting: Accounting for Climate*, Ceres (November 2021).
[7] *Flying blind: The glaring absence of climate risks in financial reporting*, Carbon Tracker Initiative (September 16, 2021).
[8] *U.S. Billion-Dollar Weather and Climate Disasters*, NOAA National Centers for Environmental Information (NCEI) (2022).
[9] Adam Smith, *2021 U.S. billion-dollar weather and climate disasters in historical context*, NOAA (January 14, 2022).
[10] *Financing a Net Zero Economy: Measuring and Addressing Climate Risk for Banks*, Ceres (October 2020).
[11] *Financing a Net Zero Economy: The Consequences of Physical Climate Risk for Banks*, (September 2021).

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material climate-related financial risks or companies' announced climate strategies. 80% of the audit reports provided no indication of consideration of material climate-related matters, such as the impact of emissions reduction targets, changes to regulations, or declining demand for company products."[12]

One might expect to see disclosure about climate risks in the auditor's report of Critical Audit Matters, or CAMs, but this rarely exists. The absence of climate-related disclosures in this regard has long been known to the PCAOB. For example, in a speech given in 2020, then Board Member J. Robert Brown stated: "After one year of experience with this disclosure requirement, however, CAMs that address ESG matters, or ESG CAMs, remain uncommon, particularly those addressing the effects of climate change. Only three of the approximately 2,400 or so audit reports with CAMs appear to have included a meaningful discussion of the impact of climate change on the financial statements."[13]

By contrast, reports prepared pursuant to International Standards on Auditing frequently include considerable information about climate in the Key Audit Matters (KAMs) portion of the report. While the PCAOB's definition of CAM is different from the IAASB's definition of KAM, the difference in reporting that we have observed cannot be attributed to definitional differences. Moreover, CarbonTracker has researched reports filed by companies located in Europe that are dual-listed in the US and Europe. It has found that the auditors of such companies' annual reports, prepared pursuant to IAASB standards, will sometimes include KAMs that describe climate change in the company's annual report but the auditors will remove references to climate change in the CAMs contained in the Form 20-F filed with the SEC. These differences are confusing to investors and should concern the PCAOB. Investors in U.S. securities deserve gold standard reporting.

c. *PCAOB Inspections and Guidance:* Climate risk has for some time been a matter that should be significant to auditors and to the PCAOB, and its significance is growing. There have been experiences in decades past where public company financial statements are retrospectively found to have been based on overly rosy, undisclosed assumptions, and we fear that may be happening again with respect to the financial impacts of climate change. Accordingly, we urge the PCAOB to ensure that its inspections include procedures with respect to climate risk.[14]

We also believe that the PCAOB should issue guidance on this topic. As noted above, FASB and the IASB – the accounting standard-setters – have issued guidance. On the audit side, the International Auditing and Assurance Standards Board issued guidance in October 2020, stating:

[12] *Flying blind: The glaring absence of climate risks in financial reporting*, Carbon Tracker Initiative at 1 (September 16, 2021).

[13] J. Robert Brown Jr., *It's Not What You Look at that Matters: It's What You See, Revealing ESG in Critical Audit Matters*, ICGN Global Virtual Summit (November 4, 2020).

[14] This may be happening now, but the inspection process is largely opaque and we have no way of knowing. The PCAOB did state in its *Spotlight: Staff Overview of Planned 2022 Inspections* at 6 (June 2022), that its inspection target team in 2022 would focus on, among other things, "audits of public companies that include risks related to climate change that would affect a company's financial statements." We do not mean to diminish the significance of this statement, which is right on point, but for the reasons discussed in this letter we believe that climate risk deserves far more attention and should be viewed as a strategic long-term issue.

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"If climate change impacts the entity, the auditor needs to consider whether the financial statements appropriately reflect this in accordance with the applicable financial reporting framework . . .".[15] Separately, regulators and standard-setters throughout the world -- the SEC, the EU, the UK Financial Conduct Authority, the newly-created International Sustainability Standards Board, and dozens more -- are issuing guidance and proposing or adopting rules and standards relating to the financial impact of climate change.

Missing from this roster of climate-minded regulatory and standard-setting bodies is the PCAOB. That should be remedied. We believe there is a need for the PCAOB to issue guidance on climate-related matters before the next calendar year-end audit season. The Plan mentions the goal of publishing staff "Spotlight" reports to describe observations from the inspections. A Spotlight report could also be issued with respect to climate developments, much like the audit guidance issued by the Board in connection with the war in the Ukraine.[16]

2. *The SEC's Proposed Climate Disclosure Rule:* The need for the PCAOB to put climate change on its agenda became even more apparent when the SEC issued its rule proposal, with its proposed attestation requirement of GHG emissions and its proposed footnote relating to the financial impact of climate change. The SEC's rulemaking release makes numerous references to the PCAOB's in this area, including the PCAOB registration process and PCAOB auditing standards. For example, the rulemaking release includes the following set of questions:

> Under the proposed rules, PCAOB auditing standards would be applicable to the financial statement metrics that are included in the audited financial statements, consistent with the rest of the audited financial statements. What, if any, additional guidance or revisions to such standards would be needed in order to apply PCAOB auditing standards to the proposed financial statement metrics? For example, would guidance on how to apply existing requirements, such as materiality, risk assessment, or reporting, be needed? Would revisions to the auditing standards be necessary? What additional guidance or revisions would be helpful to auditors, preparers, audit committee members, investors, and other relevant participants in the audit and financial reporting process?[17]

Numerous commenters on the rule also described the PCAOB's role. For example, the US Chamber of Commerce said that the proposed rule would have "meaningful implications for audit standard setters like the PCAOB." This is because, the Chamber said:

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[15] *IAASB* *Climate Audit Practice Alert* at 4 (October 2020).
[16] *PCAOB Highlights Key Considerations for Auditors Related to the Russian Invasion of Ukraine* (March 31, 2022).
[17] *Rule Proposal: The Enhancement and Standardization of Climate-Related Disclosures for Investors, Release Nos. 33-11042; 34-94478; File No. S7-10-22*, U.S. Securities and Exchange Commission at 146 (March 21, 2022).

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> the PCAOB may need to consider updating its standards, particularly the attestation standards that auditors use to provide limited or reasonable assurance on GHG emissions. Unlike the attestation standards of the AICPA Auditing Standards Board (ASB) and the International Auditing and Assurance Standards Board (IAASB), the PCAOB attestation standards have not been updated in more than two decades. Except for conforming amendments, the PCAOB's current attestation standards remain as the AICPA ASB attestation standards that the PCAOB adopted in 2003 as "interim" standards, although the PCAOB subsequently dropped the term "interim." The Proposing Release also has implications for the PCAOB's other regulatory activities including inspections and enforcement. While the Proposal is unclear as to whether any climate related assurance engagements would be subject to these activities for PCAOB registered and inspected CPA firms, investors generally may expect this to be the case.[18]

Individual corporate commenters also expressed their views on the necessary involvement of the PCAOB. For example, The Allstate Corporation stated:

> First, the PCAOB will need to review its current attestation standards to determine if the standards provide a sufficient framework for the attestation engagement covering climate disclosures. While the PCAOB can start with the attestation standard in AT Section 101 ("AT 101"), AT 101 has not been updated since its issuance in 2003. Second, the creation and publishing of interpretive guidance is necessary. From a registrant's point of view, we have found publicly issued interpretive guidance to be a good resource when considering the establishment of processes and related controls, along with understanding how third-party practitioners view our business. For example, for attestation engagements on GHG emissions under current AICPA attestation standards, AICPA leadership recognized the need for additional guidance beyond established standards. In July 2017, when the AICPA released its guide "Attestation Engagements on Sustainability Information (Including Greenhouse Gas Emissions Information)," Susan S. Coffey, CPA, CGMA, AICPA executive vice president, public practice noted the following (emphasis added by Allstate): "The guidance we have developed, which is applicable to all aspects of sustainability reporting, including environmental, social and governance, will serve as a critical mechanism **for enabling consistency across sustainability assurance engagements.** This will further distinguish CPA assurance services and increase stakeholders' confidence in the credibility and reliability of organizations' reported sustainability information."[19]

Other comment letters further described the need for PCAOB involvement. For example, PwC said in its comment letter that the Commission should consider asking the PCAOB to examine its possible role in connection with PCAOB registration and inspection of entities that provide attest

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[18] *U.S. Chamber of Commerce response Re: The Enhancement and Standardization of Climate-Related Disclosures for Investors [File Number S7-10-22)*, U.S. Chamber of Commerce at 64 (June 16, 2022).
[19] *Allstate response Re: The Enhancement and Standardization of Climate-Related Disclosures for Investors [File Number S7-10-22]*, Allstate Corporation at 4 (June 17, 2022).

reports on GHG emissions.[20] Thus, given the attention given to the PCAOB's role by the SEC and by well-informed commenters, PCAOB standard-setting in this area should be a strategic priority.

3. *Experts and Training:* The Board should consider two additional points. First, the Plan states the Board "will look for opportunities to leverage our internal teams and external experts when developing thought leadership on the impact of emerging technologies on audit quality."[21] Might the external experts include experts on climate risk? We believe the answer should be yes. Second, the Plan refers to the need for "investing in professional development."[22] There have been news reports that the largest accounting firms are spending hundreds of millions or billions of dollars on recruitment and training with respect to climate and other ESG issues. We believe it important that the PCAOB keep pace with the profession in this area so that investors can continue to be confident in the Board's oversight role – a role that we value greatly.

* * * *

Accordingly, we recommend that the PCAOB amend its Plan to include a description of work that needs to be done on climate change. This includes several elements: an assessment of the PCAOB's role with respect to registration and oversight of firms issuing attestation reports on climate disclosures, such as GHG emissions; an examination of changes that might need to be made to attestation standards; issuance of guidance on application of the existing auditing standards, including CAMs; and further emphasis on climate risk as an element of the inspection process. We also urge references to climate in the Plan's discussion of use of experts and staff training.

We appreciate your consideration of our comments. Please feel free to contact me or Tom Riesenberg, Ceres Accelerator for Sustainable Capital Market's Senior Regulatory Advisor.

Respectfully submitted,

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Managing Director
Ceres Accelerator for Sustainable Capital Markets

Cc: Erica Y. Williams, Chair
Duane M. DesParte
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[20] *PwC response Re: The Enhancement and Standardization of Climate-Related Disclosures for Investors [File Number S7-10-22]*, PricewaterhouseCoopers LLP (June 17, 2022).
[21] *Strategic Plan 2022-2026 Draft for Comment*, PCAOB at 7 (August 2022).
[22] Id. 11 (August 2022).

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