Financial Reporting Council

Financial Reporting LAB

# FRC Climate Thematic

## Professional Oversight – How are professional bodies and audit regulators taking account of climate change in their regulatory responsibilities?

November 2020

# Introduction

Throughout 2020, the FRC has undertaken a thematic review of climate-related considerations by boards, companies, auditors, investors and professional associations. This report forms part of that review and addresses the question 'How are professional bodies and audit regulators taking account of climate change in their regulatory responsibilities?'.

Other aspects of the FRC's findings can be found at the following links:

- The consolidated findings across corporate reporting and audit can be found here.
- The detailed findings on governance can be found here.
- The detailed findings on corporate reporting can be found here.
- The detailed findings on audit can be found here.
- The detailed findings on investor reporting and better practice reporting under the Task Force on Climate-related Financial Disclosures can be found here.

# Contents


## We asked:

How are professional bodies and audit regulators taking account of climate change in their regulatory responsibilities?

## Why is this important?

The FRC oversees the supervisory and qualification activities of a range of professional associations in the United Kingdom. In 2019, the bodies we oversee had over 370,000 members in the UK and Republic of Ireland and almost 560,000 members worldwide. In addition, over 164,000 students in the UK and Republic of Ireland, and nearly 600,000 worldwide, are studying with these organisations. As climate change is a crisis that affects everyone globally, accountants, auditors and actuaries need not only to be taking climate-related considerations into account in their work now, but the next generation of students also needs to be equipped as effectively as possible to help the societies and companies in which they work to respond.

## What did we do?

We sent questionnaires to six professional accountancy bodies: the Association of Chartered Certified Accountants (ACCA), the Institute of Chartered Accountants of England and Wales (ICAEW), the Institute of Chartered Accountants in Ireland (ICAI), the Institute of Chartered Accountants of Scotland (ICAS), the Chartered Institute of Public Finance and Accountancy (CIPFA), and the Association of International Accountants (AIA); the Institute and Faculty of Actuaries (IFoA); and the audit regulators in the Crown Dependencies (Jersey, Guernsey and Isle of Man) to enquire how they were considering climate-related issues within their remits. Questions covered: strategy; risk; governance; education; enforcement and discipline; and members' insights on climate change.

## What did we find?

UK professional bodies, and audit regulators in the Crown Dependencies, are responding to climate change, but approaches differ in terms of substance and granularity regarding references to climate-related reporting and the impacts of climate change.

# Background

## The challenges of climate change

The Paris Agreement aims to strengthen the response to climate change by: "Holding the increase in the global average temperature to well below 2°C above pre-industrial levels and pursuing efforts to limit the temperature increase to 1.5°C above pre-industrial levels, recognising that this would significantly reduce the risks and impacts of climate change", amongst other aims.

A serious reallocation of resources would be required to meet these goals and therefore companies can be exposed to a wide range of risks and opportunities. Below is a high-level overview of some of the physical and transitional risks and opportunities companies will face. Climate change considerations are obviously relevant for entities across many industries and will therefore be relevant for their reporting and the audit of their financial statements.

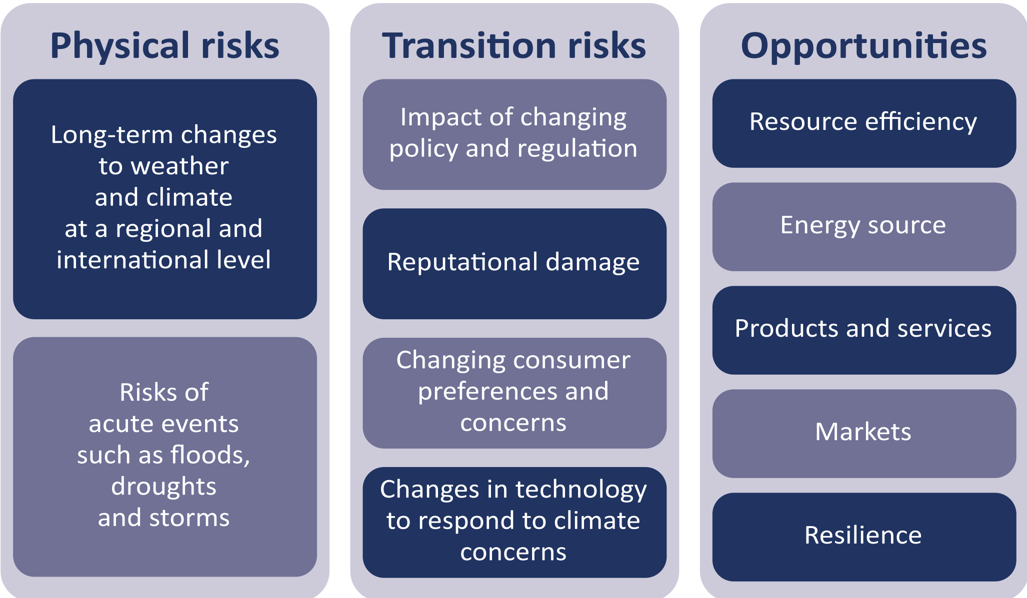


*Figure 1: Possible physical risks, transitional risks and opportunities companies may face, as identified by the Task Force on Climate-related Financial Disclosures (TFCD).*

## How might disclosure respond?

When deciding what they need to disclose in relation to climate change, companies need to consider whether the issue is a 'relevant environmental factor' and whether it is material to the company.

There is no standalone International Financial Reporting Standard (IFRS) which addresses climate change specifically. However, the requirements of IFRS provide a clear framework for incorporating the risks of climate change into companies' financial reporting. These apply, for example, to measurement uncertainty associated with forward-looking assumptions and estimates, and the related disclosures.

In November 2019, a member of the International Accounting Standards Board (IASB) provided an overview of existing IFRS requirements and guidance on the application of materiality in the article 'IFRS Standards and climate-related disclosures' (IASB Article). The article does not have the status of a standard and does not provide a complete 'checklist' of relevant requirements but does provide helpful insight into how climate change should be considered when addressing certain requirements. The article also emphasises the existing materiality requirements and guidance.

In addition, the regulatory landscape for UK companies is developing, with the Government's 2019 Green Finance Strategy stating that it expected all listed companies and large asset owners to be reporting in line with the recommendations of the Task Force on Climate-related Financial Disclosures' (TCFD) framework by 2022. The FRC's position on non-financial reporting can be found here.

Climate change is relevant for many companies and will therefore be relevant for those developing, and those auditing, their financial statements.

# Professional oversight – headline finding:

UK professional bodies, and audit regulators in the Crown Dependencies, are responding to climate change, but approaches differ in terms of substance and granularity regarding references to climate-related reporting and the impacts of climate change.

## UK Professional Bodies review

All of the Bodies are aware of climate change and the importance of providing the right information and support to both staff undertaking duties fulfilling the Bodies' regulatory responsibilities, as well as to current members and future accountants, auditors and actuaries in training.

### Governance and Strategy

**KEY FINDING:** The Professional Bodies' approaches to governance and strategy are developing to include greater reference to climate-related issues.

The Bodies are at different stages of developing their response to climate change and have communicated different approaches as to how they will continue to develop their climate change agenda within their regulatory remit.

#### *Governance*

We asked the Bodies which board or committee holds overall or specific responsibility for their response to climate change and related matters. Six of the Bodies informed us of the board or committee that holds the overall or specific responsibility over climate change and related matters. Three Bodies informed us that the responsibility was explicitly contained within the terms of reference for the board or committee assigned with the duty.

*Better practice we were informed of at the professional bodies included:*

- Identifying and allocating climate change responsibility to an appropriate governance entity, detailed in the terms of reference and ensuring the appropriate expertise is represented on the governance entity, or that it has access to information or specialists in the field.
- Four Bodies have dedicated panels to consider and progress climate change as organisations and as developers of material for the profession. These panels act as subject matter experts and are accessible to the internal governance structure.

#### *Strategy and Risk*

Four of the Bodies have included climate change within their strategic plans, either explicitly or under the umbrella of sustainability. One Body was finalising a new strategy which will include a sustainability theme.

*Better practice we were informed of at the professional bodies included:*

- Two of the Bodies have specific strategies to embed sustainability across activities and business decisions, reduce critical impacts and celebrate success. To date, three of the Bodies have considered and incorporated climate change within their risk management processes. Although only one of these Bodies has explicitly included and categorised climate change, the other two Bodies consider climate change under umbrella terms.
- One Body informed us that climate change risks are explicitly contained and centrally mapped within organisation and regulation risks.
- Two of the Bodies map risks associated with climate change from their corporate level registers through to operational risk registers.

### Educational process

**KEY FINDING:** Some Professional Bodies incorporate climate change considerations into their educational process, and are looking to develop this area further.

#### *Education*

Climate change is not a separate subject in the Statutory Auditors (Examinations) Instrument 2008 for which theoretical knowledge is required. However, five of the Bodies reported that climate change is contained in their syllabus either explicitly or within associated sustainability subjects.

Five Bodies have noted future syllabus developments which will further incorporate and embed climate change into appropriate subject areas.

*Better practice we were informed of at the professional bodies included:*

- One of the Bodies recognised that more bespoke content is required for inclusion in the syllabus and set out an immediate plan of action. It anticipated that new learning materials and relevant recommended reading about climate change would be added.
- Six of the Bodies informed us of climate change information available to members and students, which included: webinars, podcasts, insight reports and articles, consultations, technical fact sheets, continuous professional development (CPD) material and magazines. Three of the Bodies have dedicated climate change hubs on their websites. Two of the Bodies informed us they had held events on climate change.
- One of the Bodies has challenged its membership by asking: 'Are you professionally ready for climate change?' as a professional issue.

### *Practical Experience*

Practical experience is part of the requirement to achieve a Body's qualification. One Body noted that submissions of climate change experience are required in line with their syllabus. Two Bodies consider experience in climate change as a specialist field or competency.

### *Approved/Authorised Training Offices – Student Training*

Approved training offices (ATOs) are employers that have been approved by the Bodies to train and provide practical experience to students as set out by the practical experience requirements of the Body's qualification.

Six of the Bodies do not specifically require the ATOs to provide training or practical experience in this area.

*Better practice we were informed of at the professional bodies included:*

- One Body will be identifying climate change as one of the employers' key business issues and therefore training would be provided.

We asked the Bodies for their suggestions on what more could be done to educate future auditors, accountants and actuaries competently to consider climate change. We received the following suggestions:

- annual syllabus reviews and syllabus enhancements;
- specific CPD modules;
- encouragement to report against the United Nations Sustainable Development Goals (UNSDGs);
- a topic proposal to the International Federation of Accountants, to consider climate-related issues, with the purpose of heightened global perspective and reach;
- consideration by the Consultative Committee of Accountancy Bodies of ethical matters relating to climate change, sustainability and the environment;
- specific sustainability and environmental training in areas of risk such as: flood; energy; waste management; finance; and supply chain; and
- a range of learning opportunities for differing levels of experience, and continued thought leadership.

## Audit monitoring, Registration, Complaints and CPD

**KEY FINDING:** Some Professional Bodies informed us they intend to review their audit monitoring, registration and renewals and complaints approaches.

### *Audit monitoring*

As part of the Recognised Supervisory Bodies' (RSBs see Appendix – Scope) delegated duties under the delegation agreement, they conduct inspections on the quality of audits. We asked the Bodies what guidance and training are provided to audit inspectors. Currently, none of the Bodies provide their inspectors with guidance or training on climate change. One Body noted an imminent change to provide insights and guidance on climate change and its impact on financial statement audits.

We also asked the Bodies if processes, procedures or tools are provided to the audit quality monitoring team. We found that one Body provides its audit quality monitoring team with information packs on the Companies Act 2006, Section 172 reporting requirements (the statement on how the section 172 duty has been performed). This Body also informed us of further updates to these packs to include carbon and energy reporting requirements and TCFD disclosures.

Lastly, we asked the Bodies how auditors' competence in climate change is assessed. One Body noted that auditor competence is assessed through evidence obtained from the audit file reviews. Another Body informed us that inspectors review the audit approach and the evidence obtained and held on file, to assess if the audit work recorded supports the audit opinion.

*Better practice we were informed of at the professional bodies included:*

- Providing information and guidance to the audit quality review team to equip staff conducting the reviews with sufficient knowledge to be able to challenge the quality of audit work where climate change may impact on the financial reporting.

### *Registration and renewals of registered Auditors*

The RSB(s) must have rules requiring persons eligible under its rules for appointment as a statutory auditor, and maintain a register of all statutory auditors. The eligibility criteria are set by the FRC. Applications from individuals and firms must be assessed by the RSB to ensure the applicant demonstrates sufficient and appropriate experience and competence to fulfil the role. The Bodies informed us they do not currently conduct checks on whether registered auditors have experience of considering climate change at the initial application or on renewal of auditor registrations.

### *Climate-related complaints*

We asked the Bodies how climate-related complaints are categorised and monitored. The Bodies are yet to receive complaints in this area. They informed us that climate change has not been formally categorised within their complaints system and is therefore not monitored.

All the Bodies confirmed that climate-related complaints, once received, will be considered in line with current procedures and processes.

### *CPD monitoring process*

The Bodies informed us that currently there are no specific checks made in relation to members completing climate change CPD activities during the monitoring process. Five of the Bodies noted that CPD is assessed by its relevance to the specific job held by the individual.

## Operational Impacts

**KEY FINDING:** The Professional Bodies are also considering their operational impacts.

Although we do not oversee or monitor the Bodies' operations, we were pleased that all of the Bodies shared organisational developments in climate change. Six of the Bodies have conducted assessments of their environmental factors to measure their climate change impact and risks.

Many have adopted the voluntary UNSDGs Goal 13, or have joined forces through networks such as A4S to discuss and respond to climate change. All of the Bodies have implemented changes to reduce their environmental impact.

## Climate-related initiatives

A number of the Bodies are involved in educational and/or networking initiatives that consider and shape climate-related deliberations. This upskills those taking part better to take account of related matters. Such activities the Bodies are involved with include A4S' networks, and the Green Finance Education Charter, as outlined in the Government's Green Finance Strategy.

The Bodies are also considering reporting frameworks, both in terms of the remit and responsibilities of their members, such as the UNSDGS, but also their own operations, for example, in relation to disclosures some bodies are providing in accordance with CDP (formerly the Carbon Disclosure Project).

*Better practice we were informed of at the professional bodies included:*

- Some of the Bodies participated in an open letter to the global accountancy profession calling on them to act upon climate change.
- One of the Bodies has used an external provider to compile and verify Greenhouse gas expenditure through energy consumption, waste, and travel. The company was able to provide its industry comparisons and suggestions on how the Body could set targets to reduce it's carbon footprint and make savings. This Body also submits reports to CDP and the Government's Energy Saving Opportunity Scheme.
- One Body has taken significant steps to minimise its impact on the environment by using renewable energy resources, using recycled paper, and shifting towards online digital ways of working.

## Next steps

As expectations for reliable and relevant financial information on climate change increase, there will be greater expectations on auditors and preparers of financial information, which we assume will be reflected in the regulation of professionals. We will follow up on regulatory alignment in our future professional oversight and monitoring activities.

We will continue to review the governance of the regulatory activities at the Professional Accountancy Bodies. We would expect the key governance entities at each of the accountancy Bodies to be considering climate change matters relevant to the Bodies' regulatory responsibilities and we will enquire how this is executed in practice:

- We will identify which governance entities at each of the accountancy Bodies have climate change responsibility in relation to the regulatory functions.
- We will seek evidence that the governance entities with the climate change responsibility have the appropriate climate change expertise and knowledge or have access to the required information.
- We will enquire how the accountancy Bodies consider climate change within their strategic plans and risk management processes.

We will also assess how the professional accountancy Bodies recognised as Qualifying Bodies (RQBs – the accountancy bodies we oversee with responsibility for offering the audit qualification in line with the Companies Act 2006 – see Appendix – Scope) are incorporating climate change in education, examinations, and practical experience requirements for the audit qualification.

- We will focus on future updates to syllabi, educational materials and examinations.
- We will also oversee how the RQBs regulate the training and practical experience of student members.

Through our continuous oversight of the RSBs we will seek evidence that the competence of auditors in the area of climate change is considered in each of the key pillars of auditor regulation as follows:

- registration;
- Continuous Professional Development;
- audit quality inspections; and
- enforcement and complaints handling.

# Appendix – Scope

## *Professional Oversight*

The Professional Oversight Team sent questionnaires to six professional accountancy bodies (ACCA, ICAEW, ICAI, ICAS, CIPFA & AIA), the Institute and Faculty of Actuaries (IFoA), and the audit regulators in the Crown Dependencies to understand how they were considering climate-related issues within their remits.

The questionnaires asked each respondent for their organisation's current and future processes and perspectives on climate change, as regulators of auditors, accountants, and actuaries, as applicable. The questions covered: strategy, risk, governance, education, enforcement, and discipline. We also asked the professional accountancy bodies for their insight about their members' responses to climate change. Although, the regulators asked do not have a formal regulatory obligations within the remit of our oversight relating to climate change we were pleased that all agreed to and provided responses.

We covered similar areas in the questionnaires sent to the IFoA and the audit regulators in the Crown Dependencies.

To allow for anonymous reporting: "Body" or "Bodies" refers to one or more of the respondents to our questionnaires.

**Recognised Qualifying Bodies (RQBs):** The FRC exercises delegated statutory functions under Part 42 of the Companies Act 2006 for the recognition, supervision and de-recognition of those accountancy bodies responsible for offering the audit qualification in line with the requirements of Schedule 11 of the Act and under Local Audit and Accountability Act 2014. There are six RQBs: ACCA, AIA, ICAI, CIPFA, ICAEW and ICAS overseen by FRC.

**Recognised Supervisory Bodies (RSBs):** The FRC also exercises delegated statutory functions under Part 42 of the Companies Act 2006 for the recognition, supervision and de-recognition of RSBs. Under the Statutory Audit and Third Country Auditor Regulations (SATCAR) 2016, the FRC is the designated Competent Authority for statutory audit in the UK. SATCAR 2016 sets out the responsibilities of the Competent Authority and permits the FRC to delegate some of the tasks required to fulfil its responsibilities. There are four bodies: ACCA, ICAI, ICAEW and ICAS.

**Regulators of Auditors in the Crown Dependencies:** The FRC has statutory powers and responsibilities delegated by each Crown Dependency (Jersey, Guernsey, and Isle of Man) for exercising oversight over the regulation of recognised auditors by the ICAEW, and notifying the Relevant Authority if it is not satisfied that the ICAEW is meeting its regulatory responsibilities effectively; and through its Audit Quality Review (AQR) team, for monitoring directly the performance of audits of major Market Traded Companies (MTCs) by recognised auditors.

An MTC is a company incorporated in one of the CDs with issued securities admitted to trading on a regulated market in the EU.

Two types of companies are excluded from the definition of MTCs. The first is a company whose transferable securities admitted to trading on an EEA regulated market are debt instruments which have a minimum denomination of €100,000 (or equivalent) per unit. The minimum denomination figure is reduced to €50,000 if the securities were admitted to trading prior to 31 December 2010. The second is certain open-ended investment companies.

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The FRC's purpose is to serve the public interest by setting high standards of corporate governance, reporting and audit, and by holding to account those responsible for delivering them.



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