

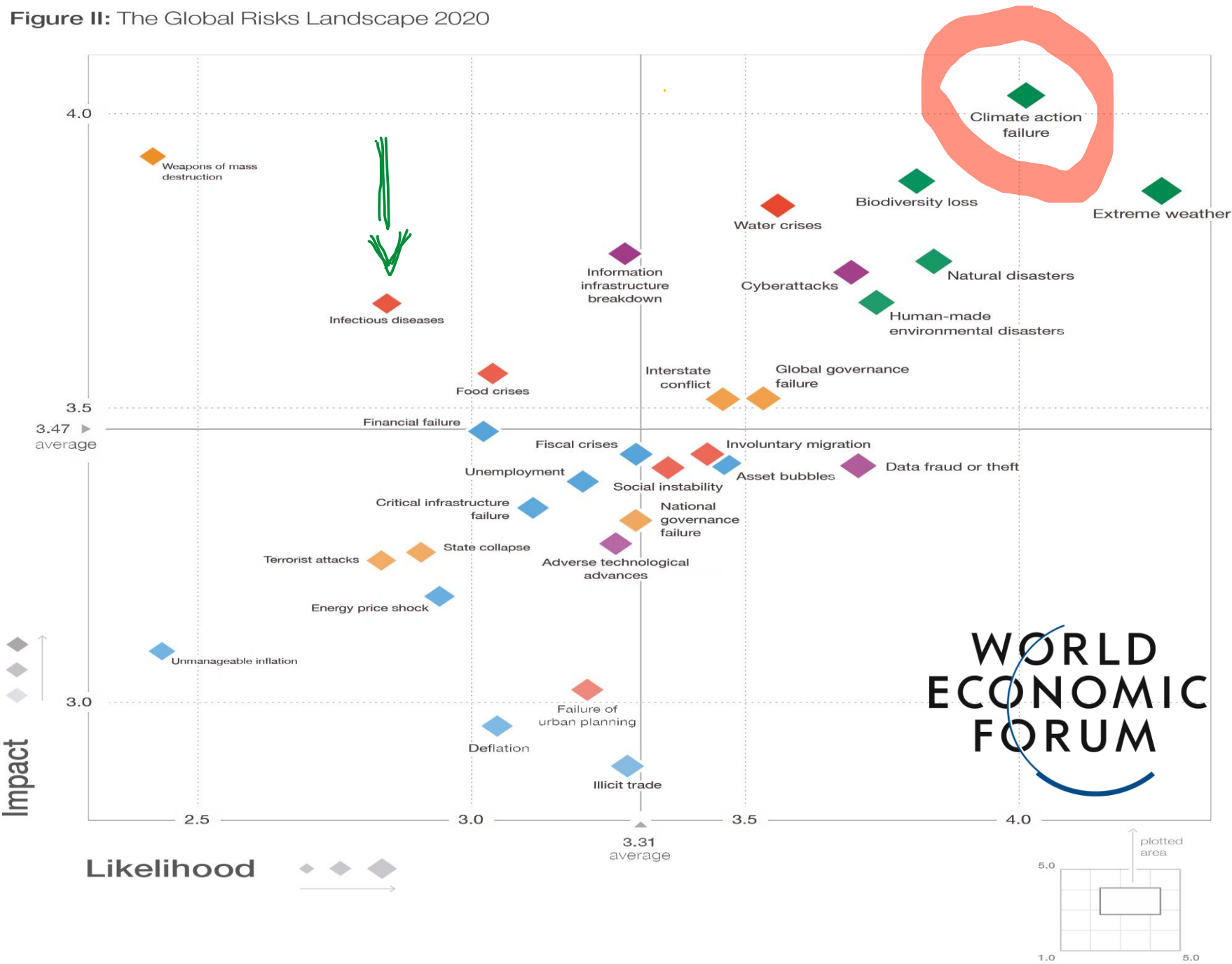


# ***Climate risk – Why it should be on the audit plan***

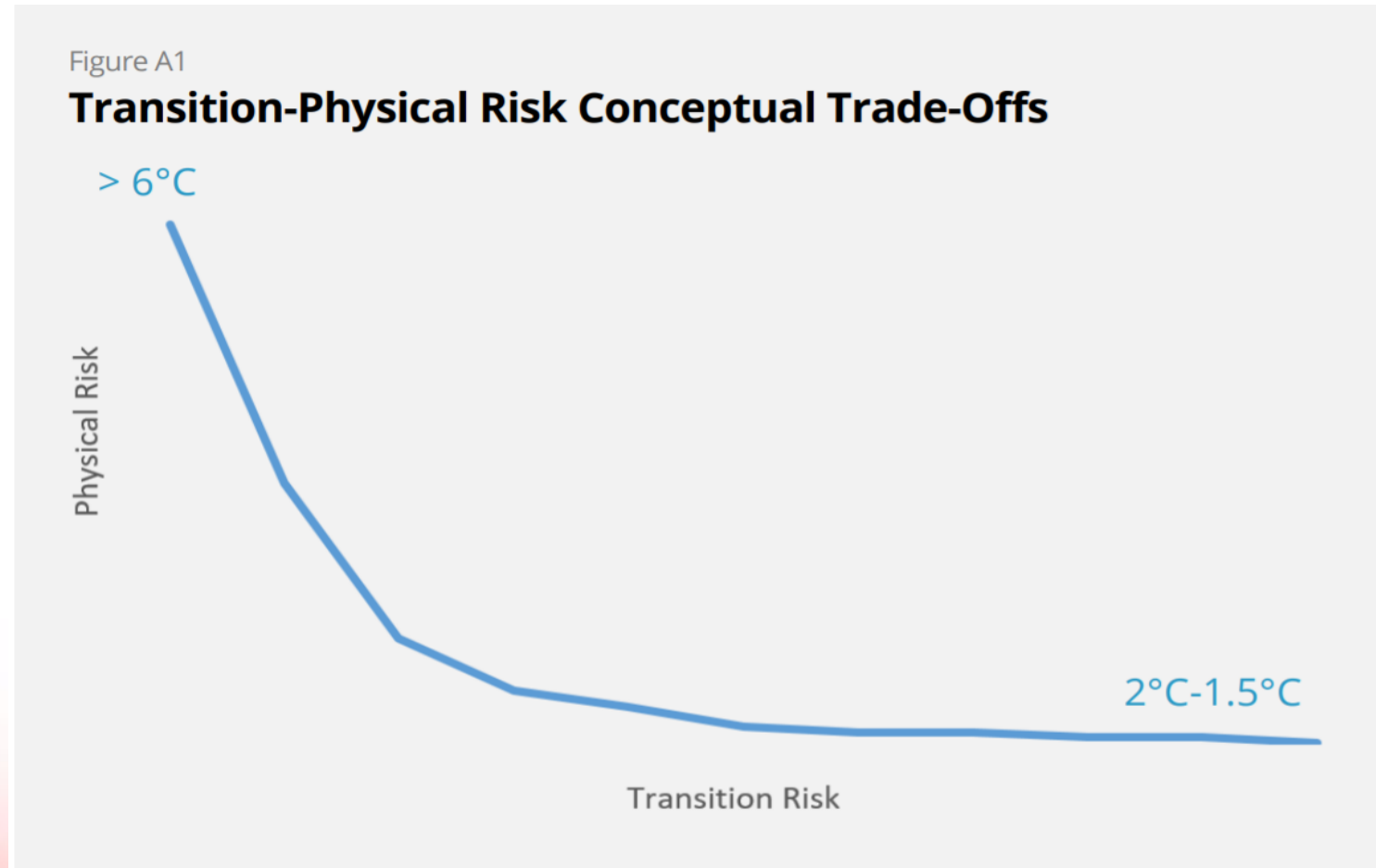
**Thursday 22 October 2020: Session 5.**

Evan Stamatiou  
Managing Director  
Carbon Risk Management

Figure II: The Global Risks Landscape 2020

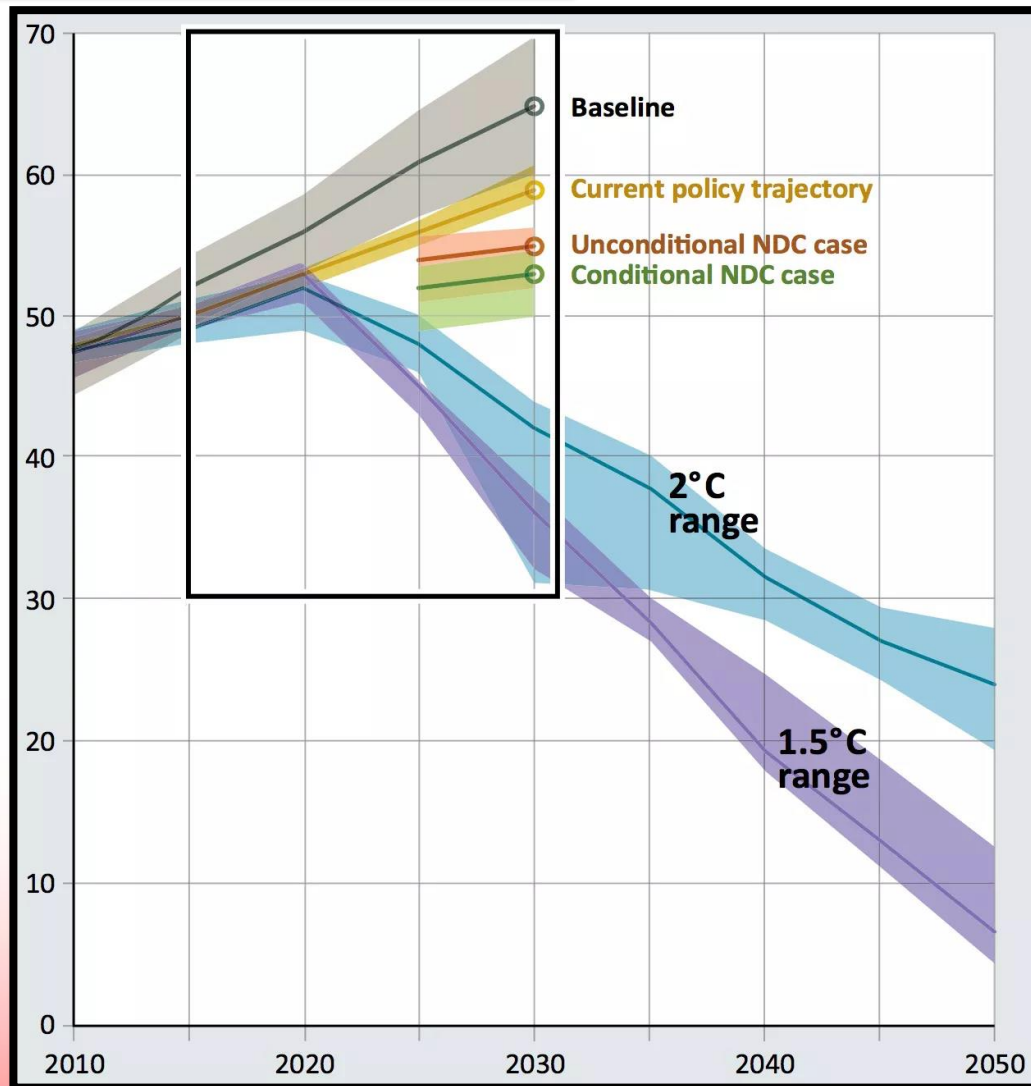


# Transition v Physical Risks



Source: TCFD Technical Supplement

# Don't Underestimate Transition Risks



Source: UNEP 'Emissions Gap' report 2019, Figure ES.4 (y axis: global GHG emissions- Gt CO<sub>2</sub>-e)

# Climate Disclosure Expectations Growing



**As risks from climate change grow exponentially** there is strong demand for decision-useful, climate-related information from a range of participants in financial markets.

Creditors and investors are increasingly demanding access to risk information that is **consistent, comparable, reliable, and clear.**

Growing demand for decision-useful, climate-related information has resulted in a process initiated by the G20 to develop the TCFD Disclosure Recommendations.

The **TCFD** creates a detailed reporting framework to guide climate risk disclosures.

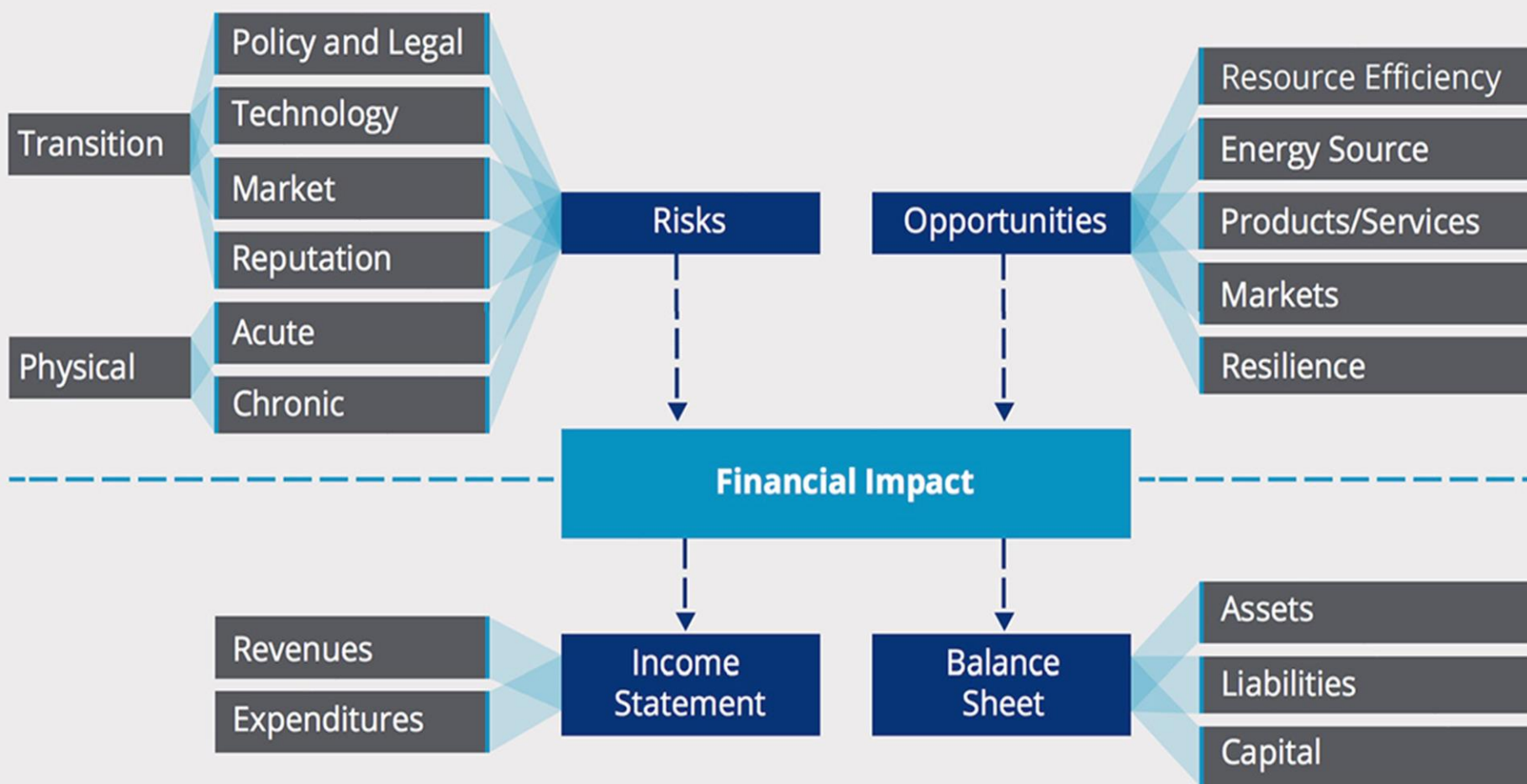


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# Climate Risk Categories: TCFD Language

Figure 1

## Climate-Related Risks, Opportunities, and Financial Impact





# Elevating Climate Risk

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## ASIC's updated regulatory guidance on climate-related disclosure:

- Climate change risks are *“foreseeable business risks”* .
- *“Conceivable that directors who fail to consider climate change risks now could be found liable for breaching their duty of care and diligence in the future”*.
- *“reinforces the need for directors to adopt a probative and proactive approach in assembling the information reasonably required to inform their decision making in this area”*.
- ASIC's Regulatory Guide 247: **climate change is a “systemic risk”** and that the *“Operating and Financial Review (OFR) ... should include a discussion of climate risks where those risks could affect the entity's achievement of its financial performance or outcomes disclosed”*.

# The Disclosure Gap

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Investor Group on  
Climate Change

Company disclosures are not meeting investor requirements.

## IGCC :

*“while the need for good disclosure on climate risks is now widely accepted, corporate reporting on climate change is not yet meeting investor needs”.*

*“while the TCFD has provided a framework for company reporting, there remains significant room for improvement on the quality, comparability and investability of corporate climate reporting”.*

**Under-disclosure is often a symptom of climate risk governance issues.**



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# What's Going Wrong?



**Governance over climate-related issues is inadequate**



**Climate-related risks not being assessed comprehensively, and without executive-level validation**



**Risk management actions ineffective, risk management responsibilities not assigned throughout organisation**



**Climate strategy unsophisticated; underdeveloped metrics and performance targets to support management objectives**



**Incoherent climate strategy resulting in under-disclosure, greenwashing, and misalignment with the TCFD**

# Unanticipated Complexity: A Headache for Management

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**The complexities of the 'carbon world' magnify problems for under-resourced organisations:**

- Carbon accounting and reporting frameworks are complicated;
- Carbon offset markets are complicated;
- Climate policy mechanisms and their global drivers are complicated and ever-evolving;
- Climate science and physical impact modelling is complicated and ever-evolving; &
- The world of low, zero, and negative emission technologies is its own nebula.



# Internal Audit

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## The role of internal audit, risk and compliance professionals

An organisation's internal audit function needs to adopt a **forensic and diagnostic mindset** when evaluating an organisation's climate strategy and its relationship with the enterprise-wide risk framework.

- Does your organisation have a problem with **climate-related risk awareness, risk management**, or both?
- If so, why?
- Does the organisation need to change: **governance structures, incentive structures, resourcing & expertise, internal processes**?

# Internal Audit

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## Risk Awareness – Internal Auditor Questions:

- Has the organisation ever conducted a stand-alone climate-related materiality assessment informed by the TCFD? If not, why not?
- Is the materiality assessment conducted periodically, with expert guidance, and board-level oversight? &
- How is the risk evaluation process integrated into the enterprise-wide risk framework?



# Internal Audit

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## Risk Management Process

Climate 'risk evaluation' often receives the greatest attention, and organisations often fall short in defining strategic responses to manage identified risks.

**Strategic risk management workshops are just as important as the materiality assessments that first define risks**, and need to be highly structured and properly resourced.

Failure to clearly define a clear climate risk management strategy often sets up a chaotic game of '**management ping-pong**' within organisations.





# Climate Strategy

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## Risk Management - Internal audit questions:

- Once climate risks are identified, is there adequate governance over strategic risk management?
- Is your organisation conducting stand-alone and structured climate risk management workshops with expert support? If not, why not?
- Have management accountabilities for each risk driver been clearly defined, and are incentive structures appropriate to encourage proactive management?
- Do internal structures need to change, i.e. do new sub-committees need to be formed?
- How are climate-related risks integrated into the enterprise risk management framework?

# Disclosure Risk

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TCFD



## Scrutinising Climate Disclosures

TCFD creates pressure on organisations to increase the detail of their disclosures. This includes:

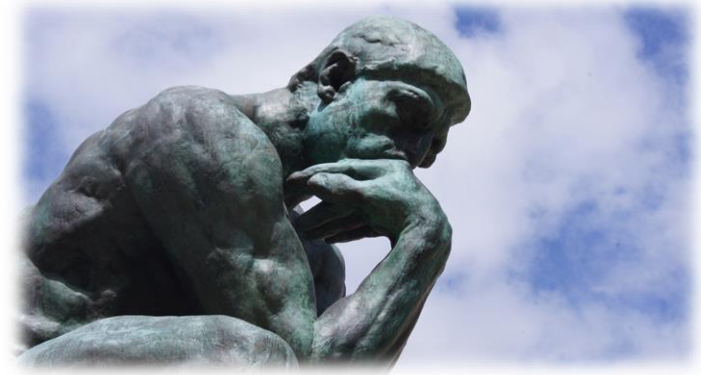
- Financial impacts of risks / opportunities
- Costs of managing risks / realising opportunities
- Results of climate-related scenario analysis, including financial impact estimates by scenario.

In addition, global climate disclosure questionnaires like **CDP award higher scores to responders that disclose financial impact estimates**, in alignment with the TCFD.

When risk evaluation and management is deficient, the estimates are often not well-informed. This creates disclosure risk.

# Managing Disclosure Risk

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## How can internal audit function help?

The internal audit function should scrutinise climate disclosure and ask:

- How were financial impact estimates developed, and were they part of a structured materiality assessment?
- Is there appropriate governance over climate-related financial impact disclosures including executive-level review?
- Are climate-related performance metrics and targets that are being disclosed informed by risk, and the risk management process?
- **Use your professional scepticism when reading your own organisation's disclosures.** Don't be carried away by the hype and 'climate glitter'.

# Supporting Strategic Management

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## Overview of what to look out for:

**Governance:** Committees reporting to the board may need updated charters, structures, principles, and processes to improve consideration of climate risk.

**Strategy:** Equipped with your knowledge of the TCFD recommendations and risk language, make sure you critically analyse internal risk processes to ensure that the climate strategy is risk-informed and sophisticated.

**Risk Management:** Are KPIs and accountabilities clearly defined and directly informed by risk management processes? If climate change responsibilities are overly concentrated in the sustainability/ environment/ CSR functions then there's a problem!

**Metrics and Targets:** As climate strategies mature, organisations will have more management actions, targets, and metrics to develop, review, and monitor. Metrics and targets need to be risk-informed.

# Conclusions

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- **Dynamic risks shouldn't translate to chaotic risk management.**
- **The foundation of effective climate-related risk management is structure, following TCFD guidance.**
- **Because **external resources are scarce**, internal auditors should keep an open mind on resourcing solutions including internal '*capacity incubators*'.**



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# Thank you !!

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