Ceres | Ceres Accelerator for Sustainable Capital Markets

August 4, 2023

Phoebe W. Brown, Secretary
Public Company Accounting Oversight Board
1666 K Street, N.W.
Washington, D.C. 20006-2803

Re: Amendments to PCAOB Auditing Standards related to a Company's Noncompliance with Laws and Regulations, Rulemaking Docket 051

Dear Madam Secretary,

We are writing to provide comments on the PCAOB's proposed amendments to the auditing standards relating to a company's noncompliance with laws or regulations ("NOCLAR Proposal").

Ceres is a nonprofit organization with over 30 years of experience working on climate change with the world's leading investors and companies to drive sustainability in the bottom line and through ambitious federal and state climate and clean energy policy. Ceres works with leading global investors and companies. Our Investor Network currently includes over 220 institutional investors that collectively manage over $50 trillion in assets. Our Company Network includes approximately 60 of the largest global companies and banks with whom we work on an in-depth basis on climate strategy and disclosure, among other issues.

Our comments on the NOCLAR Proposal address two specific issues – (1) the inclusion in the proposal of environmental laws and regulations as potential areas of the auditor's focus and, more specifically, the relevance of climate change; and (2) the obligation of auditors to identify inconsistencies between the information contained in financial reports and other documents such as sustainability reports.

We have been outspoken about the need for the PCAOB's standards and guidance to address the potential impact of climate change on companies' financial performance and operating conditions.[1] Our network members also demand and are willing to pay for more accurate climate-related disclosure. While the PCAOB has not taken the actions we have urged, we are pleased to see a mention of climate change in the proposal.

[1] September 15, 2022: Ceres submission re. PCAOB Strategic Plan, 2022-2026 Draft for Comment; February 1, 2023: Ceres submission re. PCAOB Rulemaking Docket Matter No. 46, Quality Control. In these comment letters, we urged the PCAOB to take appropriate action to address the impacts of climate change and the energy transition on audits and audit oversight.

I. Financial Impact of Climate Change

As to environmental issues generally, the NOCLAR Proposal emphasizes the "role of the auditor in detecting violations of consumer, environmental, or other laws and regulations relating to the company's operations." We agree with the Board that "the investor harm from such violations can be significant." This is because, as the Board correctly states, "[m]aterial misstatements of the financial statements can arise when violations of laws and regulations occur and are not properly presented in the financial statements in accordance with the applicable financial reporting framework." (NOCLAR Proposal at 9, 17, and 26.)

Laws relating to climate change are one important consideration in this regard, and the proposal makes that clear. The proposal gives, as an example, the potential financial impact where a company expands operations in a location with strict regulations on greenhouse gas emissions. NOCLAR Proposal at 38. Under the proposal, the auditor would be required to consider the business risks of the new operations, including "the potential for contingencies or reserves associated with the strict climate regulations." *Id*.

We agree that companies and their auditors need to consider potential liabilities relating to climate impacts. For example, fossil fuel companies have been sued for damages caused by deceptive marketing and disinformation related to climate change. *See, e.g., Rhode Island v. Chevron Corp. et al.*, Case No. PC-2018-4716, Bristol Cnty., Sup. Ct. (July 2, 2018). Also, states have banned coal-fired power, set phase-out timetables for fossil fuel-fired power plants, and proposed bans on natural gas use for heating in new buildings. *See, e.g.,* Virginia Clean Economy Act, 2020 Va. Acts H.B. 1526; Washington Healthy Homes and Clean Buildings Act, 2021 Wash. Law H.B. 1084. These are developments that could impose obligations on companies and, like laws and regulations more generally, could plausibly result in fines or other penalties – matters that warrant the attention of the independent auditor.

This sort of analysis should already be taking place as part of the required risk assessment. See AS 2110. As such, the requirement should not add significant cost to the audit.

Nonetheless, if additional audit work is required, we believe that investors are willing to pay for such work relating to climate and sustainability risks. This was clearly demonstrated by the overwhelmingly supportive comments from investors on the climate-related disclosure rule proposed by the Securities and Exchange Commission (SEC). During the SEC's public comment period for its proposed climate disclosure rule, 320 institutional investors, who collectively own or manage more than $50 trillion in assets, provided comments on the proposal or signed statements in support. Ceres analyzed key provisions and found support for an audit requirement. Fifty-seven investors specifically mentioned the proposed mandatory attestation of Scopes 1 and 2 greenhouse gas emissions in their comment letters, with 80% supporting that provision of the rule. Furthermore, in March 2023, Ceres and the Center for Audit Quality sponsored a roundtable discussion of the SEC's proposal to amend Regulation S-X to require footnote disclosure of the financial statement impact of climate-related risks. The discussion included representatives from major accounting firms, investors, and issuers. Participants were supportive of including climate disclosures in audited financial statements, arguing it would improve comparability, lower the cost of digesting information, and help investors understand how registrants' financials are sensitive to climate risks and opportunities.

II. Auditor Consideration of Sustainability Information

The proposal also makes clear that auditors must examine documents outside of filed reports and specifically mentions sustainability reports: "The auditor would also consider any contradictory audit evidence that the sustainability report and annual report might be presenting with respect to information supporting amounts in the financial statements." (NOCLAR Proposal at 38). Again, this is something that auditors should be doing today, but including an explicit requirement is advisable.

We believe that there is a real problem with the occurrence of contradictions between sustainability disclosures outside of the annual report and the financial disclosures. Issuers sometimes use assumptions or data in sustainability reports that is different from and even inconsistent or contradictory with those used in the financial reports. The release gives an example of a sustainability report stating that certain facilities will be closed to meet the planned reduction of greenhouse gas emissions while assuming in other places that the facilities will continue to operate.[2] Evidence is also found in the recently issued report, *Still Flying Blind.*[3] That report described how the assumptions used in the financial statements of three oil and gas companies were "not aligned" with statements the companies had made with respect to achieving net zero goals. Matters such as these should be reported to the audit committee. Also, where the auditor uncovers information indicating that the sustainability report could be materially incorrect, that likewise should be reported to the audit committee.

*   *   *

As noted, this rulemaking release would be [a step forward for the PCAOB](). We recently released [Ceres' 2023 Climate Risk Scorecard](), which assesses ten federal financial agencies on their

[2] See NOCLAR Proposal at 37-38: "[A] company's sustainability reporting may indicate that the company plans to reduce greenhouse gas emissions to a certain level within a defined period of time. The company may further note that such a reduction in emissions would require the company to close certain facilities. In addition, assume the company's prior year annual report indicates that the company is anticipating to grow its operations through opening new facilities while continuing to operate all existing facilities."

[3]. Carbon Tracker, B. Davidson, R. Schuwerk, *Still Flying Blind: The Absence of Climate Risk in Financial Reporting* (October 2022)

actions to protect our capital markets, financial institutions, and communities from climate-related financial risks.[4] These actions were urged by the Financial Stability Oversight Council (FSOC) in its [2021 Report on Climate-Related Financial Risk](). Our analysis shows that the PCAOB is the only regulator that has not publicly affirmed climate as a systemic financial risk since [the Scorecard]() was first published in 2021. This is a critical early step that federal regulators must take given the systemic nature of climate-related financial risks. We urge the PCAOB to take this step and thereby protect investors and further the public interest in the preparation of informative and accurate audit reports.

We note in this regard Chair Williams recent commentary, published in the *Wall Street Journal*, critical of audit deficiencies and emphasizing how "investors trust audits to verify the financial reporting that underlies our capital markets.*"* [5] While this commentary did not mention climate-related audit risk, it is important for the PCAOB to reiterate, in as many fora as possible, the vital investor protection role of the audit profession.

We would be pleased to provide any additional information on this topic. Please contact Steven Rothstein (srothstein@ceres.org), Managing Director of the Ceres Accelerator for Sustainable Capital Markets, or Tom Riesenberg (triesenberg@ceres.org), Senior Regulatory Advisor.

Respectfully submitted,

Steven M. Rothstein

Managing Director
Ceres Accelerator for Sustainable Capital Markets

CC: Erica Y. Williams, Chair, PCAOB
Duane M. DesParte, Board Member, PCAOB
Christina Ho, Board Member, PCAOB
Kara M. Stein, Board Member, PCAOB
Anthony C. Thompson, Board Member, PCAOB

[4] Although the PCAOB is technically not a federal financial agency, we included the PCAOB in our Scorecard because of its critical role in the US capital markets.
[5]^ *Wall St. J.,* "We Audit the Auditors, and We Found Trouble", July 24, 2023.