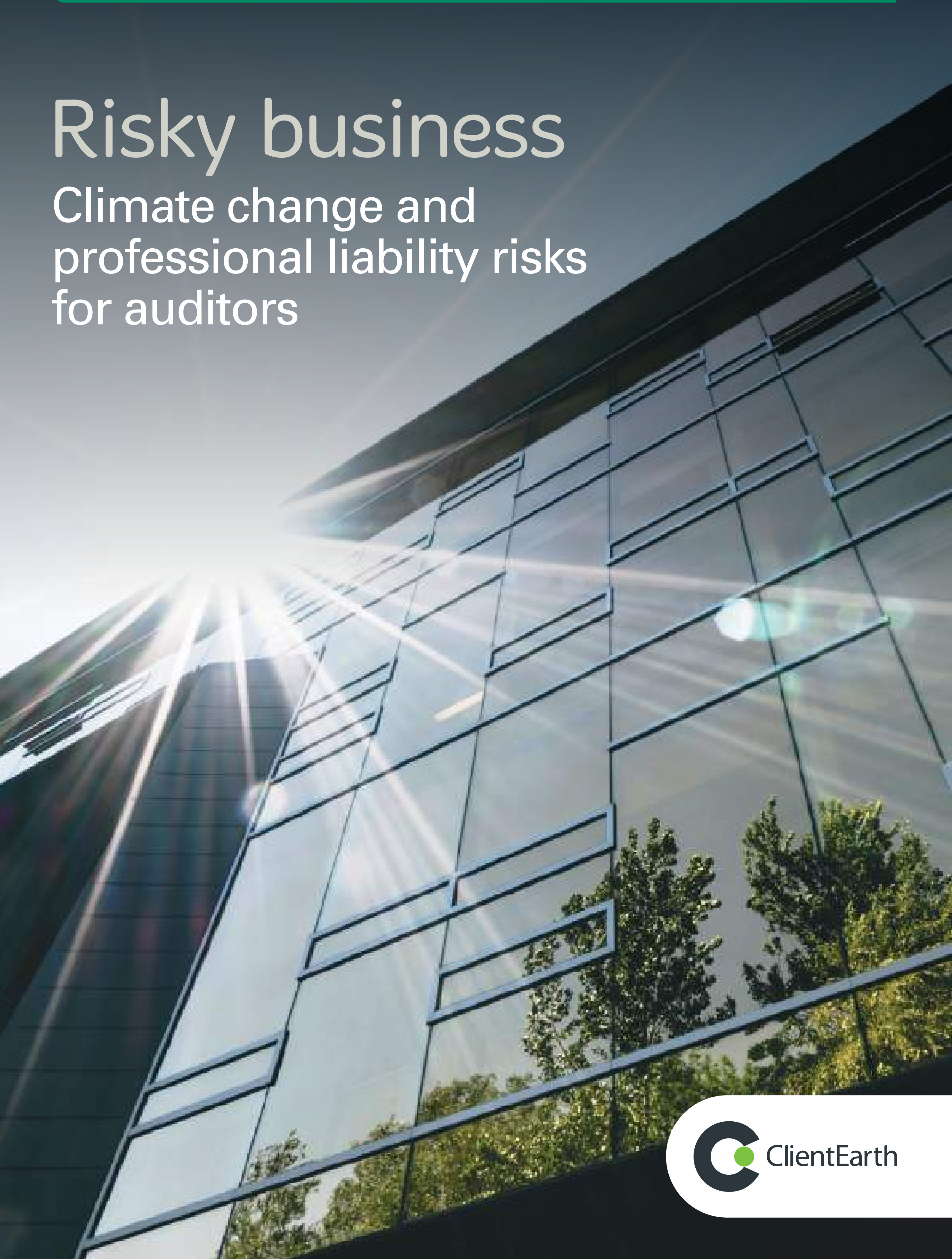
December 2017

Risky business

Climate change and professional liability risks for auditors



ClientEarth

ClientEarth is Europe's leading environmental law organisation.

We are lawyers working at the interface of law, science and policy. Using the power of the law, we develop legal strategies and tools to address major environmental issues.

Today's investment decisions will affect the planet for decades to come. Our Company and Financial Project uses the law to drive greater integration of climate-related financial risks into the management decisions of influential economic actors.

Our aim is to minimise the risk to the economy and to investors from climate change and to support a rapid shift of capital toward green investments.

Acknowledgements

This Discussion Paper is for information only. It has been produced by ClientEarth with the generous support of Friends Provident Foundation and the Children's Investment Fund Foundation.

ClientEarth would also like to acknowledge and thank the many individuals who reviewed and provided invaluable comments on early drafts of the Discussion Paper.

Front cover photo credit: Scott Webb

Disclaimer

While all information contained in this Discussion Paper is obtained from sources believed to be accurate and reliable, ClientEarth and the individual authors of the Discussion Paper do not accept responsibility for any errors, omissions, or inaccurate information, or any decisions made in reliance on this Discussion Paper. Any inaccuracies may be reported in writing to **dwiseman@clientearth.org.**

This Discussion Paper is not offered as advice on any particular matter and must not be treated as a substitute for specific advice. In particular, information in this publication does not constitute legal, professional, financial or investment advice. Advice from a suitably qualified professional should always be sought in relation to any particular matter or circumstances.

Contents

Abbreviations

- BoE – Bank of England
- BEIS – Department of Business, Energy and Industrial Strategy
- CA – Companies Act 2006
- CFO – Chartered Financial Officer
- FRC – Financial Reporting Council
- IAS – International Accounting Standards
- ISA (UK) – International Standard on Auditing (UK)
- IFRS – International Financial Reporting Standards
- PP&E – Property Plant and Equipment
- TCFD – Task Force on Climate-related Financial Disclosures
- UK – United Kingdom
- UK GAAP – UK Generally Accepted Accounting Practice

"For shareholders concerned about how robustly the companies they invest in are considering and disclosing climate risk, an obvious next step for engagement may be to target the companies' auditors."

See page 21

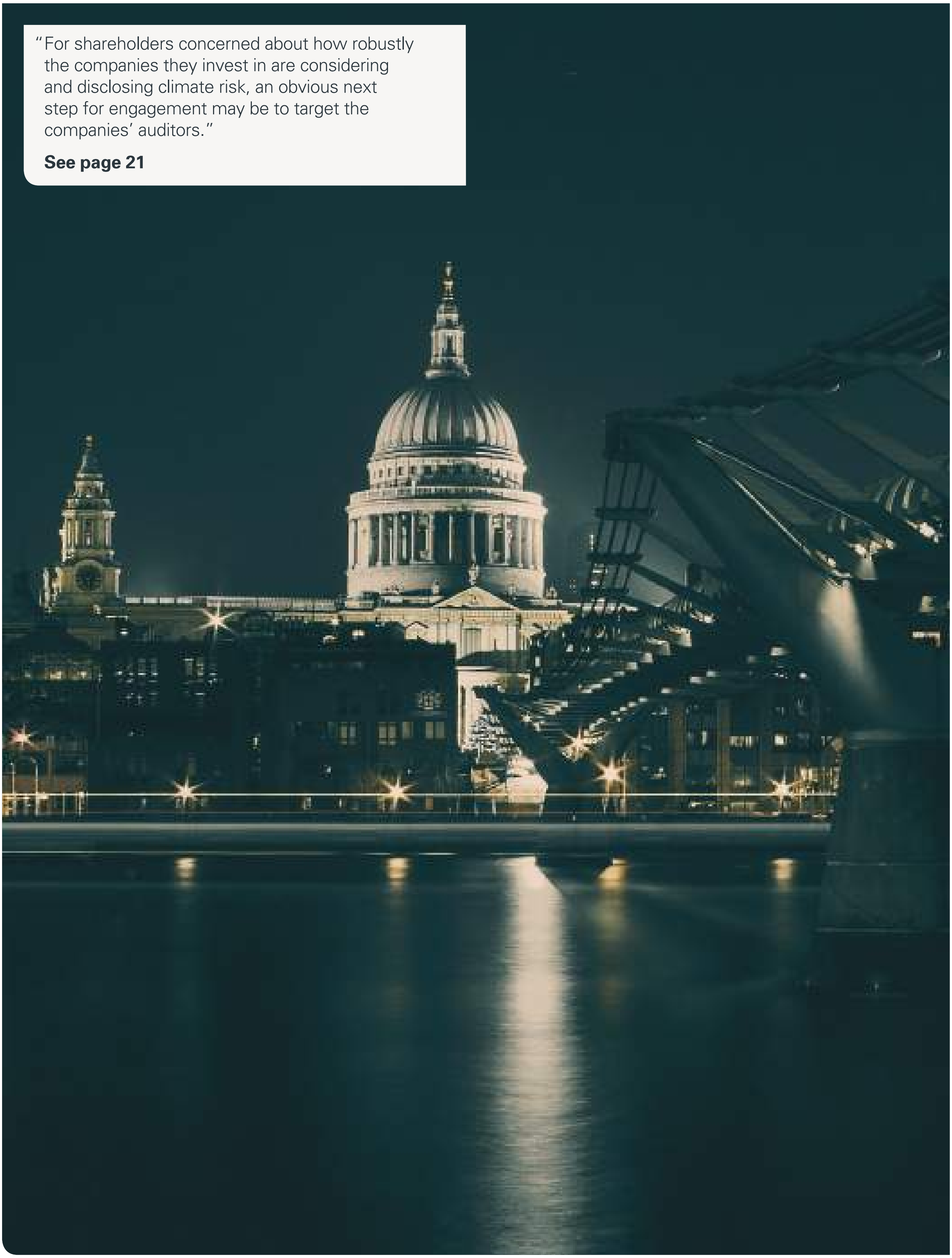


Photo credit: Vadim Sherbakov

ClientEarth

Climate change is a financial risk

Climate change is creating significant financial risks and opportunities for many companies, now and into the future. This is accepted wisdom for companies and investors alike.

> "Rising climate change concerns have led and could lead to additional legal and/or regulatory measures which could result in project delays or cancellations, a decrease in demand for fossil fuels and additional compliance obligations, and therefore could adversely impact our costs and/or revenue."
>
> **Royal Dutch Shell plc, 'Annual Report' (2016)**

> "Investors can no longer ignore climate change. Some may question the science behind it, but all are faced with a swelling tide of climate-related regulations and technological disruption."
>
> **BlackRock, 'Adapting Portfolios to Climate Change' (2016)**

As with any other business risk, companies in the UK must consider and manage climate risk and, if material, report it to their shareholders and the market. Increasingly, many are now doing exactly that. In line with their legal duties, they have acknowledged that the physical impacts of climate change and the accelerating shift to a low-carbon economy may have significant financial impacts for their business. They are embedding these insights within core strategic, risk, governance and reporting processes – repositioning to build resilience and capture opportunities.

While the frontrunners are setting the new standard, many are lagging behind.[1] Misconceptions about the financial impacts of climate risk are pervasive and many boards still see climate change as just another 'environmental' issue to list in a sustainability report. Despite mounting evidence of immediate and escalating financial impacts, they continue to turn a blind eye. In doing so, they may be breaching their duties and facing increasing legal, reputational and commercial risks.

Auditors must consider climate risk

As influential advisers with a unique role in corporate governance and clear professional duties, auditors must now understand the implications of climate risk and consider how it affects their own work and advice. If an element of climate risk is financially material for a company, auditors may need to consider whether this is adequately reflected in annual accounts, as well as in other information that auditors must now review – including strategic reports and corporate governance statements.

In order to address these issues confidently, auditors will need to understand how climate risk relates to their existing legal and professional duties. If a company or its shareholders suffer loss because of a failure to consider or report climate risks, auditors may become a prime target for costly and damaging litigation. Even before loss crystallises, auditors who fail to consider climate risk may face increased risks of regulatory intervention and shareholder pressure.

This discussion paper aims to draw these issues to the attention of UK auditors, boards, audit committees and investors. Its objective is to improve visibility and clarity about legal issues relating to climate risk for auditors and to enhance management and disclosure of climate risks by companies – ultimately, strengthening the UK's financial and economic resilience and minimising some of the worst impacts of climate change.

Climate risk: what is it?

It is now widely accepted that climate change will create physical, social and economic disruption on an unprecedented scale. With roughly 1°C of global warming already driven by human activity, the physical impacts of climate change are being felt now.[2] Droughts are becoming more extreme, storms are increasing in severity and sea levels are rising. These impacts will increase dramatically into the future, even under the most optimistic scenarios.[3]

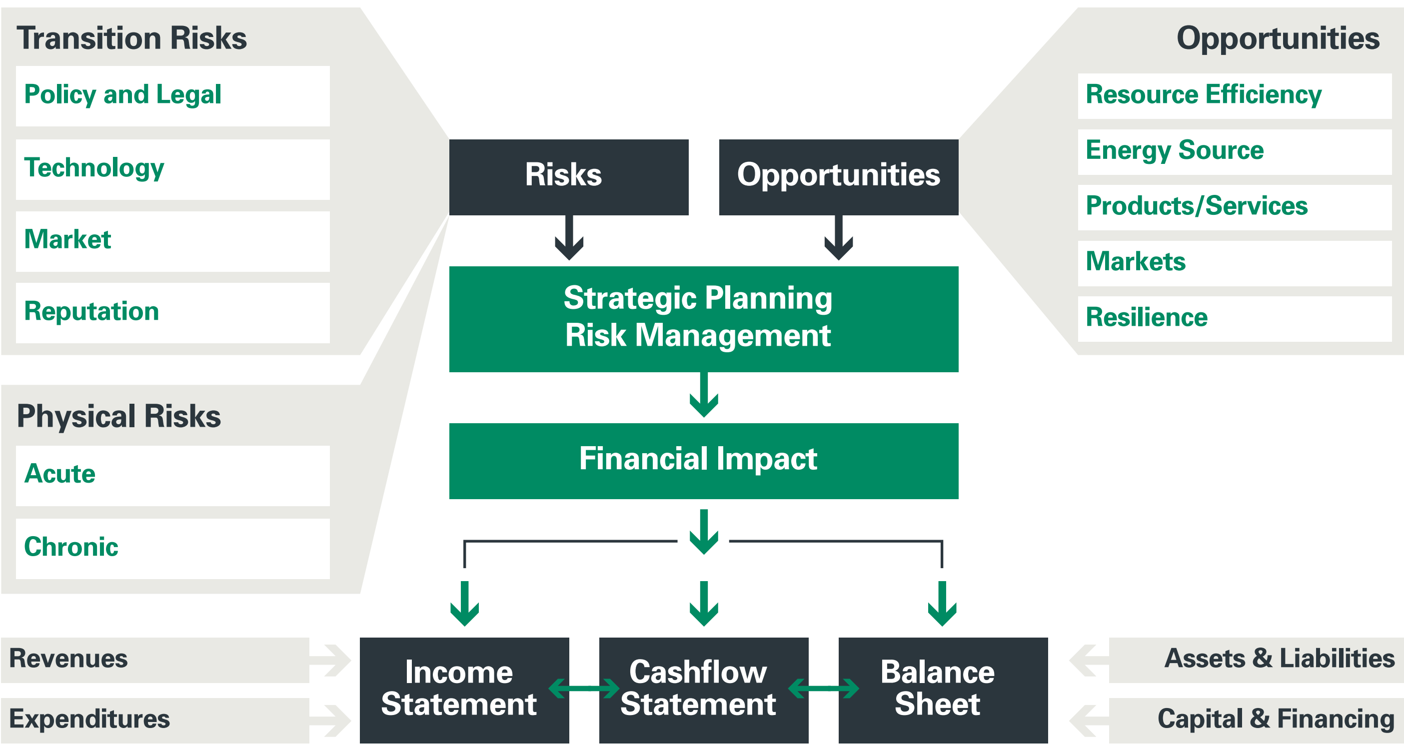
The impacts of climate change are not just physical. Efforts to address and adjust to its effects are fundamentally reshaping economies. Decisive actions by governments, companies and civil society, combined with sharply declining costs of renewable energy and shifting consumer preferences are rapidly accelerating the transition to a low-carbon economy.[4] For companies and industries that cannot or do not adjust, falling share prices, asset write-downs and bankruptcies are an immediate reality.[5]

The way in which financial impacts will manifest for different businesses will of course depend on the specific risks to which they are exposed, as well as how they are managed. Undoubtedly, there will be winners and losers. Because of the potential scale of these financial impacts, investors, lenders, insurers and regulators are increasingly demanding that these risks (and corresponding opportunities) be properly considered, managed and reported.[6]

Investors, in particular, are paying attention. Many are now taking active steps to better understand and manage the financial impacts[7] and to integrate these insights into risk management, investment and engagement processes.[8]

> "BlackRock expects the whole board to have demonstrable fluency in how climate risk affects the business and management's approach to adapting and mitigating the risk."
>
> **BlackRock, 'Our Engagement Priorities for 2017-2018' (2017)**

Figure 1. Climate-related risks, opportunities and financial impact



Source: TCFD, 'Final Report' (2017)

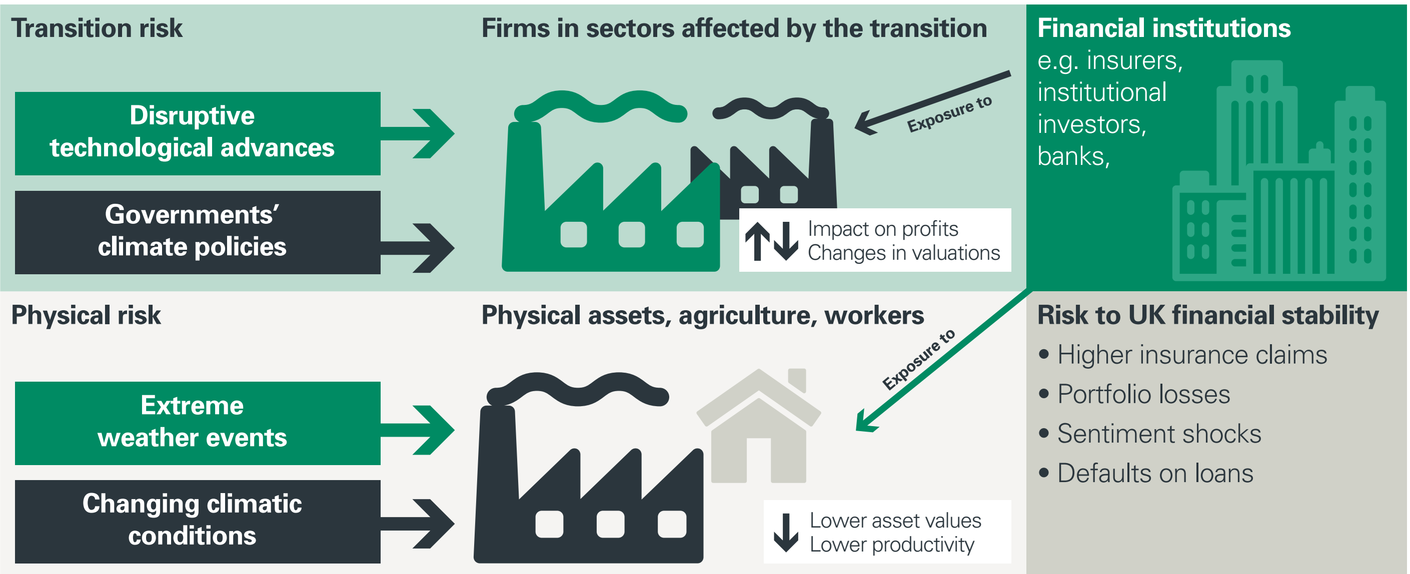
Explainer: A climate risk taxonomy

The most widely adopted taxonomy to describe climate risk, now adopted by the Bank of England (BoE) and the industry-led Task Force on Climate-related Financial Disclosures (TCFD), divides climate risk into two broad categories – physical risks and transition risks:

Physical risks refer to risks arising from the direct physical impacts of climate change. These may be driven by specific events, including increased severity of extreme weather events, or by longer-term shifts in climate patterns, including sea level rise or chronic heatwaves. The financial impacts of these risks could include losses from damage to assets and supply chain disruption; reductions or disruption to production capacity; increased operating and input costs; and increased insurance premiums.

Transition risks refer to risks arising from the transition to a low-carbon economy. Extensive policy, legal, technology, and market changes to address mitigation and adaptation requirements related to climate change are well underway. They are already having financial impacts. Policy changes and new regulation are driving write-offs and balance sheet impairments; disruptive technology is creating new competitive pressures; and consumer demand for low-carbon and sustainable products is shifting markets.

Figure 2. Primary channels for climate-related financial risks



Source: Bank of England, 'The Bank of England's Response to Climate Change' (2017)

A new legal landscape: company directors must consider, manage and report climate risks

In light of the particular and systemic risks related to climate change, all companies and their directors should now consider the financial implications of climate risk for their business.[9] Where appropriate, these risks will need to be actively managed and reported. For publicly listed and large private companies this will likely require direct integration of climate risk within existing risk management and strategic decision-making processes.[10]

As is made clear by the TCFD Final Report, the risks and financial impacts of climate change may already need to be reported under existing mandatory reporting regimes.[11] Companies and directors that fail to do so face increasing risks of litigation, regulatory intervention and shareholder pressure.[12] These are important issues for auditors to understand when providing their own services.

Directors' duties

Under UK company law, all company directors have legal duties 'to promote the success of the company'[13] and 'to exercise reasonable care, skill and diligence'.[14] In acting to promote the success of the company, directors must consider a range of factors, including the likely consequences of their decisions in the long term, as well as the impact of the company's operations on the community and the environment.[15] In addition to immediate short-term impacts, climate risk will increase significantly into the future and will have clear social and environmental impacts that directors may need to consider and manage now in order to comply with this duty.[16]

In determining whether a director has exercised their duty of care, skill and diligence to a 'reasonable' standard, one of the key considerations a court may look at is industry guidance and practice.[17] The industry-led TCFD Final Report makes it clear that climate risk is an issue that all companies must consider and manage. Many are now doing so (**see page 12**).

At the very least, this emerging standard may mean that directors are now expected to:

- obtain expert advice about climate risk;
- acquire and maintain sufficient knowledge and understanding of the impact of climate risk on the company; and
- ensure climate risk is considered, managed and reported by the company, where appropriate.

Currently, where a director breaches one of these general duties, it is the company that has the right to bring an action.[19] In certain circumstances, shareholders may also be able to bring a derivative action on the company's behalf.[20] In either case, the company or the shareholders may be able to seek damages for any loss caused to the company by the breach of duty or (in more limited circumstances) an injunction in relation to a prospective future breach.[21]

In some circumstances, a breach of these duties may also be grounds for the termination of an executive director's service contract, or for disqualification as a director.[22]

Although it does not currently have the power to do so, the Financial Reporting Council (FRC) has also requested additional powers to investigate and prosecute breaches of directors' duties.[23]

Photo credit: Aleksejs Bergmanis

Accounting and reporting duties

In addition to their core directors' duties, directors also have numerous duties in relation to accounting and reporting requirements, for which climate risk may be directly relevant.[24] Most notably, these include requirements in relation to the preparation and approval of the company's annual accounts[25] and the preparation and approval of other information, such as the strategic report[26] and directors' report (including the viability statement, where required).[27]

Annual accounts: climate risk implications

It is a fundamental company law requirement that the directors of every company must prepare annual financial accounts, which comprise the balance sheet and the profit and loss account of the company (or group).[28] For quoted UK companies, the accounts must be prepared in accordance with the international accounting standards (IFRS) as adopted by the European Union (EU).[29] Other companies may choose to adopt the UK framework (UK GAAP).[30]

In either case, the directors must approve the accounts and have primary responsibility for their accuracy. They also have an overarching duty not to approve them unless they are satisfied that they give a 'true and fair view' of the assets, liabilities, financial position and profit or loss of the company or group.[31] This duty requires that accounts be prepared in accordance with the relevant accounting framework and standards, with departures permitted and required if mechanistic compliance would be misleading.[32]

As noted in the TCFD Final Report, because climate risk has potentially significant financial impacts, where relevant, these may need to be considered in the preparation of the annual accounts. Most obviously this may require factoring climate risk into assumptions used for fair value estimates for certain assets or for identification of potential impairments. Further possible examples are identified in **Table 1**.[33]

In all these cases, directors' are likely required to exercise a certain level of prudence when making judgments about the assumptions and estimates that are used, particularly where there is uncertainty.[34]

> "Use of long-lived assets and, where relevant, reserves may be particularly affected by climate-related issues. It is important for organizations to provide an indication of the potential climate-related impact on their assets and liabilities, particularly long-lived assets. This should focus on existing and committed future activities and decisions requiring new investment, restructuring, write-downs, or impairment."[35]
>
> **TCFD, 'Final Report' (2017)**

Failure by the directors to comply with the relevant requirements in relation to the annual accounts may be a breach of their directors' duties. Knowing or reckless failure is a criminal offence.[36]

Where accounts are approved that do not comply with the relevant legal requirements, including due to a failure to properly consider climate risk implications, there is also a risk that any distribution or dividends made by reference to those accounts will be unlawful. Such a situation may occur where, due to improperly prepared accounts, there has been a distribution out of capital, a dividend declared in excess of a company's distributable profits, or even where there is a technical breach of the rules relating to distributions.[37]

Where an unlawful distribution has been made, directors may be personally liable to repay the company, as may any shareholder who had reasonable grounds to believe that the distribution was unlawful.[38]

> "There are some situations where management may need to quantify the key assumptions underlying their estimates in order for investors to understand the positions taken and facilitate intercompany comparison; for example, the commodity price assumptions adopted by companies in the extractive industries."
>
> **FRC, 'Summary of key developments for 2017/18 annual reports' (2017)**

Table 1. Directors' reporting duties: examples of climate risk implications for annual accounts	
Legal duty (paraphrased)	**Suggested examples of climate risk implications**
For quoted companies, the annual accounts must be prepared in accordance with international accounting standards (CA s 395; EU IAS Regulation, No 1606/2002). (Although not covered in this report, similar requirements may also apply to other companies preparing accounts in accordance with UK GAAP).	Climate risk may be relevant for estimates and assumptions used in preparing accounts, e.g.: • recognition of mineral resources and reserves (IFRS 6); • fair value measurements of Property, Plant and Equipment (PP&E) (IFRS 13); • impairments of PP&E, goodwill, mineral resources, agriculture (IAS 36, IFRS 6, IAS 41); • depreciation method and assumptions for PP&E (IAS 16); and • asset retirement obligations (IAS 16, IAS 37).
The directors of a company must not approve accounts unless they are satisfied that they give a true and fair view of the assets, liabilities, financial position and profit or loss of the company (CA s 393).	• Accounts must be prepared in accordance with the relevant accounting framework and standards, with departures permitted and required if mechanistic compliance would be so misleading as to conflict with the objective of financial statements (see e.g. IAS 1; FRC, 'True and Fair' (2014)). • Directors may need to consider whether the preparation of accounts strictly in accordance with the relevant standards adequately takes into account climate risk implications. In doing so directors will need to: – stand back and ensure that the accounts as a whole do give a true and fair view; – provide additional disclosures when compliance with an accounting standard is insufficient to present a true and fair view; – use the true and fair override where compliance with the standards does not result in the presentation of a true and fair view; and – ensure that the consideration they give to these matters is evident in their deliberations and documentation.

Other information: climate risk implications

Alongside their obligations in relation to the annual accounts, directors also have a range of duties in relation to the preparation and reporting of other information to be included in the annual report, including the strategic report,[39] directors' report, corporate governance statement and long-term viability statement.[40]

Strategic report

Unless an exemption applies, all companies must now prepare a strategic report.[41] The purpose of the strategic report is to inform shareholders and help them to assess how the directors have performed their duty to promote the success of the company.[42] Among other things, it must contain a fair review of the company's business and describe the principal risks and uncertainties facing the company.[43] For quoted companies the strategic report must also include:

- the main trends and factors likely to affect the future development, performance and position of the company's business;[44]
- information about other matters, including 'environmental matters';[45] and
- a description of the company's strategy and business model.[46]

Following the introduction of the EU Non-Financial Reporting Directive, all traded companies (as well as banks and insurance companies) must also include a non-financial information statement in their strategic report.[47] This must include information about the impact of the company's activities in relation to various matters, including the environment, and a brief description of the company's business model and the 'principal risks and uncertainties' to the business in relation to these matters.[48]

Although climate change is not explicitly mentioned, for many companies, where it is financially material, climate risk will need to be considered and reported in the strategic report – particularly in relation to principal risks and uncertainties facing the business.[49] Many companies already do so (**see page 13**). Recent proposed reforms to the FRC's Guidance on the Strategic Report would include express reference to climate risks, highlighting climate change as an issue requiring particular attention by directors.[50] A number of examples of climate risk implications for other information are included in **Table 2**.

If directors approve a strategic report that does not comply with these requirements, they may be criminally liable.[51] Directors may also be personally liable to compensate the company for any loss suffered by the company as a result of a false or misleading statement included in the strategic report, or any relevant omission.[52] Any such failures may also indicate a breach of the directors' general duties.

Long-term viability statement

Under the UK Corporate Governance Code (Code), directors are required to include in their annual report a statement about the long-term viability of the company.[53] In preparing this statement, the directors are required to take into account the company's current position and principal risks and explain how they have assessed the prospects of the company, over what period they have done so and why they consider that period to be appropriate.[54]

According to guidance provided by the FRC, it is expected that the time period selected should be aligned with a company's investment and planning period.[55] For many companies, this may require consideration of risks facing the business over five, ten or even twenty-year time horizons. In these circumstances, for many companies, climate risk may be highly relevant.[56]

While the Code is generally voluntary, companies with a premium listing of equity shares in the UK are required to report in compliance with the Code or explain why they have not done so.[57]

ClientEarth

Table 2. Directors' reporting duties: examples of climate risk implications for other information	
Legal duty (paraphrased)	**Suggested examples of climate risk implications**
The strategic report must include a fair review of the company's business (CA, s 414C(2)(a)).	• Directors should consider whether climate risk is an issue that needs to be disclosed in order to provide a fair review of the company's business.
The strategic report must include a description of the principal risks and uncertainties facing the business (CA, s 414C(2)(b)).	• Directors should ensure that the company has a robust risk assessment and management system in place. • If climate risk is identified as a principal risk or uncertainty facing the business, it must be disclosed.
The strategic report must include the main trends and factors likely to affect the future development, performance and position of the company's business (quoted companies) (CA, s 414C(7)(a)).	• Directors should ensure that the company has a robust strategic and scenario planning process in place. • If climate risk is identified as a factor likely to affect the future development, performance and position of the company's business, it must be disclosed.
The strategic report must include information about environmental matters, including the impact of the company's business on the environment (CA, s 414C(7)(b)(i)).	• Directors should ensure that the company has robust processes to assess the impacts of the company's business on the environment. • How the company's business will impact the environment must be disclosed.

What are UK companies already disclosing?

Many companies in the UK are already providing climate risk-related information in their annual reports. Following the publication of the TCFD Final Report many companies have publicly affirmed their support for the recommendations, indicating a growing awareness and acceptance of the materiality of climate risk issues for corporate reporting requirements.[58]

Despite these developments, so far, the majority of climate risk disclosures in the UK are confined to the risk reporting section of the strategic report and are often provided at a high level of generality.

Very few companies provide granular detail about how they are managing climate risk and even fewer are reporting how they have quantified potential financial impacts.[59] This potential mismatch between risk disclosures and their impact on the annual accounts is an issue that may require careful attention by companies, as well as by their auditors.

Photo credit: AFP/Getty

"We are actively engaged in public policy debate on the risks and impacts of climate change to our business and customers. We use reinsurance to reduce the financial impact of catastrophic weather events. Our flood mapping analytics helps us identify properties most at risk and improve our risk selection. Our responsible investment strategy ensures climate change, as well as other environmental and social issues are integrated into our investment decisions."

Aviva plc, Annual Report and Accounts 2016 (2017)

"CRH believes that a proactive approach to addressing the challenges and opportunities of climate change is fundamental to its "making businesses better" approach. CRH has evaluated the risks and opportunities arising from climate change and has put in place a management strategy focusing on energy efficiencies and carbon reduction."

CRH plc, 2016 Annual Report and Form 20–F (2017)

"We acknowledge the changing global climate, and support the intent and aspirations of the Paris Agreement to limit global warming to less than two degrees Celsius above pre-industrial levels. We are aiming for a substantial decarbonisation of our business by 2050 and are taking steps to reduce emissions, manage risk and build resilience to climate change."

Rio Tinto plc, 2016 Annual Report (2017)

"Climate change, and the imperative to decarbonise energy systems, creates both risks and opportunities for SSE… In response to the 2015 Paris Agreement on Climate Change, and out with [sic] the scope of the Viability Assessment, a number of scenarios have been assessed to consider SSE's long-term resilience to carbon reductions that would be required to prevent global average temperatures rising by 1.5 °C or 2 C."

SSE plc, Annual Report 2017 (2017)

"For a number of years we have recognised that changes in climate pose a risk to our business and hence as a part of our Unilever Sustainable Living Plan we are trying to both reduce our impact on climate change and to prepare ourselves for the impact climate change will have on our business in the coming years."

Unilever plc, Unilever Annual Report and Accounts 2016 (2017)

Auditors in the hot seat: an expanding duty of care

As influential advisers with a unique role in corporate governance and clear professional duties, auditors will increasingly be expected to understand the implications of climate risk and integrate this into their own work and advice. If an element of climate risk is financially material for a company, auditors may be required to consider whether this is adequately reflected in the annual accounts.

Beyond the annual accounts, auditors may also need to consider whether a company's internal financial and risk management functions are adequately addressing climate risk and whether identified risks to the business are consistent with the accounts and are being accurately and robustly disclosed in the strategic report or corporate governance statement.

As for any other financially material factor, in some cases, failure to consider these issues and address them in the audit may be a breach of an auditor's legal or professional duties. The legal and regulatory landscape for audit is also shifting rapidly, as are investor expectations and demands for the internal audit. As the auditor's role continues to expand and evolve, so too will the scope of their legal duty of care to consider climate risk.

Auditors' legal duties: climate risk in annual accounts

Under UK company law, unless a specific exemption applies, all companies must have their annual accounts and reports audited[60] and appoint an auditor to do so.[61] Historically, the auditor's core duty has been to make a report to company members on whether, in the auditor's opinion, the company's annual accounts:

- give a 'true and fair view' of the state of affairs (assets, liabilities and financial position) and profit or loss of the company;
- have been properly prepared in accordance with the relevant financial reporting framework; and
- have been prepared in accordance with Companies Act and relevant EU regulations.[62]

In carrying out this work, the auditor must comply with detailed prescriptions set out in the relevant audit standards while also being attentive to whether or not the accounts overall provide a true and fair view of the financial position of the company.[63] This process does not involve a certification of the absolute accuracy of the annual accounts. Rather, the overall objective of the audit is to provide shareholders with 'reasonable assurance' that the financial statements as a whole are free from material misstatements and meet the relevant legal requirements.[64]

In order to achieve this standard of assurance, the audit must be carried out in accordance with the relevant audit standards. These are detailed and prescriptive but also require auditors to apply 'professional scepticism' and 'exercise professional judgment' throughout the process.[65]

The auditor is also required to have regard to the directors' duty not to approve the accounts unless they give a 'true and fair view' of the assets, liabilities, financial position and profit or loss of the company.

In this context, auditors for many companies will need to be alert to the implications of climate risk for the conduct of the audit, particularly in relation to estimates and assumptions made by management in preparing the accounts and when gaining an understanding of the company and its environment.[66] Where relevant, auditors may need to identify and document the steps they have taken to test management's estimates, assumptions and impairment reviews.

The implications of climate risk for the application of accounting and audit standards will be context-specific and a detailed analysis is beyond the scope of this paper. By way of illustration, however, some suggested examples of climate risk implications are included in **Table 3**.

ClientEarth

Table 3. Auditors' duties and annual accounts: examples of climate risk implications

Relevant standards (paraphrased)	Suggested climate risk implications
The auditor shall evaluate whether the financial statements are prepared, in all material respects, in accordance with the requirements of the applicable financial reporting framework. This evaluation shall include consideration of the qualitative aspects of the entity's accounting practices, including indicators of possible bias in management's judgments. ISA (UK) 700 [12], [A1]–[A3].	Auditors may need to consider the implications of climate risk for assumptions and estimates used in preparing annual accounts, including in relation to: • recognition of mineral resources and reserves (IFRS 6); • fair value measurements of PP&E (IFRS 13): • impairments of PP&E, goodwill, mineral resources, and agriculture (IAS 36, IFRS 6, IAS 41); • depreciation method and assumptions for PP&E (IAS 16); and • asset retirement obligations (IAS 16, IAS 37).
The auditor is required to evaluate, based on the audit evidence, whether the accounting estimates in the financial statements are either reasonable in the context of the applicable financial reporting framework, or are misstated. ISA (UK) 540 [18].	Where the auditor identifies that climate risk may be relevant for significant assumptions used in making accounting estimates the, auditor may need to: • obtain written representations from management (ISA (UK) 540 [21]); and • include in the audit documentation the basis for the auditors' conclusion about the reasonableness of accounting estimates and indicators of possible management bias (ISA (UK) 540 [18]).
In order to identify and assess the risks of material misstatement, the auditor must obtain an understanding of the company and its environment, including the company's internal control. The auditor must understand, among other things: • relevant industry, regulatory, and other external factors; • the nature of the entity, its operations, ownership and governance structures; • the types of investments that the entity is making and plans to make; and • the entity's objectives and strategies, and related business risks that may result in risks of material misstatement. ISA (UK) 315 [11].	Auditors may need to consider the implications of climate risk when obtaining an understanding of the company and its environment, in light of its objectives, strategies and other business risks and the adequacy of its internal controls and risk management systems. This may include having an understanding of: • regulatory climate risk implications; • climate-related market risk implications; • climate risk implications for committed and proposed capex; and • climate risk implications for the entities objectives and strategies.

Auditors' legal duties: climate risk in other information

In addition to their duties in relation to the annual accounts, auditors in the UK, and across most of Europe, must now also review and provide assurance on other information included in the annual report, such as the strategic report, directors' report and corporate governance statement.[67]

For a number of years, auditors have already been required to review this information and to provide an opinion on whether it is consistent with the annual accounts.[68] Following recent changes to the law, in addition to this requirement, auditors must now also consider and provide assurance that this other information is not just consistent with the accounts, but has itself been prepared in accordance with applicable legal requirements and is free from material misstatements.[69]

In light of these additional requirements, auditors must now take even greater care to ensure they understand legal requirements relevant to climate risk reporting in this other information and be prepared to challenge management where they identify deficiencies. This will require auditors to understand the primary EU and UK legal disclosure requirements, as well as any relevant guidance issued by the FRC[70] and relevant industry standards, such as the recommendations contained in the TCFD Final Report.[71]

The relevant audit standards set out detailed requirements about auditors' responsibilities in relation to 'other information'.[72] How these standards are applied in practice will, of course, be context-specific. By way of illustration, however, a number of potential examples of climate risk implications are included in **Table 4**.

Case study

Complaints filed against SOCO International plc and Cairn Energy plc

In August 2016, ClientEarth submitted regulatory complaints to the FRC, alleging that two oil and gas companies listed on the main market of the London Stock Exchange, SOCO International plc (SOCO) and Cairn Energy plc (Cairn), had not complied with their legal duties under the Companies Act by failing to adequately report climate-related risks to their business.

While both companies complied with explicit requirements to disclose their greenhouse gas emissions, unlike many of their peers, neither of them identified climate change as creating a risk to their business. SOCO made no mention of climate change whatsoever and while Cairn identified climate change as an issue in its corporate responsibility materiality matrix, it did not disclose any information about climate-related risk to its business model or strategy.

Following engagement by the FRC as a result of the complaint, both companies' subsequent strategic reports included significantly more comprehensive information about climate-related risks to their business.

Now that auditors are required to review and provide an opinion on whether the information in the strategic report meets the relevant legal requirements, they will need to have a clear understanding of how the disclosure rules are being applied in practice in relation to climate risk.

ClientEarth

Table 4. Auditors' duties and other information: examples of climate risk implications	
Relevant standards (paraphrased)	**Climate risk implications**
The auditor must read the 'other information' and, in doing so, consider whether there is a material inconsistency between the other information and the financial statements. (ISA (UK) 720 [14(a)]).	Auditors may need to adopt procedures to identify whether disclosures about climate risk in strategic reports or directors' reports (including the viability statement) are consistent with the assumptions and estimates adopted in preparing the financial statements.
The auditor must obtain an understanding of: • the legal and regulatory requirements applicable to the statutory other information; and • how the entity is complying with those legal and regulatory requirements. (ISA (UK) 720 [12–1]). The auditor must read the 'other information' and, in doing so, consider, based on the work undertaken in the course of the audit, whether the 'other information' appears to be materially misstated in the context of the auditor's understanding of the applicable legal and regulatory requirements. (ISA (UK) 720 [14–1]).	Auditors may need to consider and identify whether an entity is complying with its legal requirements in relation to climate risk – including in relation to its duties to disclose: • a fair review of the company's business; • a description of the principal risks and uncertainties facing the company; • the main trends and factors likely to affect the future development performance and position of the company's business; and • information about environmental matters (including the impact of the company's business on the environment). Companies Act 2006 (ss 414C, 414CB).
The auditor must read the 'other information' and, in doing so, consider whether there is a material inconsistency between the other information and the auditor's knowledge obtained in the audit, in the context of audit evidence obtained and conclusions reached in the audit. (ISA (UK) 720 [14(b)]).	Auditors may need to consider the implications of climate risk when obtaining an understanding of the company and its environment and consider whether there is any material inconsistency between disclosures in the 'other information' and the knowledge and information obtained by the auditor in the course of the audit.

Climate liability: are auditors at risk?

With climate change receiving increased interest and scrutiny from regulators and investors alike, auditors that fail to consider climate risk and take it into account in their work and advice may now face increasing risks of regulatory sanctions, legal liability and investor pressure.

Regulatory sanctions

Across the UK, regulators for the financial sector and associated professional services are increasingly taking action to address failures to consider climate risk by those they regulate.[73]

Where they are slow to act, civil society is providing additional oversight – identifying and reporting firms or organisations that are lagging behind.[74] For auditors that fail to meet legal and professional requirements to consider and act on climate risk, there may now be a growing risk of regulatory intervention.

The FRC is responsible for carrying out investigations, enforcement and sanctions in connection with the audits of UK-listed companies and other public interest entities.[75] It has powers to investigate allegations of a breach by an auditor or audit firm of any requirements under UK company law, EU law, audit standards and ethical standards issued by the FRC.[76]

It can impose a range of sanctions, including reprimands, exclusion orders and financial penalties.[77] The FRC has also recently been increasing its enforcement action and has issued a number of significant financial penalties.[78]

Although it has not yet occurred, it is not difficult to imagine a climate risk-related investigation commenced against an auditor in the UK in the near future. The FRC has repeatedly noted that it is increasingly concerned with auditors' assessments of impairments and judgments concerning material accounting treatments – matters particularly relevant where climate risk is concerned.

> "An emerging theme is that we continue to see examples of insufficient auditor scepticism in identified areas of significant risk such as the assessment of potential impairments and judgments concerning material accounting treatments."
>
> **FRC, 'Developments in Audit: February 2017 Update' (2017)**

Table 5. Examples of recent misconduct findings by the FRC

Company	Audit firm	Outcome/ status	Date concluded	Sanction	Cost
Cattles plc	PwC	Misconduct admitted	22 Aug 2016	Severe reprimand Fine £2,300,000	£750,000
Aero Inventory plc	Deloitte	Misconduct by tribunal	10 Nov 2016	Severe reprimand Fine £4,000,000	£2,275,000
RSM Tenon Group plc	PwC	Misconduct admitted	16 Aug 2017	Severe reprimand Fine £5,100,000	£500,000

Legal liability

With the financial impacts of climate risk becoming an increasing reality across the economy, the risks of legal liability are also rising. As the TCFD Final Report notes, recent years have already seen an increase in climate-related litigation being brought before the courts.[79] Where climate risk materialises and threatens a company's financial performance or solvency, audit firms may increasingly become a target for parties that have suffered loss – including shareholders, creditors, directors, and any insurers standing behind them.

Just like other professionals, auditors will owe certain legal duties of care to the company they are auditing.[80] As the law stands currently, this duty will usually be owed to the company directly, in the interests of its existing shareholders.[81] If the company becomes insolvent, the company's creditors may also benefit from a claim.[82] In special circumstances, auditors may also owe duties to a range of third parties directly, such as existing shareholders, potential investors, directors or banks and other creditors.[83]

The content of these duties will of course depend on the specific circumstances in which they arise. Generally, however, the legal standard of care required of an auditor in carrying out their engagement will be that of 'the reasonable skill and care of an ordinary skilled person carrying out the same engagement'.[84] This inherently flexible standard is intended to evolve in line with the regulatory landscape and industry practice. Legislation, regulations, codes of practice, industry guidance and expert opinions will all be relevant when assessing what is required.[85]

In light of the high profile of climate risk issues and the increasing steps being taken by investors, companies, regulators and audit firms to address them, the direction of travel for this standard is increasingly clear. Climate risk may already be a relevant factor for the application of accounting and audit standards (**see Tables 3 and 4**) and failure to act in accordance with relevant professional standards is a strong indicator of a breach of a duty of care.[86]

With the increase of shareholder and creditor class actions across the UK and Europe in recent years,[87] auditors should be paying close attention to these issues. As in other jurisdictions, such claims are particularly likely to crystallise following significant stock drops or insolvencies.[88] Auditors working in industries exposed to climate risk should be particularly alert to this risk.

> "It is clear that climate change is no longer an issue that can be consigned to a corporate compliance or public relations silo. Its impact on balance sheet items and forward-looking risk and strategy must be reconsidered, in an integrated manner, in the light of contemporary economic realities. This is critical not only for directors, who sign-off on both financial accounts and narrative managerial statements, but accounting and risk advisers."
>
> **Minter Ellison Lawyers (2016)**

Criminal offences and whistleblowing duties

In addition to regulatory sanctions and legal liability, individual auditors may also commit a criminal offence if they 'knowingly or recklessly' cause an auditor's report to 'include any matter that is misleading, false or deceptive in a material particular'.[89] While recklessness is a high bar, to avoid concern, auditors may need to document how or whether they have considered climate risk. If the auditor identifies a material breach of laws and regulations by the company they are auditing, including in relation to climate risk, they also have duties to report this to the FRC.[90]

Liability hypothetical

Pump it Up plc and AA Auditors

2017

Pump it Up plc is a multinational company listed on the main market of the London Stock Exchange. Its primary business is oil and gas production and development. It operates significant oil and gas assets in the UK North Sea, and has interests in Malaysia, Vietnam and Nigeria. Pump it Up's annual reports are audited by a 'Big 5' accounting firm, AA Auditors.

Pump it Up's 2017 annual report does not refer to climate risk, either in relation to its impacts on the annual accounts or in the discussion of principal risks to the business. The auditors report that accompanies the annual report also does not indicate whether AA Auditors considered climate risk issues in carrying out its audit.

The strategic report does identify two of the principal risks to the company as being a decline in oil and gas prices and changes in the regulatory and fiscal environment. It identifies the potential impact for each of these as 'high' but the likelihood as 'low'. It specifically refers to the potential unknown impacts of Brexit. There is no indication about whether these risk assessments have been taken into account when setting the assumptions and estimates used in preparing the annual accounts.

2022

Over the past five years, the combined impacts of government regulation, decreasing costs of renewable energy and changing consumer demand in the transport sector have resulted in sustained low oil prices. As with the coal industry before it, oil industry growth has stalled, new exploration and capex has been dramatically reduced and many companies reliant on the industry have been forced into bankruptcy – including Pump it Up plc.

Over the same time period, many of Pump it Up's peers considered the implications of climate risk for their business, reported their potential exposure in line with the TCFD recommendations, and used the insights gained to realign their business to manage the potential risks and seize the upside opportunities. Some have significantly reduced new oil and gas capex plans and boosted dividends for shareholders. Others have actively diversified and transitioned towards developing lower emission energy sources.

In light of Pump it Up's bankruptcy, shareholders and creditors have suffered significant losses. The liquidators are attempting to sell off many of Pump it Up's assets, which, in part because of the remediation liabilities that attach to them and the bearish outlook for global oil prices, now appear to have been substantially overvalued in the company accounts. Many of these assets were supported by debt funding arrangements entered into shortly after publication of the 2017 annual report.

In an attempt to recover creditors' losses, the liquidators commence proceedings against the directors for breaching their directors' duties. One of the heads of claim relates to a failure to adequately consider, report and manage climate risk. The directors' potential liability is largely covered by their D&O insurance and the insurers step in to defend the claim.

To limit their own exposure, the D&O insurers join AA Auditors to the claim. They argue that AA Auditors is concurrently liable for failing to consider climate risk and its implications in performing its audit and other services—in breach of their legal duties of skill and care. Separately, the FRC also opens an investigation into AA Auditors and the head audit partner responsible for the audit of Pump it Up plc.

ClientEarth

Investor pressure is rising

Over the past few years, investors across the world have become increasingly active in demanding that the companies they invest in are robustly disclosing their exposure to climate risk as well as the steps they are taking to increase resilience.

Recent UK and European examples include successful shareholder resolutions supported by management at major oil and gas companies, BP plc[91], and Royal Dutch Shell plc;[92] and at mining companies like Rio Tinto plc,[93] Glencore plc[94] and Anglo American plc.[95]

The resolution at BP, for example, acknowledges the risks and opportunities associated with climate change and commits the company to including in its annual reporting additional disclosures relating to operational emissions management and asset portfolio resilience to the low-carbon transition, as well as executive incentives and public policy positions relating to climate change.[96]

In the US, resolutions contested by management, but ultimately successful, have also recently been brought at ExxonMobil, Occidental Petroleum and PPL Corporation.[97]

In addition to supporting these resolutions on climate-related disclosures, many of the world's largest asset managers, including the likes of BlackRock and Vanguard, have made climate risk management and disclosure a top priority for their stewardship and company engagement strategies.[98]

While some companies are responding to this shareholder engagement by increasing their climate risk disclosure and resilience planning, there is also rising concern that they may not be addressing or reporting these risks with the same levels of transparency, rigour and balance as they might apply to other parts of their business.[99]

Are auditors climate competent?

For shareholders concerned about how robustly the companies they invest in are considering and disclosing climate risk, an obvious next step for engagement may be to target the companies' auditors.

Such a step could provide shareholders with further assurance that climate risks are being accurately and prudently incorporated into the company accounts, reports and strategic decisions.

In the UK, it is shareholders who ultimately have the power to appoint and remove the company auditors, as well as to approve remuneration.[100] Shareholders also have rights to ask questions about matters relating to how the accounts have been audited.[101]

These powers provide shareholders with significant potential leverage to engage with the company board and auditors on how climate risk issues are considered, treated and reported in company reports. In addition to demands for climate competent boards, it may not be long before shareholders are also actively calling for climate-competent auditors.

"The concept of the "climate competent board" has surfaced in recent years. For directors of companies in sectors that are significantly exposed to climate risk, BlackRock expects the whole board to have demonstrable fluency in how climate risk affects the business and management's approach to adapting and mitigating the risk."

BlackRock, 'Our Engagement Priorities for 2017–2018' (2017)

Photo credit: Pixabay

Action points: rising to the challenge, managing the risk

To minimise the risks of regulatory sanctions, legal liability and reputational damage, auditors must now understand the implications of climate risk for their work, and, where relevant, actively integrate it into their advice and audit processes.

To best protect themselves and their clients, auditors should consider the following action points:

1

Understand climate risk and its financial implications – see, for example:

- **Bank of England**, 'The Bank of England's Response to Climate Change' (2017)
- **Task Force on Climate-related Financial Disclosures**, 'Final Report' (2017)
- **BlackRock**, 'Adapting Portfolios to Climate Change' (2016)
- **Mercer**, 'Investing in a Time of Climate Change' (2015).

2

Understand existing directors' duties to consider, report and manage material financial risks to the business of the company – including climate-related risk.

3

Consider the implications of climate risk for assumptions and estimates used in preparing annual accounts and understand the implications of climate risk for the application of existing accounting treatments and audit standards.

4

Develop internal tools and guidance for audit teams to help them identify areas of risk and incorporate these into standard audit programmes.

5

Consider if recruiting (or transferring) climate specialists into the firm's audit function may be necessary, or whether further training is required for existing audit teams.

6

Remain alert for misstatements in annual accounts and other information included in (or excluded from) the annual report that may arise due to failure by management or directors to adequately consider climate risk.

7

Proactively discuss climate risk issues with Chief Financial Officers (CFOs) and audit committees and include details in relevant audit committee communications.

ClientEarth

Photo credit: Peter Heeling

Endnotes

1 PWC's annual director survey identifies that over 40% of company directors still do not believe that climate change should impact company strategy at all: PWC, 'Annual Corporate Directors Survey' (2017).

2 NASA, 'Global Temperature', https://climate.nasa.gov/vital-signs/global-temperature/ (accessed 14 August 2017); UK Met Office, 'Global climate in context as the world approaches 1°C above pre-industrial for the first time', (2015).

3 See Intergovernmental Panel on Climate Change, 'IPCC Fifth Assessment Report – Climate Change 2014: Synthesis Report' (2014); Christiana Figueres et al. 'Three Years to Safeguard our Climate', Nature (28 June 2017).

4 See Task Force on Climate-related Financial Disclosures, 'Final Report: Recommendations of the Task Force on Climate-related Financial Disclosures' (June 2017) (TCFD Final Report); Bank of England, 'The Bank of England's Response to Climate Change' (June 2017).

5 See Moody's, 'Oil and gas industry faces significant credit risks from carbon transition' (2017); Wood Mackenzie 'Positioning for the future: benchmark upstream corporate carbon emissions and value at risk' (2017); International Renewable Energy Agency, 'Stranded assets and renewables: How the energy transition affects the value of energy reserves, buildings and capital stock' (2017).

6 See, e.g., BlackRock, 'Our Engagement Priorities for 2017–2018' (2017); Aviva, 'Aviva's Strategic Response to Climate Risk'; Megan Bowman, 'Banking on climate change' (2015); Securities and Exchange Commission, 'Commission Guidance Regarding Disclosure Related to Climate Change' (2010); TCFD Final Report; Sustainable Insurance Forum, 'Leading Insurance Supervisors Support Adoption of Climate Disclosure Recommendations' (2017).

7 See Cambridge Institute for Sustainability Leadership, 'Unhedgeable risk: how climate change sentiment impacts investment' (2015); Simon Dietz et al., 'Climate value at risk of global financial assets', Nature: Climate Change (2016); G20 Green Finance Study Group, 'Enhancing environmental risk assessment in financial decision-making' (2017).

8 See World Business Council for Sustainable Development. 'Sustainability and enterprise risk management: The first step towards integration' (2017); See The B Team, 'Playing offence: Corporate boards as catalysts for climate action' (2016).

9 See TCFD Final Report, 17.

10 TCFD Final Report, 15.

11 TCFD Final Report, 2.

12 See, e.g., Lloyds of London, 'Stranded Assets: the transition to a low-carbon economy – Overview for the Insurance Industry' (2017).

13 Companies Act 2006, s 172.

14 Companies Act 2006, s 174.

15 Companies Act 2006, s 172(1).

16 See, e.g., United Nations Global Compact et al, 'Fiduciary Duty in the 21st Century' (2015) 9; Staker et al., 'Concerns misplaced: will compliance with the TCFD recommendations really expose companies and directors to liability risk? (2017); regarding similar issues discussed in an Australian law context, see Noel Hutley SC and Sebastian Hartford-Davis, 'Climate Change and Directors' Duties' (2016).

17 The standard of care against which directors are assessed under s 174 of the Companies Act 2006 includes a subjective and an objective limb. Industry and regulatory guidance may be relevant in determinations about the objective standard to be applied.

18 See, e.g., Baker McKenzie and UN Principles for Responsible Investment, 'Recommendations of the Task Force on Climate-related Financial Disclosures – review of local relevance: United Kingdom (2017), 4 – 5; see further Secretary of State for Trade and Industry v Baker (No 5) (Re Barings) (No 5) [1999] 1 BCLC 433, [489].

19 Companies Act 2006, s 170(1).

20 Companies Act 2006, s 260(3); see also further procedural requirements contained in Companies Act 2006, Part 11.

21 Companies Act 2006, s 178; an injunction is however unlikely to be available for a breach of the duty to exercise due care, skill and diligence under s 174; in certain circumstances shareholders may also be entitled to petition for relief for unfair prejudice under section 994 of the Companies Act 2006.

22 See Company Directors Disqualification Act 1986.

23 See FRC, 'FRC Response to BEIS Corporate Governance Reform Green Paper' (17 February 2017).

24 See, e.g., Baker McKenzie and UN Principles for Responsible Investment, 'Recommendations of the Task Force on Climate-related Financial Disclosures – review of local relevance: United Kingdom (2017).

25 Companies Act 2006, chap 4.

26 Companies Act 2006, chap 4A.

27 Companies Act 2006, chap 5; Large and Medium-sized Companies and Groups (Accounts and Reports) Regulations 2008 as amended by the Companies Act 2006 (Strategic Report and Directors' Report) Regulations 2013 (SI 2013/1970), sched 7; FCA Handbook DTR 7.2.1 and 7.2.9 (the DTR require listed companies subject to DTR 7.2 to include a corporate governance statement either in their directors' report or as a separate corporate governance statement); FRC, 'The UK Corporate Governance Code (2016), [C.2.2].

28 See Companies Act 2006, ss 394, 396 (unless the company is exempt from that requirement under section 394A); further requirements apply in relation to accounts for companies that are part of a group: Companies Act 2006, ss 399 – 408.

29 See Companies Act 2006, s 395; EU IAS Regulation, No 1606/2002.

30 Subject to the conditions in Companies Act 2006, s 395.

31 Companies Act 2006, s 393.

32 See FRC, 'True and Fair View' (June 2014); there does remain some contention about the exact content of the 'true and fair view' requirement: see further Martin Moore QC, 'The Financial Reporting Council: The True and Fair Requirement Revisited – Opinion (21 April 2008); George Bompas QC, 'International Financial Reporting Standards (Issues Arising in relation to the Companies Act 2006) – Opinion (8 April 2013); Martin Moore QC, 'The Financial Reporting Council: International Accounting Standards and the True and Fair View' (8 October 2013); George Bompas QC, 'International Financial Reporting Standards (Issues Arising in relation to the Companies Act 2006) – Further Opinion (14 August 2015).

ClientEarth

33 How accounting standards are applied in practice will be context-specific. These examples are provided by way of illustration only. See further: ICAEW, 'Environmental Issues and UK Annual Reporting' (2015).

34 See IAS 8, para 10(b); UK GAAP FRS 102, s 2; FRC, 'True and Fair View' (June 2014).

35 See TCFD Final Report, 9.

36 Companies Act 2006, ss 414; see also further offences under Theft Act 1968, ss 17–19, and the Financial Services and Markets Act ss 90A. In addition, both the Conduct Committee of the FRC and the Secretary of State for the Department of Business, Energy and Industrial Strategy (BEIS) also have the power to apply to the court for a declaration that accounts are defective and an order that revised accounts be prepared. Where this happens, the court is empowered to make a costs order against the directors personally, covering not just the court application but also the expenses incurred by the company in the preparation, audit and distribution of the revised accounts: see Companies Act 2006, s 456.

37 See Trevor & Anor v Whitworth & Anor (1887) 12 AC 409; Companies Act 2006, Part 23A.

38 See, e.g., Bairstow v Queens Moat Houses plc and Others ([2000] 1 BCLC 549); Companies Act 2006, s847(2).

39 Companies Act 2006, chap 4A.

40 Companies Act 2006, chap 5; Large and Medium-sized Companies and Groups (Accounts and Reports) Regulations 2008 as amended by the Companies Act 2006 (Strategic Report and Directors' Report) Regulations 2013 (SI 2013/1970), sched 7; FCA Handbook DTR 7.2.1 and 7.2.9 (the DTR require listed companies subject to DTR 7.2 to include a corporate governance statement either in their directors' report or as a separate corporate governance statement); FRC, 'The UK Corporate Governance Code (2016), [C.2.2].

41 Companies Act 2006, ss 414A–B.

42 Companies Act 2006, s 414C.

43 Companies Act 2006, s 414C(2).

44 Companies Act 2006, s 414C(7)(a).

45 Or explain why it has not included such information: Companies Act 2006, s 414C(7)(b).

46 Companies Act 2006, s 414(8)(a)–(b).

47 Companies Act 2006, ss 414CA.

48 Companies Act 2006, ss 414CB.

49 See Baker McKenzie and UN Principles for Responsible Investment, 'Recommendations of the Task Force on Climate-related Financial Disclosures – review of local relevance: United Kingdom (2017), 3.

50 FRC, 'FRC Consults on Non-financial Reporting Guidance' (15 August 2017).

51 Directors commit a criminal offence where they approve a strategic report, and knew that it was noncompliant with the requirements under the Act, or were reckless as to whether it was compliant: Companies Act 2006, s 414D(2); see also Theft Act 1968, ss 17–19.

52 See Companies Act 2006, s 463: a director will only be liable under this section if the director knew the relevant statement to be untrue or misleading or was reckless as to whether it was untrue or misleading, or knew the omission to be dishonest concealment of a material fact.

53 FRC, 'UK Corporate Governance Statement' (2016), [C.2.2].

54 FRC, 'UK Corporate Governance Statement' (2016), [C.2.2].

55 See FRC, 'Guidance on Risk Management, Internal Control and Related Financial and Business Reporting' (2014).

56 See Sarasin and Partners and ClientEarth, 'Investors expect fossil fuel companies viability statements to address climate risk' (29 January 2016).

57 FCA Handbook DTR 7.2.1 and 7.2.9.

58 See, e.g., TCFD, 'Statement of Support and Supporting Companies' (June 2017).

59 According to a recent KPMG report, in 2017, 72% of companies globally did not disclose climate risk in their annual reports and fewer than 2% quantified the financial impacts: KPMG, 'The Road Ahead: Survey of Corporate Responsibility Reporting' (2017).

60 Companies Act 2006, s 475.

61 See Companies Act 2006, ss 485 (private companies); s 489 (public companies); exceptions apply to: small companies (s 477); dormant companies (s 480); some group companies (s 479); some subsidiaries (s 479A); and some not-for-profit companies (s 482).

62 Companies Act, ss 393(2), 495(3).

63 SATCAR, reg 4(1); UK auditing standards are based on international standards on auditing (ISAs) and are designated as ISAs (UK and Ireland). They are generally very close to international standards, which are issued by the International Auditing and Assurance Standards Board (IAASB), but with some additions and variations to deal with UK law and regulation.

64 International Standard on Auditing (UK) 200, [11].

65 International Standard on Auditing (UK) 200, [15]–[16].

66 See, e.g., International Standard on Auditing (UK) 700 [13(c)]).

67 Companies Act 2006, ss 496, 497A.

68 Companies Act 2006, s 496.

69 Or describe the nature of any misstatements identified: Companies Act 2006, ss 496, 497A.

70 Financial Reporting Council, 'Guidance on the Strategic Report' (2014) (currently under review).

71 See TCFD Final Report.

72 See International Standard on Auditing (UK) 720 (Revised June 2016).

73 See, e.g., Bank of England, 'The Bank of England's Response to Climate Change' (June 2017).

74 See, e.g., ClientEarth, 'Climate risk and regulators: an investor's guide' (September 2016).

75 SATCAR, reg 3; see also FRC Audit Enforcement Procedure (1 June 2016).

76 FRC, 'Conduct Committee Guidance: Thresholds/Guidance for referral for investigation' (17 June 2016); FRC Audit Enforcement Procedure (1 June 2016), [6], [9]–[10].

77 FRC Audit Enforcement Procedure (1 June 2016), Part 5.

78 See further, FRC, 'Speech by Stephen Haddrill – Audit Since The Financial Crisis' (25 October 2017).

79 See, Peter Seley, 'Emerging Trends in Climate Change Litigation', Law 360, March 7, 2016; TCFD Final Report, 5.

80 Jackson and Powell on Professional Liability (8th Ed, 2017) [17–008].

81 Caparo Industries v Dickman [1990] 2 WLR 358.

82 Bilta (UK) Ltd v Nazir (No 2) [2016] AC 1; see further Insolvency Act 1986, s 214.

83 See Jackson & Powell on Professional Liability (8th Ed, 2017), [17–008], [17–048}–[17–084]: as the law is currently stated, whether or not a duty is owed to a third party will generally depend on whether or not the auditor has undertaken a specific responsibility to that party—this has been held not to include a general duty towards individual shareholders or future investors: Caparo Industries v Dickman [1990] 2 WLR 358. In light of the evolving nature and purpose of audit, this interpretation may be subject to challenge in the near future.

84 Re Kingston Cotton Mill Co No.2 (1896) 2 Ch. 279 CA.

85 Jackson & Powell on Professional Liability (8th Ed, 2017) [17–090].

86 Jackson & Powell on Professional Liability (8th Ed, 2017) [17–090].

87 See, e.g., AIG, 'Rise of the European shareholder class action?' (2016); Herbert Smith Freehills, 'UK Class Action Market Heating up in 2016' (2016).

88 Wall Street Journal, 'SEC Probes Exxon Over Accounting for Climate Change' (20 September 2016); Reuters, 'Knives out for auditors as class actions go global' (21 March 2013) (not climate-related).

'89 Companies Act 2006, s 507(4).

90 EU Audit Regulation (537/2014), art 12.

91 ClientEarth, '98 percent vote for climate change resolution at BP AGM' (16 April 2015), https://www.clientearth.org/98-vote-for-climate-change-resolution-at-bp-agm/

92 ClientEarth, 'Shell follows BP with climate change resolution' (19 May 2015), https://www.clientearth.org/shell-follows-bp-with-climate-change-resolution/

93 ClientEarth, 'Rio Tinto board backs climate resolution' (3 March 2016), https://www.clientearth.org/riotinto-board-backs-climate-resolution/

94 Church of England, 'Aiming for A climate change resolution overwhelmingly approved by Glencore shareholders' (19 May 2016).

95 ClientEarth, 'Mining giant Anglo American backs climate change resolutions' (14 March 2016) https://www.clientearth.org/mining-giant-anglo-american-backs-climate-change-resolutions/

96 Church of England, 'BP, Special resolution: strategic resilience for 2035 and beyond' (April 2015) https://www.churchofengland.org/media/2125554/bp%20resolution%20and%20statement.pdf

97 Ceres, 'ExxonMobil Investors Make History with Majority Vote on Climate Risk Disclosure' (31 May 2017) https://www.ceres.org/news-center/press-releases/exxonmobil-investors-make-history-majority-voteclimate-risk-disclosure

98 BlackRock, 'Our engagement priorities for 2017–2018', https://www.blackrock.com/corporate/en-gb/aboutus/investment-stewardship/engagement-priorities; Reuters, 'Vanguard seeks corporate disclosure on risks from climate change' (14 August 2017).

99 ClientEarth, 'Bullish forecasts create liability risk, ClientEarth warns fossil fuel giants' (22 May 2017). https://www.clientearth.org/bullish-forecasts-create-liability-risk-clientearth-warns-fossil-fuel-giants/

100 Companies Act 2006, ss 489(4), 510; but see, ss 488(3) and 490.

101 Companies Act, s 527(1)(a).

Notes

Notes

ClientEarth is Europe's leading environmental law organisation.

We are lawyers working at the interface of law, science and policy. Using the power of the law, we develop legal strategies and tools to address major environmental issues.

ClientEarth is funded by the generous support of philanthropic foundations, institutional donors and engaged individuals.

Brussels
60 Rue du Trône (Box 11)
Ixelles
Brussels
1050
t +32 (0)2 808 34 65

London
Fieldworks
274 Richmond Road
London E8 3QW
United Kingdom
t +44 (0)20 7749 5970

Warsaw
Żurawia 45
(staircase B, 2nd floor)
00-680 Warsaw
Poland
t +48 22 3070190

www.clientearth.org

ClientEarth