PwC's fall ESG webcast series –

Accounting and disclosure in the financial statements and SEC filings

October 21, 2021

Common net zero strategies

Reduce

- Capital projects to improve efficiency, cost, and effectiveness of operations to reduce emissions
- Examples:
  - Electrification
  - Going “green” (buying renewable energy)

Absorb

- New technology to absorb emissions that cannot be reduced
- Examples:
  - Carbon sequestration
  - Carbon storage

Offset

- Offset emissions that cannot be reduced or absorbed
- Examples:
  - Renewable energy credits (RECs)
  - Carbon offset programs from reforestation, carbon capture, methane abatement

Carbon offsets vs. emissions allowances

Carbon offsets

- A reduction of one ton of carbon dioxide or greenhouse gas emission from a verified offset program
- Examples
  - Carbon sequestration
  - Reforestation

Emission allowances

- Also called carbon credits
- Legal right to emit one ton of carbon dioxide or greenhouse gas
- Does not incrementally reduce amount of emissions an entity emits
- Generally used to meet regulatory compliance requirements

Renewable energy credits (RECs)

What are they?

- Certificates created for each megawatt hour of electricity that is generated from a renewable energy resource

How are they acquired?

- Direct purchase (standalone REC purchase)
- Power purchase agreements
- Can be acquired on a voluntary basis or to meet compliance requirements

Power purchase agreements for RECs

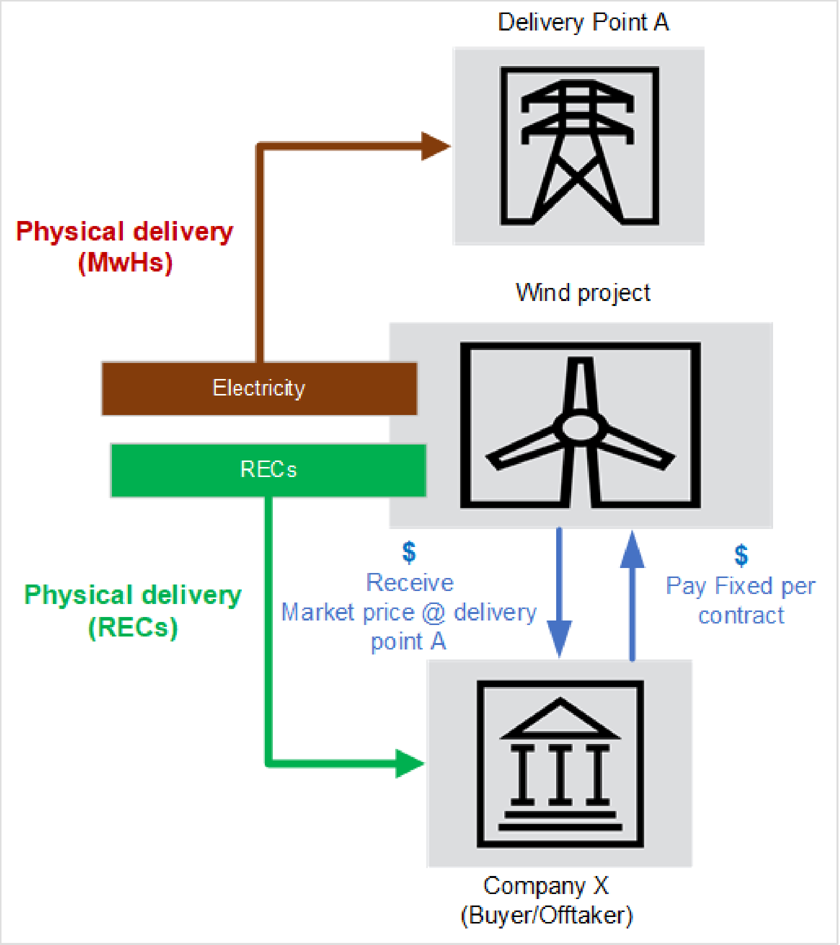
Benefits to buyer and seller

Seller

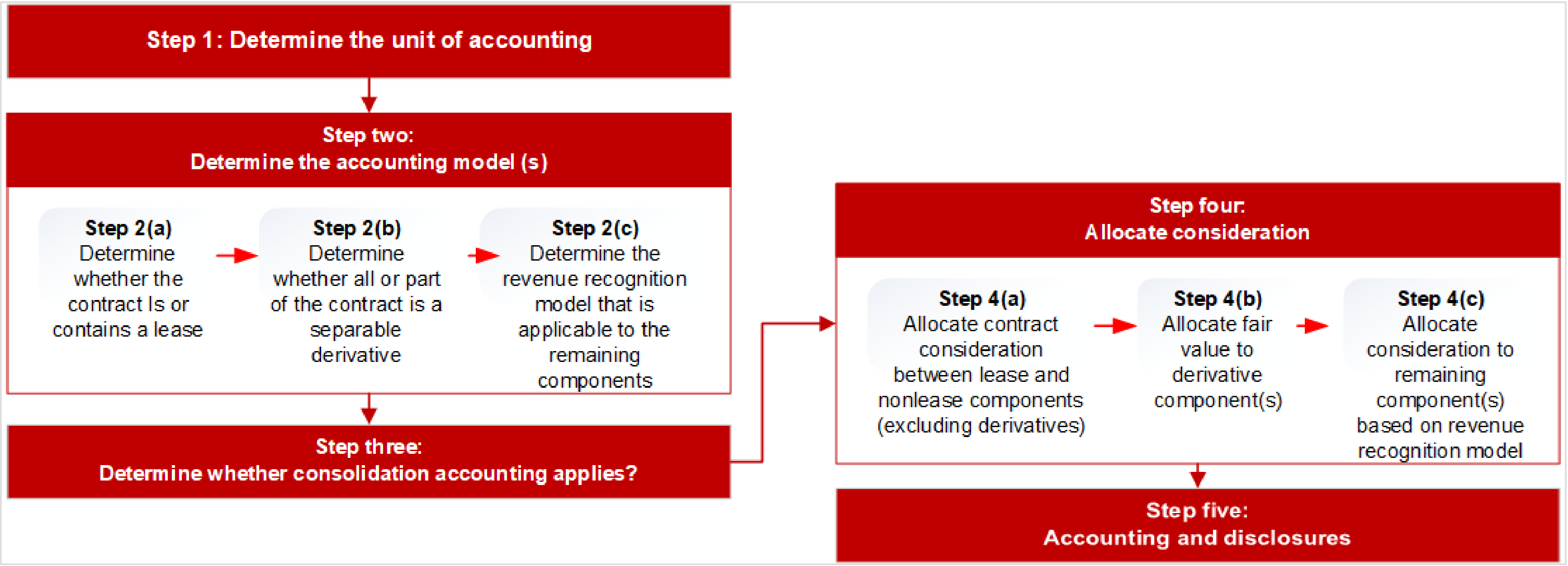
- Secures long term fixed pricing for energy produced
- Often required to finance investment in facility
- Eliminates exposure to market pricing for renewable energy at delivery point

Buyer

- Flexibility to receive “green” physical power (if close to delivery point) or not (virtual PPA)
- Receives RECs based on generated power
- Uses RECs to offset energy usage from non-renewable sources



Commodity contract accounting framework



Commodity contract accounting framework (continued)

Step two: Determine the accounting model(s)

Lease

- Definition of a lease
  1. Specified asset
  2. Control
     a. Substantially all of the economic benefits and,
     b. Direct the use of the asset

Derivative

- Definition of a derivative
  a. Underlying/Notional amount
  b. No initial net investment
  c. Net settlement

Consolidation

- Variable interest
- Variable interest entity
- Primary beneficiary determination

Environmental attributes – Standard setting timeline

November 2003:
FASB exposes EITF 03-14, Participant's accounting for emission allowances under a 'Cap and trade' scheme (subsequently removed from EITF agenda)

December 2004:
IFRIC issues IFRIC Interpretation 3, Emission Rights (IFRIC 3)

June 2005:
IASB withdraws IFRIC 3

September 2005:
IASB adds project on emission allowances (deferred in February 2006)

February 2007:
FASB adds new project

October 2008:
FASB and IASB begin joint project on emission allowances and other environmental attributes

April 2009:
IASB tentative decisions on classification and measurement; FASB defers decisions

November 2010:
FASB and IASB defer joint project

2014:
Emissions project officially removed from FASB agenda

February 2015:
IASB changes scope of project - no decisions reached

2021:
FASB and IASB extend Invitation to comment on technical agenda
- Specifically highlight accounting for emissions allowances, renewable energy credits, and pollutant pricing mechanisms

Sample SEC comments

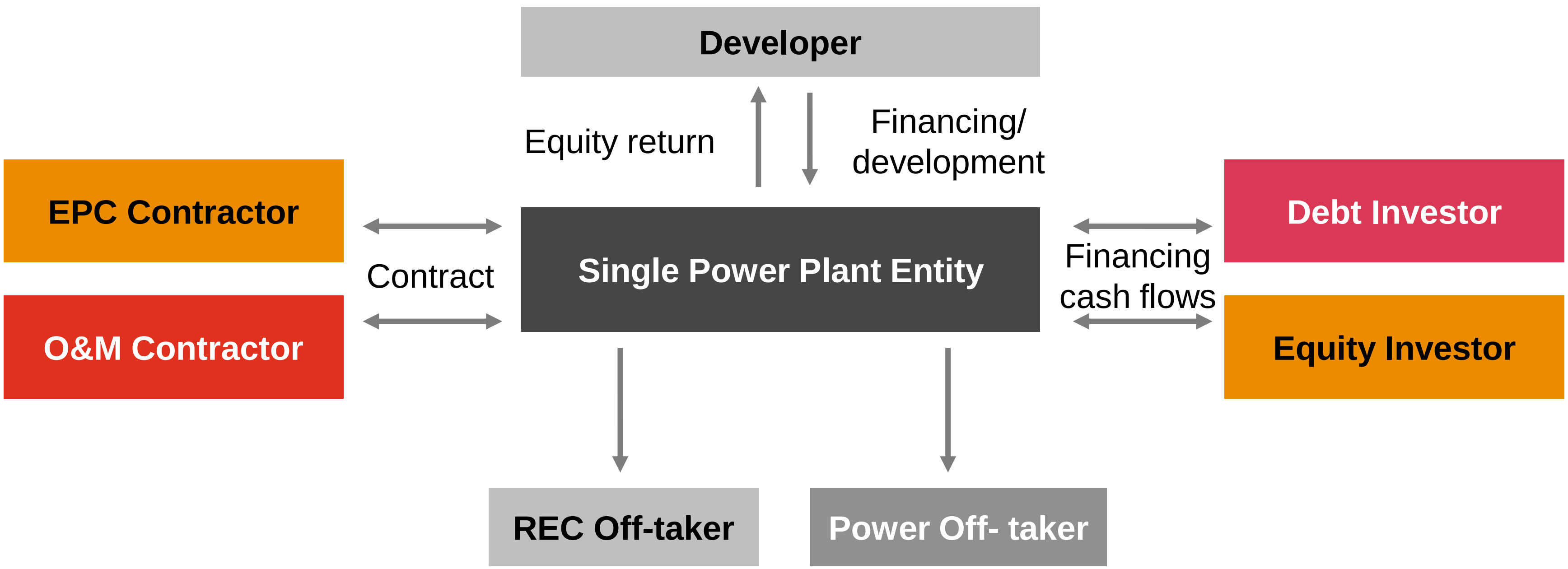
Please tell us how you account for purchased renewable energy credits. Please ensure your response also addresses renewable energy credits that are bundled with energy and those that are associated with purchased power contracts. In addition, please tell us your consideration of disclosing your accounting policies for renewable energy credits.

Please summarize for us your accounting basis for the classification of renewable energy credits as intangible assets. As part of your response, please tell us whether the renewable energy credits are held for use or held for sale.

Please explain to us and disclose your accounting for renewable energy credits (RECs) citing any authoritative accounting guidance or predominant practice. Please include in your response, when and how you determine the amounts recorded, where you classify the related amounts in your financial statements including the sales of these credits, the method by which you derecognize the RECs from your financial statements, and the RECs amounts recorded for the historical periods presented.

Please tell us how you account for emission allowances under US GAAP and the authoritative accounting literature supporting your accounting.

Common renewable energy project structure

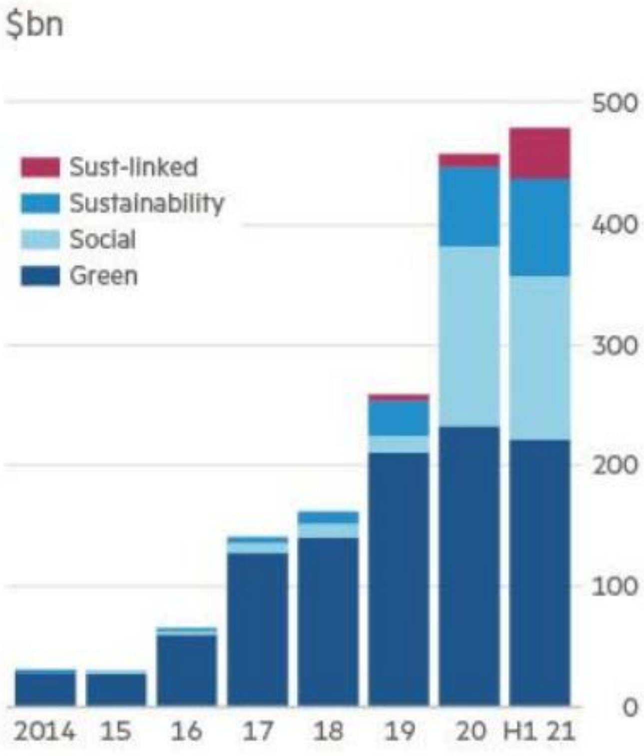


Additional information:

- PwC's Utilities guide: Section 9.4

ESG related bond issuances

ESG-related bond issuances by year



* Figures include sovereigns, supranationals, government agencies, local authorities, corporates, financials
Source: The Numbers
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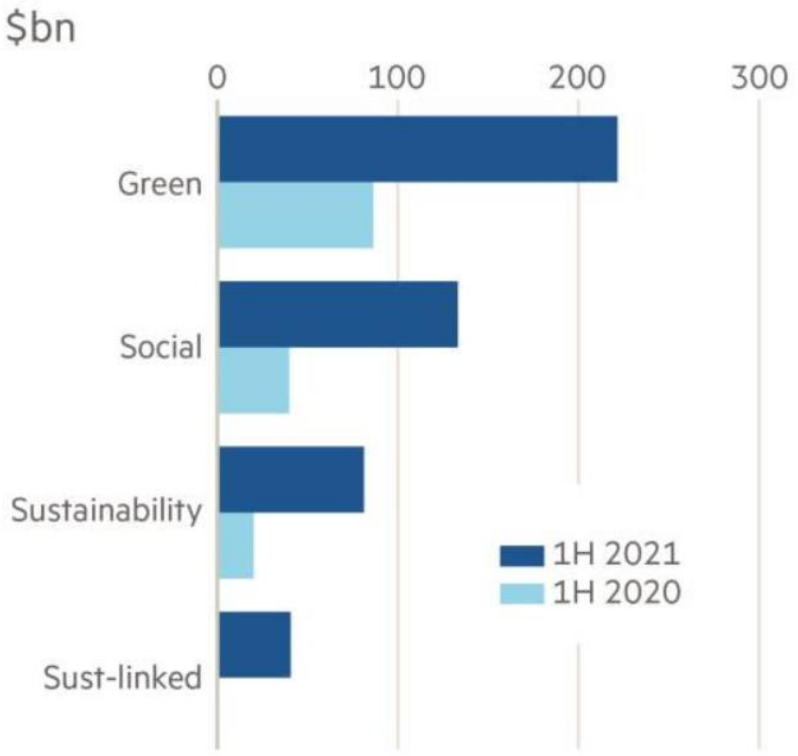
ESG-related bond issuance growth compared to 2020



Figures include sovereigns, supranationals, government agencies, local authorities, corporates, financials
Sources: BofA Global Research estimates; Bloomberg
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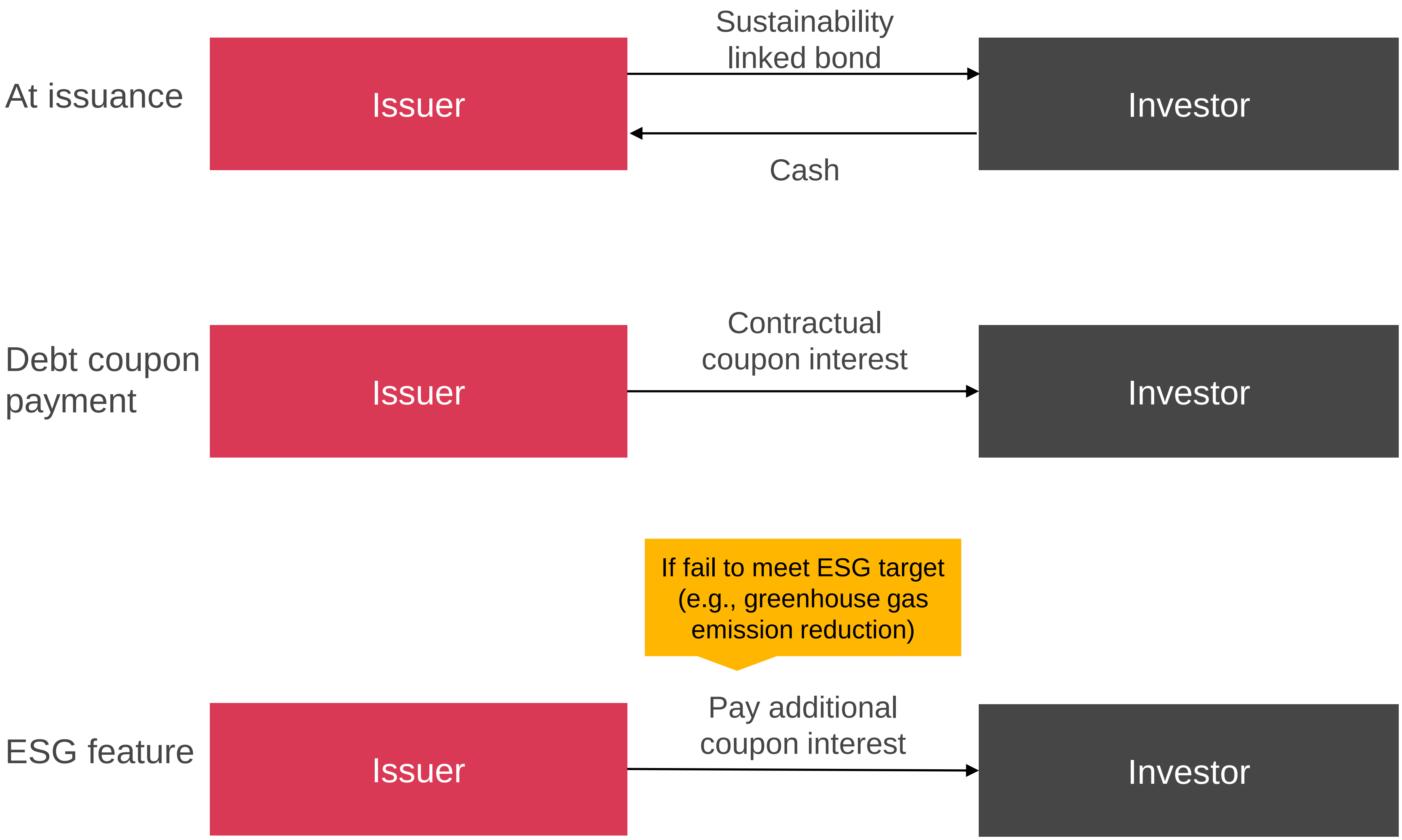
Cash flows of a sustainability linked bond



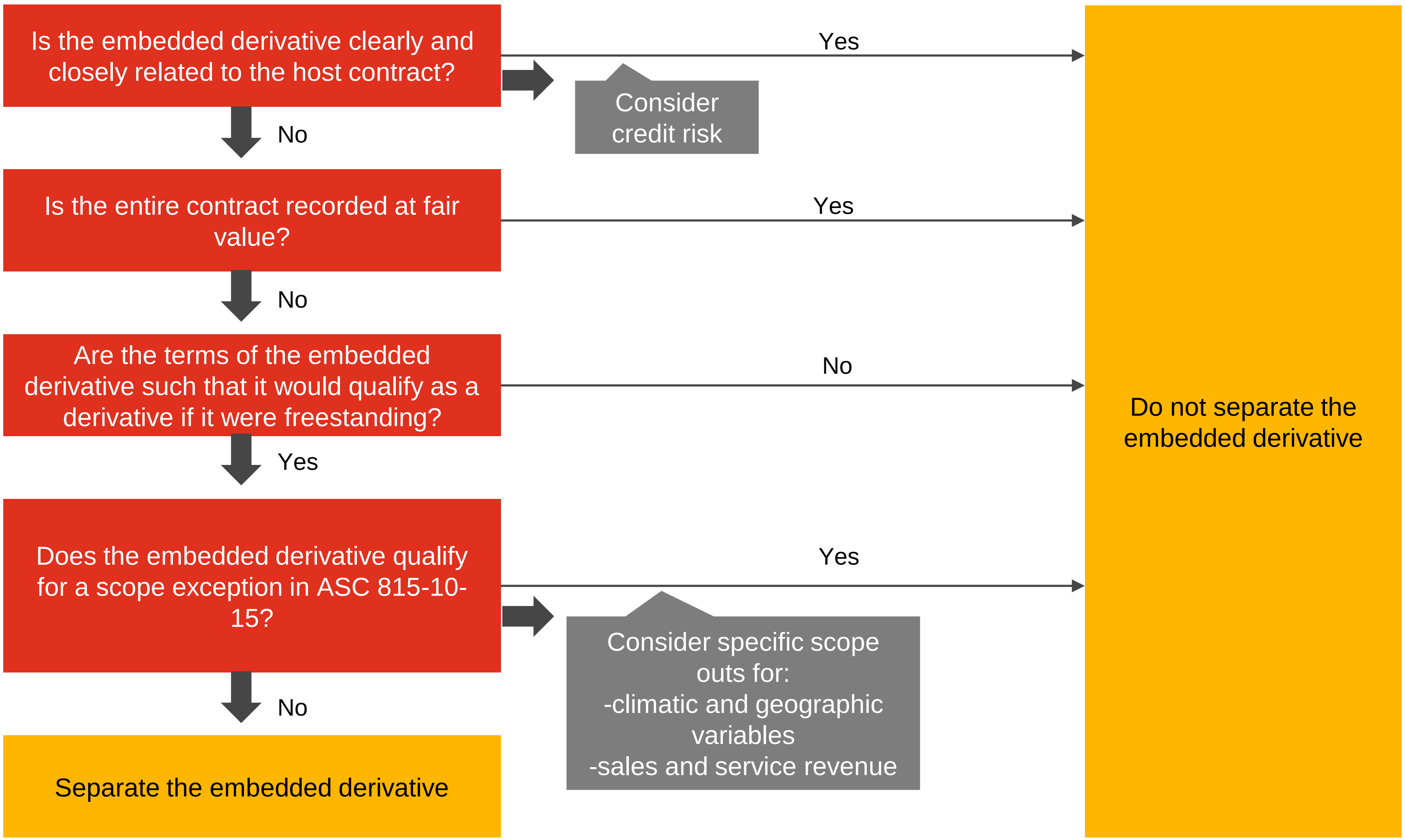
Example ESG-linked loans/debt instruments

- Rate linked to company’s previously-announced climate goals
  – Achieving 50% reduction of absolute greenhouse gas (GHG) emissions by 2025 and reaching net-zero GHG emissions by 2050
  – Failure to meet targets = +25 basis points interest

- Rate linked to targets on expanding access to innovative medicines and addressing key global health challenges
  – Failure to meet targets = +25 basis points interest

- Rate linked to key performance measures
  – Reducing greenhouse gas emissions from and increasing the % of renewable electricity consumed by manufacturing plants
  – Lowering CO_2 tailpipe emissions per passenger vehicle
  – Performance against metrics = increases/decreases costs on credit facility

Evaluating embedded derivatives in a host contract



Intersection of ESG matters with financial accounting standards

FASB Staff Education **Paper** issued in March 2021

IASB Staff Education **Paper** issued in November 2020

Topics addressed in one or both of the education papers:

- Going concern
- Risks and uncertainties
- Inventory
- Intangibles/Goodwill
- PP&E
- Asset retirement obligations
- Environmental obligations
- Gain/Loss contingencies
- Income taxes
- Fair value
- Climate-linked financial instruments
- Insurance contracts

When to test long-lived assets that are held and used for impairment

Impairment indicators or triggering events

- Decrease in the market price
- Change in how the asset is being used or its condition
- Change in legal factors, business climate, or actions by a regulator
- Costs above what was originally expected
- Current, historical or projected operating or cash flow information that demonstrates continued losses associated with the asset
- Expectation that a long-lived asset will be sold or disposed of before the end of its useful life

Additional information:

- PwC's PP&E Guide: Section 5.2
- Podcast: COVID-19: Accounting for goodwill and other impairments

Long-lived assets– Potential ESG impairment considerations

Potential impairment indicators:

- Material decline in market demand for products
- Shift to new technologies
- Change in regulation that adversely affects a company
- Updates to make manufacturing “greener”
- Increased energy costs
- Supply chain changes

Measurement of impairment loss:

- Market participant assumptions used to calculate the fair value of the asset group can be impacted

Long-lived asset impairment disclosure requirements

- Description of the impaired long-lived asset (asset group)
- Facts and circumstances leading to the impairment
- If not separately presented on the face of the statement, the amount of the impairment loss and the caption in the income statement or the statement of activities that includes that loss
- Method(s) for determining fair value
- If applicable, the segment in which the impaired long-lived asset (asset group) is reported

Additional information:

- PwC's Financial statement presentation guide: Section 8.6.1
- Podcast: Full disclosure: PPE, inventory, intangibles and goodwill

Interim impairment triggers for goodwill and indefinite-lived intangible assets

Example events and circumstances

- Macroeconomic conditions
- Industry and market considerations
- Cost factors
- Overall financial performance
- Relevant entity-specific events
  - Changes in management, key personnel, strategy, or customers
  - Litigation
- If applicable, legal, regulatory, contractual, political, business, or other (including asset-specific) factors
- If applicable, a sustained decrease in share price
- If applicable, events affecting a reporting unit, such as other impairments or changes in the composition or carrying amount of the net assets

Additional information:

- PwC's Business combinations guide: Section 8.3
- Podcast: COVID-19: Accounting for goodwill and other impairments
- Podcast: COVID-19: Impairment valuation questions, answered

Goodwill/Intangibles – Potential ESG impairment considerations

Potential impairment indicators:

- Material decline in demand
- Increased competitive environment
- Expected changes in distribution channels or cost factors
- Changes in regulations
- Decision to deemphasize or exit certain businesses/ product lines

Measurement of impairment loss:

- Market participant assumptions used to calculate the fair value of the reporting unit (goodwill) or the fair value of the indefinite-lived intangible asset can be impacted

Goodwill/Intangibles – Impairment loss disclosures

- Description of the impaired intangible asset
- Factors and circumstances leading to the impairment
- Amount of the impairment loss and method of determining fair value
- Caption in the income statement or the statement of activities in which the impairment losses are aggregated
- Segment in which the impaired intangible asset is located (if applicable)

Additional information:

- PwC's Financial statement presentation guide: Section 8.8.1
- Podcast: Full disclosure: PPE, inventory, intangibles and goodwill

SEC's existing climate-related disclosure considerations

- In February 2010, the SEC published an interpretive release to provide guidance to public companies regarding the Commission's existing disclosure requirements as they apply to climate change related risk.
- The SEC viewed S-K Items 101 (Description of Business), 103 (Legal Proceedings), 105/503c (Risk Factors), and 303 as potentially applicable to climate-change related disclosures.
- Depending on its particular facts and circumstances, registrants should evaluate the following topics that highlight some ways climate change may trigger disclosure required by these rules and regulations:

1 Impacts of legislation and regulation (e.g., greenhouse gas emissions laws)

2 Impacts of treaties or international accords

3 Legal, technical, political and scientific developments may present new opportunities or risks

4 Physical impacts of climate change

Additional information:

- Interpretation: Commission Guidance Regarding Disclosure Related to Climate Change
- In the Loop - Don't wait until the SEC staff asks you about climate change

Climate change disclosures sample comments

General

- We note that you provided more expansive disclosure in your corporate social responsibility report (CSR report) than you provided in your SEC filings. Please advise us what consideration you gave to providing the same type of climate-related disclosure in your SEC filings as you provided in your CSR report.

Risk Factors

- Disclose the material effects of transition risks related to climate change that may affect your business, financial condition, and results of operations, such as policy and regulatory changes that could impose operational and compliance burdens, market trends that may alter business opportunities, credit risks, or technological changes.
- Disclose any material litigation risks related to climate change and explain the potential impact to the company.

Additional information:

- SEC - Sample Letter to Companies Regarding Climate Change Disclosures

Climate change disclosures sample comments (continued)

MD&A

- There have been significant developments in federal and state legislation and regulation and international accords regarding climate change that you have not discussed in your filing. Please revise your disclosure to identify material pending or existing climate change-related legislation, regulations, and international accords and describe any material effect on your business, financial condition, and results of operations.
- Revise your disclosure to identify any material past and/or future capital expenditures for climate-related projects. If material, please quantify these expenditures.
- To the extent material, discuss the indirect consequences of climate-related regulation or business trends
- If material, discuss the physical effects of climate change on your operations and results.
- Quantify any material increased compliance costs related to climate change.
- If material, provide disclosure about your purchase or sale of carbon credits or offsets and any material effects on your business, financial condition, and results of operations.

Additional information:

- SEC - Sample Letter to Companies Regarding Climate Change Disclosures pwc.com

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