Sustainable Cost Accounting
The Short Guide

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Background

The Bank of England has suggested that US$20 trillion (£16 trillion) of the world's financial assets might be at risk from climate change[i]. Despite this the world's accounting standards setters have not, as yet, tackled this issue. That task has instead fallen to the Bank of International Settlements promoted Task Force on Climate-related Financial Disclosures (TCFD) who have suggested 'voluntary, consistent climate- related financial disclosures that would be useful to investors, lenders, and insurance underwriters in understanding material risks.'

The Corporate Accountability Network[ii] (CAN) thinks that this approach is inadequate for three reasons. First, it is too important to be considered outside the framework for financial accounting, which the TCFD necessarily does. Second, it is too significant to be left to voluntary disclosure. And, third, whether or not companies are carbon net neutral is of interest to a much wider range of stakeholders than the TCF approach addresses. As a result the Corporate Accountability Network thinks that a different approach is required.

Sustainable Cost Accounting

The Corporate Accountability Network suggests that a mandatory approach to climate change accounting is required. It calls its proposed approach sustainable cost accounting (SCA). To achieve the goal of mandatory reporting SCA would have to be an accounting standard akin to, or actually, an International Financial Reporting Standard.

The essence of sustainable cost accounting is simple. It would require that every large business prepare a plan to show how it would manage the consequences of climate change. That plan would have to state how it might become net carbon-neutral by a specified date, both within its own business and within its supply chain.

The plan would have to be specific as to what the business must do to achieve this goal, or alternatively state that this is not yet known. A precautionary principle would apply: in other words, the plan could only rely upon those technologies now known to exist and that have been proven to work. In addition, the plan would have to show where the impact of the changes would arise geographically: it would be unacceptable to solve the problem in some countries and not others, or to export carbon risk to developing countries.

That plan would then have to be costed. The requirement of sustainable cost accounting would then be that the full cost of the change to being a net-zero carbon emitter should be provided for in the accounts of the companies to which sustainable cost accounting would apply at the time that it was adopted, which could be by 2022 if sufficient urgency was applied to this task. Annual reappraisal would then be required thereafter to show progress.

If the inclusion of this cost in the accounts of a company resulted in it being shown to be insolvent then the company would have to address that issue so that their solvency might be restored. For example, it could end dividend payments to shareholders and retain profits over time to fund the change to being net carbon-neutral. Alternatively, solvency could be achieved by raising additional capital. In either case the plan would have to be deemed credible by the company's auditors. We stress: we think that all the sustainable cost accounting data would require financial audit since the intention is to include it in financial statements.

And, if a company could not show how it could fund the cost of the transition, or it could not estimate the cost of completing that process, or it concluded that it simply could not make the transition, then it is suggested that it would have to be declared 'carbon insolvent'. This would not mean that it was financially bankrupt. But it would make clear that the company was not going to survive into the era that we are going to have to live in. As a result an orderly winding up of its affairs would be required, and carbon insolvency administrators would have to be appointed to achieve that goal. But it is stressed: this is not about an immediate winding up of the reporting entity's affairs: it is instead about managing an orderly transition for all involved including, most especially, its employees.

The benefits of sustainable cost accounting

Sustainable cost accounting will achieve four goals. It will bring the biggest issue facing companies today into financial reporting. As such it will make clear which businesses can and cannot survive into an era of sustainability. It will as a result redirect capital to those best able to use it. And by providing data geographically it will enable all the stakeholders[iii] of a business to plan their future relationships with the companies with which they engage.

Sustainable cost accounting is the accounting for the climate crisis that we now need. In comparison there is no other issue more important in accounting.

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[i] https://www.theguardian.com/environment/2019/apr/17/mark-carney-tells-global-banks-they-cannot-ignore-climate-change-dangers

[ii] The Corporate Accountability Network can be contacted at 33 Kingsley Walk, Ely, Cambridgeshire, CB6 3BZ, and via its website www.corporateaccountabilitynet.work Registered at the above address. Registered number 11791864

[iii] The CAN explains its understanding of who the stakehoidlers of a reporting entity are here http://www.corporateaccountabilitynet.work/what-we-are-about/stakeholders/