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Accounting for Climate Change

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Incomplete accounting for costs is driving climate change and imperiling us all. Economist Arthur C. Pigou was far ahead of his colleagues in the 1920s when he pointed out that the “market” would fail unless it included all costs. Pigou’s discussion of external (or uncounted) costs was about damage caused by wild fires started by sparks from locomotives (Pigou, 1929). Today wildfires caused by equipment failures of utility companies lead to catastrophic wildfires. In 2018 for example, Pacific Gas and Electric equipment apparently started the Camp Fire that destroyed the town of Paradise, cost 85 lives and led to $17 billion dollars in damage. These may be “external” costs—but they are very real and someone does pay them.

External social and environmental costs are ignored by most markets and economists who consider only a small subset of the total cost (and value) in most transactions (Bainbridge, 2008). Too often economists are not troubled by these limitations and rarely acknowledge their existence in page after page of equations and functions describing how the economy theoretically should work. Their work often falls into the category my mentor, Professor Tod Neubauer, called “precisely wrong.” They are considering only a small subset of the market, so although their work is very precise it is commonly environmentally ignorant and socially bankrupt.

When proper accounting is done and total costs are known or estimated, many current transactions would not occur and we would face a much more hopeful future. The COP26 Climate meeting in Glasgow provided little except more words, but accountants, NGOs, and corporations are taking steps toward true cost accounting. Thousands of companies have now completed Global Reporting Initiative reports and the staff at GRI have worked hard with stakeholders to improve the value of this kind of reporting.

The International Sustainability Standards Board (ISSB) will be developing a comprehensive global baseline of high-quality sustainability disclosure standards to meet investors’ in-

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formation needs. The International Financial Reporting Standards Foundation will complete consolidation of the Climate Disclosure Standards Board (CDSB) and the Value Reporting Foundation (VRF) (www.valuereportingfoundation.org) in 2022. This will lead to the publication of prototype climate and general disclosure requirements developed by the Technical Readiness Working Group. These prototypes are the result of six months of joint work by representatives of the CDSB, the International Accounting Standards Board (IASB), the Financial Stability Board (www.fsb.org) Task Force on Climate-related Financial Disclosures, the VRF and the World Economic Forum. This work has been supported by the International Organization of Securities Commissions (IOSCO) and its Technical Expert Group of securities regulators. These developments will help lay the technical groundwork for a global sustainability disclosure standard-for the financial markets and a baby step toward true cost accounting. The ISSB will work in close cooperation with the IASB, ensuring connectivity and compatibility between IFRS Accounting Standards and the ISSB's standards—IFRS Sustainability Disclosure Standards.

Corporations need to rise to the challenge because the government clearly cannot. Here there is hope. The non-profit B Lab provides the framework for more than 3,500 B Corporations that balance profit and purpose for a sustainable future (https://bcorporation.net/about-b-corps). They are in many ways the opposite of Milton Friedman's "for profit only" corporation. They meet high standards of verified social and environmental performance, public transparency, and legal accountability.

The estimated uncounted cost of climate change gas emissions has been rising steadily. Four countries have been willing to establish and sustain substantial fees for CCG. Sweden leads the way at $137.50 ton CO2e (Ministry of Finance, 2021). Sweden has demonstrated that a climate change impact fee can be implemented and administered, at low costs to authorities and the public. Their carbon tax started at € 23 per ton in 1991 and has risen to € $137.50 in 2021. By increasing the tax level gradually and in a stepwise manner, households and businesses have been given time to adapt. The money is not earmarked and goes into the general fund. The emission fee has helped Sweden to a 17% decline in CCG emissions from 1990-2017, while GDP grew 78% Right wing and rural voters in Switzerland narrowly defeated a more aggressive CCG fee — but on September 26, 2021 the voters in the Swiss canton of Bern approved a binding constitutional demand for carbon neutrality by 2050 with a vote of 63.9% of the people.

A Climate Change Gas emission fee comparable to Sweden's could eliminate income taxes for all Americans earning less than $100,000 a year. Until the government manages to understand and implement true cost accounting I would challenge the companies of the world to voluntarily tithe a $50 or $100 ton CO2e fee to support the work of the sustainability

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accounting NGOs. Swiss Re provides reinsurance for insurance companies and is very clear about the risks if we do not act. They have assessed an internal climate change emission fee of $100 ton that will rise to $250 by 2030.

More than 2,000 corporations have reported to the climate not-for-profit CDP that they use or soon will adopt an internal price to cut emissions from their operations (Silver, 2021). These companies, with a combined market capitalization of $27 trillion, include 226 of the largest 500 global companies as measured by the FTSE Global All Cap Index. These companies are on the right path to TCA. This all comes at a good time for the accounting profession in the US and abroad. European accountants have been much more engaged, but the American Institute for CPA's is paying attention. AICPA supports the Security and Exchange Commissions effort to consider more detailed climate-related disclosures disclosures aligned with the Task Force of Climate Related Financial Disclosures (TCFD), Sustainability Accounting Standards Board (SASB) standards, and emerging international developments, in particular, the formation of the IFRS Foundation International Sustainability Standards Board (ISSB).

Change is coming. Baby steps but big! True cost accounting can make the difference in meeting the challenge of climate change.

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IFRS Foundation announces International Sustainability Standards Board, consolidation with CDSB and VRF, and publication of prototype disclosure requirements, November 3, 2021.https://www.ifrs.org/news-and-events/news/2021/11/ifrs-foundation-announces-issb-consolidation-with-cdsb-vrf-publication-of-prototypes/

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