



# GUIDANCE PAPER

July 2021

## RESPONSIBILITIES OF GOVERNING BODIES IN RESPONDING TO CLIMATE CHANGE

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## Executive Summary

The Guidance has been prepared to assist Governing Bodies to respond to climate change and to take the required action. While the guidance covers climate change only, it should be considered in the wider Environmental, Sustainability and Governance (ESG) arena and in the context of the King IV Report on Corporate Governance for South Africa (King Report).

Given the urgency for Governing Bodies to respond to the potential impacts of climate change, both positive and negative, the guidance highlights the more important matters which need to be considered by Governing Bodies. These matters are discussed under the headings of Leadership, Organisational Strategy, Risks and Opportunities, Management and Accountability Systems, Internalisation of Externalities, Reporting/Disclosure Considerations, Assurance on Disclosures and Legal Considerations. Examples and suggested practices are provided in Appendix 1.

Appendix 2 contains a list of available reporting frameworks which can be referred to in the absence of a common framework and Appendix 3 contains a Glossary of Terms.

The following matters summarise the main principles contained in the guidance which Governing Bodies should be aware of:

- Organisations are exposed to risks arising from climate change, particularly physical risk and transition risk. How the organisation experiences these risks depends on firstly, how these risks materialize and secondly, what actions are taken to mitigate them. Physical risk arises from the impacts of climate change. The response from Governing Bodies will mitigate or potentially lessen the risks, but the risks arise regardless. Transition risk arises outside the organisation.
- Governing Bodies have a critical role to play in responding to climate change which is an imperative and no longer optional.
- Governing Bodies must ensure that business strategy and decision-making include a broader, integrated consideration of social, economic, and environmental (including climate change) performance and impacts. This incorporates an assessment of externalities (see below), as well as determining risks and opportunities for both the short and long term.
- Insofar as environmental and climate change reporting and performance is concerned, Governing Bodies should consider the principle of 'externalities'. In simple terms, externalities<sup>1</sup> refer to societal costs not included in the cost of production resulting in costs that do not reflect the true impact on society or the environment.<sup>2</sup>
- While accountability remains with the Governing Body, responsibility for the management and monitoring of risk and impact must be delegated to management with defined indicators and targets to measure and assess performance.
- Governing Bodies should make every effort to mitigate their organisations' contribution to climate change (reduce the organisation's impact on the drivers of climate change).
- The Governing Body should ensure that the organisation is transparent about its response to climate change and disclose quantitative and qualitative information which could affect a user's decisions, irrespective of whether a common reporting framework exists or not.

<sup>1</sup> The concept of double materiality derives from this principle, which means that the entity does not only consider the effects of relevant events on the entity, but also the impact of the entity's actions on the wider environment and society (multiple stakeholder approach).

<sup>2</sup> According to Wikipedia, externalities are defined as the costs or benefits that affect a third party who did not choose to incur that cost or benefit, and which often occur when the production or consumption of a product or service's private price equilibrium cannot reflect the true costs or benefits of that product or service for society as a whole and are not accounted for through normal accounting principles.

- Governing Bodies should attempt to obtain assurance on the organisation's information regarding its response to Climate Change.

***In the latest Climate Disclosure Project (CDP) questionnaire responses, the following is quoted:***

*“In a 2019 analysis of 500 of the world's biggest companies by market capitalization (G500) CDP found just under a trillion dollars (~US\$970 billion) at risk. Over half of these risks were reported as 'likely / very likely / virtually certain' and are likely to materialize in the short- to medium-term (around five years or earlier)”*

## Contents

1. Purpose of this guidance paper .....	5
2. Scope .....	5
3. Definitions .....	5
4. Climate change in the greater ESG context .....	5
5. Considerations for Governing Bodies .....	6
5.1 Leadership .....	7
5.2 Impact on organisational strategy, risks and opportunities .....	7
5.3 Management and accountability systems .....	9
5.4 Internalisation of externalities .....	9
5.5 Reporting/ disclosure considerations .....	10
5.6 Assurance on disclosures .....	10
5.7 Legal considerations .....	11
6. Conclusion .....	12
Appendix 1 – Examples and suggested practices .....	13
Leadership .....	13
Impact on organizational strategy, risks and opportunities .....	14
Management and Accountability Systems .....	15
Internalisation of Externalities .....	15
Reporting / Disclosure Considerations .....	17
Assurance on Disclosures .....	18
Legal Considerations .....	18
Appendix 2 – Available Reporting Frameworks .....	19
Appendix 3 – Glossary of terms .....	21

## 1. Purpose of this guidance paper

The purpose of this guidance is to support Governing Bodies to:

- Appreciate the impact of climate change on the sustainability and future of the organisation and the consequences for non-action, and ensure that it is appropriately considered in decisions, strategy, and risk assessments;
- Understand the context of climate change in relation to the greater environment, society and governance;
- Raise awareness of the need to respond to matters regarding climate change;
- Allocate responsibilities for climate change appropriately;
- Identify those matters regarding climate change to which a response is required; and
- Empower Governing Bodies to take the lead and set the tone on climate change;
- Assist Governing Bodies with interpreting their governance duties as set out in King IV and applying those to climate change.

## 2. Scope

The guidance focuses on the response from Governing Bodies to Climate Change from a governance perspective and can be applied in the private and public sectors.

While the guidance deals with climate change, it must be recognized that climate change cannot be considered in isolation without also considering its impact within the wider ESG context.

The guidance should be read in the context of the King IV Report on Corporate Governance for South Africa 2016<sup>3</sup> ('The King Report'). The objectives of the King Report are to promote corporate governance as integral to running an organization and delivering governance outcomes such as an ethical culture, good performance, effective control, and legitimacy, reinforce corporate governance as a holistic and integrated set of arrangements to be understood and implemented in an integrated manner, encourage transparent and meaningful reporting to stakeholders, and present corporate governance as ethical consciousness and conduct.

## 3. Definitions

Definitions are included in Appendix 3 – Glossary of Terms.

## 4. Climate change in the greater sustainability context

The environment is quite simply everything around us. In the narrow context one associates "environment" with the natural or biophysical environment; however, there is also a broader coexisting and interdependent environment of society and economy which, together with the natural, collectively form '*everything around us*'. Human welfare is critically dependent on this full context of the environment, from the basic necessities of life such as air, water, food and shelter, through to important welfare satisfiers such as safety, culture, sense of belonging and others. Changes to the environment may present direct and inalienable risks to human welfare and it is therefore incumbent upon us as humankind to understand those risks and ensure that they are effectively managed both for current and future generations.

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<sup>3</sup> The King IV Report on Corporate Governance for South Africa 2016  
[https://cdn.ymaws.com/www.iodsa.co.za/resource/collection/684B68A7-B768-465C-8214-E3A007F15A5A/IoDSA\\_King\\_IV\\_Report\\_-\\_WebVersion.pdf](https://cdn.ymaws.com/www.iodsa.co.za/resource/collection/684B68A7-B768-465C-8214-E3A007F15A5A/IoDSA_King_IV_Report_-_WebVersion.pdf)

Unfortunately, reliance on the natural environment for survival has tipped over beyond being exploitative, to support an ever-expanding population and increasing technological advances. For a time, this over-exploitation of resources and discarding of excess amounts of waste was within the carrying capacity of the natural environment and its ability to withstand those pressures without threatening the welfare of humankind.

Today, however, we recognise that the pressures on the natural environment are becoming too much, manifesting as polluted air, soil and water, loss of biodiversity and extinction of plant and animal species. The ability of the natural environment to continue sustaining itself is seriously in question, and the answer that none of us have, is to when we reach that breaking point where natural systems collapse, directly threatening the survival of humankind.

Against this backdrop one environmental threat that stands above all others is climate change. The atmosphere contains significantly more CO<sub>2</sub> and other greenhouse gases now, than it did before the Industrial Revolution. The atmosphere and oceans are warmer, the planet's ice cover is vastly reduced, and severe weather is more common today than it was in the past.

However, it is the rate of change in the climate, which does not only require, but demands entities and all mankind to stop or even reverse climate change and its impact on the environment on which we are so critically dependent for survival.

## 5. Considerations for Governing Bodies

The foreword to the King Report introduces the context in which the report has been drafted, which includes that there have been fundamental changes in both business and society. One of the drivers of these changes is climate change, recognizing that organisations and individuals are using natural assets faster than nature is generating them.

In King IV we refer to the combined context in which organisations operate as the triple context consisting of the economy, society and the natural environment. The reference to 'context' is in the singular as these three dimensions are intertwined and should be viewed as an integrated whole. The triple context is portrayed in more granular fashion by the forms of capital that the organisation uses or affects. The 'six-capitals' model, identifies financial, manufactured, intellectual, human, social and relationship, and natural (environmental) capitals. The position of King IV, therefore, is that having regard to the natural environment is intertwined with economic and social considerations and part and parcel of governance duties.

ESG factors emerged as an investment consideration and have gained significant traction. We propose that the triple context and six capitals as well as ESG are alternative, complementary lenses through which to approach sustainable development, including the challenge of climate change.

While there might be other considerations for Governing Bodies and management in responding to climate change and related matters, the considerations below have been identified as the primary considerations, as derived from the principles and some practices (**refer to Appendix 1**) which already exist in the King Report with its associated governance outcomes of an ethical culture, good performance, effective control and legitimacy.

## 5.1 Leadership

### Relevant Principles in the King Report:

**Principle 1:** *The Governing Body should lead ethically and effectively.*

**Principle 7:** *The Governing Body should comprise the appropriate balance of knowledge, skills, experience, diversity and independence for it to discharge its governance role and responsibilities objectively and effectively.*

**Principle 9:** *The Governing Body should ensure that the evaluation of its own performance and that of its committees, its chair and its individual members, support continued improvement in its performance and its effectiveness.*

### Application of Principles:

- Governing Bodies must act in good faith and in the best interest of the organisation. Such actions must go beyond mere legal compliance. Developing a response to climate change should not be based only on requirements in applicable laws but should result from Governing Bodies ensuring that management strives to do the right thing for the organisation, society and the environment while promoting good governance.
- In considering the appropriate balance of knowledge, skills, experience and diversity, it is critical that the Governing Body ensures that the organisation has access to individuals who have the knowledge, skills and experience in respect of sustainability and ESG matters, including climate change. It would also be useful to start considering including individuals on the board who has an understanding of ESG matters.
- The tone for an ethical culture is set at the top. Unless leadership and Governing Bodies recognize and demonstrate that the organisation's sustainable future depends on how it responds to sustainability issues, including climate change, others in the organization cannot follow suit.
- Climate change could expose the organization to substantial risk if not appropriately managed, and members of the Governing Body should have the experience and skills to understand these risks in order to develop an appropriate response thereto.

## 5.2 Impact on organisational strategy, risks and opportunities

### Relevant Principles in the King Report:

**Principle 4:** *The Governing Body should appreciate that the organisation's core purpose, its risks and opportunities, strategy, business model, performance and sustainable development are all inseparable elements of the value creation process.*

**Principle 7:** *The Governing Body should comprise the appropriate balance of knowledge, skills, experience, diversity and independence for it to discharge its governance role and responsibilities objectively and effectively.*

**Principle 11:** *The Governing Body should govern risk in a way that supports the organization in setting and achieving its strategic objectives.*



### Application of Principles:

- As climate risk and opportunity are two sides of the same coin, climate risk governance should encompass both the potential positive and negative effects of the same risks on the achievement of organizational objectives.
- An opportunity might arise simply because an organisation treats a climate risk differently.
- Broadly speaking, climate-related risk can be described in terms of physical and transition characteristics and opportunities, which includes:
  - Financial opportunity, e.g., reduced impairment of climate resilient assets.
  - Reputation risk, e.g., additional expenditure on litigation.
  - Market and Economic risk, e.g., asset impairment
  - Physical risk, e.g., damage to physical assets
  - Policy and Regulation risk, e.g., compliance costs
  - Technology risk, e.g., required investment in new technologies.
- Not all countries and industries are equally affected by climate change. Some will be harder hit based on their geographical location, physical operations, the market they operate in or the type of industry. For example, there is an increasing risk of carbon intense assets such as coal or oil reserves becoming stranded assets as the demand for these decreases over time.
- The climate risk assessment should consider the entire universe of the business activities and not only focus on the physical risks, but the transition risks associated with the introduction of climate-related laws and regulations as well as consumer and investor preferences.
- Once the climate risks have been identified and prioritized, the business can develop internal programmes to mitigate these risks. It is important to not only focus on the risks that may manifest in the short term but also the long - term risks as they may carry a larger significance and require more effort and resources.
- The impacts of climate change are potentially significant if not effectively mitigated. Climate-related risks can be classified as:
  - **Physical risks from extreme weather** – directly affecting financial institutions' own operations or assets that they finance through damage, business disruption or default risks;
  - **Transition risks** – resulting from disruptive technologies, changing regulation, consumer or market preferences; and
  - **Liability and disclosure risks** – resulting from loss and damages, rising insurance costs, director's liability and disclosure failures.
- Climate – related risks and opportunities can produce tangible financial effects, which means that once the risks and opportunities have been considered in the strategic planning and risk management process, the financial impact will flow through to the Income Statement, Cash Flow Statement and Balance Sheet.



## 5.3 Management and accountability systems

### Relevant Principles in the King Report:

**Principle 10:** *The Governing Body should ensure that the appointment of, and delegation to, management contribute to role clarity and the effective exercise of authority and responsibilities.*

**Principle 14:** *The Governing Body should ensure that the organization remunerates fairly, responsibly and transparently so as to promote the achievement of strategic objectives and positive outcomes in the short, medium and long term.*

### Application of Principles:

- The Governing Body delegates to and exercises oversight over management but cannot abdicate accountability and responsibility for responding to climate change.
- There should be full and clear management accountability for the climate-related performance of the organization.
- Performance management should also include targets related to sustainability and ESG matters, including climate change, and remuneration linked to the achievement thereof.

## 5.4 Internalisation of externalities

### Relevant Principles in the King Report:

**Principle 3:** *The Governing Body should ensure that the organization is and is seen to be a responsible corporate citizen.*

**Principle 16:** *In execution of its governance role and responsibilities, the Governing Body should adopt a stakeholder-inclusive approach that balances the needs, interests and expectations of material stakeholders in the best interest of the organization over time.*

### Application of Principles:

- Governing Bodies must appreciate that in applying principles on good governance and ensuring longevity, the organisation should refocus on its purpose in the economy and society holistically with emphasis on the value it puts back versus what it extracts, aiming to achieve a net positive impact on society and the economy.
- The principle of Environmental Externalities is defined as the economic concept of uncompensated environmental effects of production and consumption that affect consumer utility and enterprise cost outside the market mechanism<sup>4</sup>. As a consequence of negative externalities, private costs of production tend to be lower than its “social” cost, as externalities are not internalised in plans and budgets.
- Climate change brings with it a number of external physical and transition risks to companies. Many companies are developing internal mechanisms to reduce carbon emissions, mitigate climate-related business risks, and identify opportunities in the transition to a low-carbon economy.

<sup>4</sup> Glossary of Environment Statistics (Studies in Methods, Series F, No. 67, United Nations, New York, 1997)

- Organisations should first establish their carbon footprint before calculating the cost thereof.
- Historically, the costs to society and the environment associated with carbon emissions have not been reflected in the price of goods and services. Increasingly, organisations have been looking at internal pricing of carbon emissions to value these impacts and as another way of internalising these risks as part of their valuation of risks and opportunities<sup>5</sup>.

## 5.5 Reporting/ disclosure considerations<sup>6</sup>

### Relevant Principles in the King Report:

**Principle 5:** *The Governing Body should ensure that reports issued by the organization enable stakeholders to make informed assessments of the organisation's performance and its short, medium and long - term prospects.*

### Application of Principles:

- Demand for better disclosure of climate-related information is urgent. It is recognized that consistency and comparability in reported information is critical. It is further recognized that a wide range of voluntary frameworks and standards are in use and that preparers are faced with opting to report using multiple standards, metrics or frameworks with limited effectiveness and impact, a high risk of complexity and an ever-increasing cost<sup>7</sup>.
- The International Financial Reporting Standards (IFRS) issued by the International Accounting Standards Board do not specifically refer to climate change; however, the standards (e.g., on valuations, provisioning, going concern) do address climate change-related risks and its non-mandatory guidance on management commentary is being updated to include companies addressing material environmental and societal issues which are expected to complement information in financial statements.

## 5.6 Assurance on disclosures

### Relevant Principles in the King Report:

**Principle 15:** *The Governing Body should ensure that assurance services and functions enable an effective control environment, and that these support the integrity of information for internal decision-making and of the organisation's external reports.*

<sup>5</sup> In a new report, CDP analysed the climate change disclosures from nearly 6,000 companies in 2020 to assess the state of internal carbon pricing by corporates alongside developments in carbon pricing regulation globally. The research shows that corporate adoption of carbon pricing is rising, with the number of companies using or planning to use an internal carbon price increasing 80% over just five years. This includes nearly half of the world's 500 biggest companies.

<sup>6</sup> Recent developments have seen bodies such as the Global Reporting Initiative (GRI), Sustainability Accounting Standards Board (SASB), Climate Disclosure Standards Board (CDSB), International Integrated Reporting Council (IIRC) and the Climate Disclosure Project (CDP) attempt to strive for universally accepted standards through their statement of intent which could lead to a common framework which will result in a more coherent, integrated reporting system which will incorporate financial and sustainability reporting.

<sup>7</sup> IFRS Foundation Consultation Paper on Sustainability Reporting <https://www.ifrs.org/content/dam/ifrs/project/sustainability-reporting/consultation-paper-on-sustainability-reporting.pdf>

**Application of Principles:**

- There are currently three potential levels of assurance which can be expressed in relation to climate change, namely negative assurance, positive assurance and certification. Both negative and positive assurance can be provided by regular assurance providers, provided they have the requisite knowledge and experience in the area to be assured. Only organisations certified and recognized to provide certifications may do so.
- An assurance framework for climate change related reporting has not yet been developed by the International Auditing and Assurance Board (IAASB) or any other body. Until such time as assurance aspects have been addressed, however, there are standards which are appropriate for expressing assurance on broader sustainability information (International Standard on Assurance Engagement (ISAE) 3000 (Revised), *Assurance Engagements other than Audits or Reviews of Historical Financial Information* issued by the IAASB and applicable to all assurance engagements, and ISAE 3410, *Assurance Engagements on Greenhouse Gas Statements*, which is applicable to specific engagements.
- The pursuit of assurance should ultimately contribute to reporting being consistent and reliable, and the reporting organisation should therefore ensure that the climate change information presented can ultimately meet the requirements of being auditable or capable of being subject to assurance being expressed thereon.

**5.7 Legal considerations****Relevant Principles in the King Report:**

*Principle 13: The Governing Body should govern compliance with applicable laws and adopted, non-binding rules, codes and standards in a way that supports the organization being ethical and a good corporate citizen.*

**Application of Principles:**

- Climate change will inevitably affect the economy, and it is imperative for members of Governing Bodies to appreciate that climate change will intersect with the interests of their organisations. In turn, that means that the exposure of individual directors to climate change litigation is likely to increase over time.
- It is the responsibility of Governing Bodies and management to ensure that the organisation is a going concern. Should the organisation be exposed to litigation resulting from climate change or should directors be exposed to climate change litigation, these factors should be taken into consideration when considering the organisation's going concern status.
- Governing Bodies and management must ensure that the organisation follows and complies with applicable laws, rules and regulations related to climate change and remain up to date with new developments in legislation.
- Governing Bodies and management should understand the potential impact of climate change on the organisation's ability to deliver on its contractual obligations and the mechanisms which are available to address non-compliance.
- Governing Bodies and management should understand the nature and extent of litigation which could arise from climate change and ensure that it is adequately insured against such potential litigation.

## 6. Conclusion

Climate change is one of the biggest contributors to the environment although it represents only one of the factors which has, does and will continue to influence the environment.

Organisations, and more specifically Governing Bodies, have to play their part, not only through compliance but through a serious commitment to demonstrate how and what they do and will do to positively impact the negative effects of climate change. A combined effort will bring about the required change and must necessarily elevate the positive impact to the greater environment.

We no longer live and do business in a world which only focuses on profits and financial results – entities will only remain relevant and, indeed, remain in existence once they recognize their wider responsibility to the environment and society as a whole. Focusing on profits alone will no longer sustain an organisation - on the contrary, it will be those entities which expand their vision to their broader stakeholders which will remain sustainable and continue to prosper, and ultimately provide the lifeline for saving the environment and secure a robust economy and prosperity for everyone.

## Appendix 1 – Examples and suggested practices

### Leadership

*(Refer to paragraph 5.1 in Guidance)*

1. Governing Bodies should ensure that the organisation communicates the importance of climate change and the organisation's response thereto to staff and stakeholders.
2. Effective and ethical leadership requires that the organization is equipped with the necessary skills and competencies to effectively discharge its responsibilities. A Gap analysis should be performed in terms of ESG competencies on the Governing Body and in the organisation. If the organization does not have the available skills and competencies to develop a response to climate change, Governing Bodies should ensure that the organisation gains access thereto and strengthen its capacity to respond to the impacts of climate change.
3. Should the organisation not be in a financial position to obtain the required skills and competencies on a permanent basis, Governing Bodies should consider contracting specialist firms to oversee management's implementation of climate change requirements.
4. Governing Bodies should ensure that climate change-related skills and competencies are not only available as a specialist resource, but also start to consider including individuals with some ESG competencies within the composition of its governance structures.
5. Steps should be taken to ensure that sufficient training is provided to Governing Bodies and management to gain and maintain the required competencies in terms of climate change-related matters.
6. Governing Bodies should ensure that they fully understand the impact of climate change on the organization, which is only possible if they have a full appreciation and knowledge of the business and how the organisation operates.
7. Ultimate responsibility and accountability for developing a response to climate change rests with Governing Bodies, and to reflect this, it should be included in the Terms of Reference of relevant committees of the Governing Body, even if only to raise awareness initially.
8. Management's response to Climate change should form part of their key performance areas (KPA) and Governing Bodies should ensure that their performance and delivery against these KPAs are monitored and evaluated as part of their performance management.

## Impact on organizational strategy, risks and opportunities

*(Refer to paragraph 5.2 in Guidance)*

1. Governance Bodies should include individuals who have a deep understanding of risk and risk management, as well as the interconnectivity between risk, opportunities and strategy.
2. Governance Bodies should have an understanding of the organization and its operations and any potential opportunities and risks it could be exposed to in terms of climate change. Such risks should be managed in the same manner that the organisation responds to other risks which could impact on its strategy and its ability to achieve its strategic objectives.
3. The strategy should include a stakeholder plan which addresses the legitimate and reasonable needs, interests and expectations of material stakeholders in respect of climate change.
4. The risk register and Enterprise Risk Management (ERM) framework should include any new risks which relate to climate change and these risks prioritized accordingly. An environmental and social risk assessment, which includes climate risk, that serves to quantify and prioritise external environmental and social risks brought about by the environmental and social aspects of the organisation's activities should be performed and such risks effectively mitigated.
5. Governance Bodies should ensure that Key Performance Indicators (KPIs) of management are updated to include KPIs related to climate change and how they respond thereto.
6. Governance Bodies should ensure that the current controls are assessed and strengthened if necessary to identify, manage and prevent any potential exposure to loss caused by climate change and that the required skills exist to do so.
7. The organisation should have a strategy to prevent loss caused by climate change and a live plan which should be re-evaluated as regulations or climate conditions change.
8. The risk of going concern linked to climate risk should be considered.
9. Governance Bodies should consider establishing an emergency team should climate change -related disaster strike unexpectedly. The existence of such a crisis team should be accompanied by a crisis communication strategy.
10. Governance Bodies should ensure that the organisation evaluates the financial effects of climate-related risks and opportunities on its financial performance and position.
11. Examples of classifying risks into short and long term could be as follows:
  - 11.1 Short term physical risk including increased severity of extreme weather events while long term risks include rising average temperatures.
  - 11.2 Short term transition risks including exposure to litigation while long term risk includes the cost of unsuccessful investment in new technologies.

## Management and Accountability Systems

(Refer to paragraph 5.3 in Guidance)

1. A management system based on outcomes-based objectives should be established to monitor climate risks identified with defined targets and indicators to measure and assess such performance.
2. The organisation should have a remuneration policy which provides for the use of performance measures that support positive outcomes in respect of climate change – related matters.
3. Incentivisation should promote and reward responses to climate change – related matters which will result in sustainable value creation over time.
4. Targets/goals should be set for climate change performance management.
5. Incentivisation should be used to align the interest of executive directors to the long-term health and resilience of the company, including management's response to climate change – related matters. The Governing Body should approve and monitor the related targets and goals against which management is assessed.

## Internalisation of Externalities

(Refer to paragraph 5.4 in Guidance)

1. **Microsoft** uses revenue from its internal carbon fee to fund renewable energy, energy-efficiency, and other projects needed to reduce emissions; research into emissions reduction technology; and raise employee awareness of climate risks and opportunities.
2. **Shell, BHP, and BP**, have embedded a shadow price in their business strategy by shifting investments in low-carbon assets or even stopping projects with high-carbon intensity.
3. In July 2020 [Just Salad](#) announced that they would display the carbon footprint of every item on their menu.
4. **ASDA** (a Walmart affiliate) was one of the first UK retailers to embed a shadow cost for carbon in all its carbon mitigation investment decisions.
5. **Novartis**, a Swiss-based global healthcare company, uses a carbon price of \$100 per ton of CO<sub>2</sub> and cites potential climate change impacts as a motivator.
6. Under President Biden, the United States is revising their Social Cost of Carbon used for policy decisions. This was around \$50 per ton of CO<sub>2</sub> under the Obama administration but was reduced to \$1-7 per ton under the Trump administration.
7. Germany's 2020 guidance on Social Cost of Carbon presented two values: €195 per ton (US\$235 per ton) and €680 per ton (\$820 per ton).
8. South Africa's Carbon Tax is R134 per ton as of January 2021. Companies that do not have the time or resources to develop an internal price could use this as a shadow price.
9. **Alcoa** is supplying sustainable low carbon aluminium for wheels on **Audi's** first electric sports car, the first time that it will be used in the transportation sector.



10. The Center for Climate and Energy Solutions states that there are essentially three methods that companies can use to calculate an internal price on carbon, as well as a combination of the three<sup>8</sup>.

10.1 **Carbon Fee**

A carbon fee is a calculation that assigns a monetary value to the emissions relating from normal business activities. This is a cost that respective parts of the business pay based on their associated emissions with the proceeds often staying within the company. The aim of the fee is to incentivise these parts of the business to reduce the costs through innovation to reduce emissions. The proceeds of this fee can also be ring fenced to fund additional innovation efforts and compound a company's ability to reduce its emissions. The fee can cover Scope 1 - 3 emissions and can be applied to specific business units (e.g., manufacturing) or whole business activities (e.g., business travel).

10.2 **Shadow Pricing**

Whereas a carbon fee is an actual fee, companies can also make use of a theoretical price on carbon, or a "shadow price," as a risk assessment tool. This helps the companies to evaluate investments (i.e., carbon intensity of a portfolio or transaction), test assumptions, and guide business strategy in anticipation of future carbon constraints. These shadow prices are often based on the prevailing and/or forecasted price of carbon regulations such as the Carbon Tax in South Africa, as well as forecasted commodity prices and technological factors.

10.3 **Implicit Carbon Pricing**

Implicit carbon pricing is essentially the marginal abatement cost that a company would pay for the measures and programmes to reduce its emissions in line with regulations or another defined target. Whereas the Shadow Price or Carbon fee are calculated proactively, the implicit carbon pricing is calculated retrospectively based on the spend on measures such as energy efficiency, renewable energy installation or carbon offsets.

- 11 There are essentially three steps which could ensure that climate change risks can be internalised.

11.1 **Risk assessment**

The first step to internalise the external impacts of climate change is to undertake a risk assessment to better understand the associated physical and transition risks the company may experience should these risks manifest. This risk assessment should consider the entire universe of the business activities and focus not only on the physical risks, but the transition risks associated with changing laws and regulations as well as consumer and investor preferences.

Once the risks have been identified and prioritized the business can develop internal programmes to mitigate these risks. It is important to not only focus on the risks that may manifest in the short term but also the long - term risks as they may carry a larger significance and require more effort and resources.

11.2 **Valuation of risks and opportunities**

Historically, the costs to society and the environment associated with carbon emissions have not been reflected in the price of goods and services. Increasingly, companies have been looking at internal pricing of carbon emissions to value these impacts and as another way of internalising these risks.

<sup>8</sup> Ahluwalia, M.B., The Business of Pricing Carbon: How Companies are Pricing Carbon to Mitigate Risks and Prepare for a Low-carbon Future. Center for Climate and Energy Solutions. Accessed online [09/03/2021]: <https://www.c2es.org/site/assets/uploads/2017/09/business-pricing-carbon.pdf>

### 11.3 **Disclosure**

Depending on where a company is based, corporate disclosure could be mandatory or voluntary, but it is another step in internalising the external risks associated with climate change once it has been costed. As the CDP recognises, the benefits of disclosure are that they help companies get ahead of regulatory and policy changes, identify and tackle growing risks, and find new opportunities for action that investors and customers worldwide are demanding. While the disclosures are published externally, they can have the benefit of generating internal buy-in.

12 Examples of identifying opportunities to do things differently in order to minimise the impact on the environment may include:

- Expanding into the field of renewable gas and low carbon hydrogen to help reduce the carbon intensity of natural gas.
- Increasing renewable power generation capacity – solar, wind, hydro – to satisfy the surge in electric power needs responsibly.
- Upgrading architectures and equipment and introducing innovative technology, for example, by installing systems to recover the heat from gas turbines and thereby eliminating the need for heaters or boilers.

## **Reporting / Disclosure Considerations**

*(Refer to paragraph 5.5 in Guidance)*

1. Governing Bodies should adopt a holistic approach, which will ensure that the organisation does not omit the impact of material critical climate change – related events and therefore present incomplete information for their own and third parties' decision-making. Information is material if the estimated effect that the presence or absence of an item of information (or identified subject matter) may have on the accuracy or validity of a statement (or decision).
2. Governing Bodies should recognize the concept of double materiality. As already stated above, the concept of double materiality derives from the principle that the organisation does not only consider and report on the effects of relevant events on the organisation, but also the impact of the organisation's actions on the wider environment and society (multiple stakeholder approach).
3. Governing Bodies should ensure that the organisation discloses climate risk impacts on governance, the business model, strategy, risk management, and performance and prospects in the Annual Report and Integrated Report and not in a separate Sustainability Report which may not be readily available or accessible<sup>9</sup>.
4. Assets and liabilities should be measured and recognized taking into account the impact of climate change. Material climate – related assumptions and associated uncertainties should be disclosed even if there are no quantitative impacts on recognized balances. The concept of a 'stranded' asset, which is an asset on a balance sheet which rapidly loses its value as a result of forced write-offs, is another indicator of the risk to a business.
5. Governing Bodies should ensure that climate change disclosures in the financial statements are consistent with statements and strategies outlined in other reports in the Annual Report.
6. Governing bodies should ensure that they are aware of legal requirements to disclose climate-related information where it is mandatory.

<sup>9</sup> KPMG - Climate Disclosures within the Annual Report – Australian Perspective (2020)  
<https://home.kpmg/au/en/home/insights/2020/06/climate-disclosures-annual-report-australian-focus.html>

7. Governing Bodies should ensure that there is disclosure of the organisation's commitment to respond to climate change (what climate change means to the business) as well as what the organisation does to reduce its impact on the drivers of climate change.

## **Assurance on Disclosures**

*(Refer to paragraph 5.6 in Guidance)*

1. Governing Bodies should consider alternative approaches to obtain the required assurance regarding climate change disclosures, e.g., using the combined assurance approach whereby assurance can be obtained from various sources to provide the necessary comfort.
2. Currently, organisations which are certified and recognized to provide certifications include the South African Bureau of Standards (SABS), Det Norske Veritas (DNV) and DQS-UL.

## **Legal Considerations**

*(Refer to paragraph 5.7 in Guidance)*

1. Consider obtaining external expert legal advice in respect of climate change – related matters if required.
2. Governing Bodies should understand the legal consequences should the organisation breach any climate change legislation and be aware of any legal requirements in respect of climate change disclosures.
3. Governing Bodies should understand what actions or omission of actions in respect of climate change – related matters would give rise to legal consequences.

## Appendix 2 – Available Reporting Frameworks

### 1. Mainstream / established reporting frameworks

#### • International Integrated Reporting <IR> framework

- Issued by the International Integrated Reporting Council (IIRC) which is in the process of merging with SASB to form the Value Reporting Foundation.
- Targeted at providing guidance on the process of integrated reporting which results in publication of a periodic integrated report, reflecting the organisation's process of value creation, erosion or preservation across six capitals.

#### • GRI Standards

- Issued by the Global Reporting Initiative's (GRI) Global Sustainability Standards Board (GSSB)
- Offers a set of modular standards to enable organisations to report on their sustainability impacts, against universal standards and topic standards selected based on material economic, environmental or social impacts. (Sector Standards are under development.)

#### • SASB

- Issued by the US-based Sustainability Accounting Standards Board (SASB) which is in the process of merging with the IIRC to form the Value Reporting Foundation.
- Offers 77 industry-specific Standards which identify the minimal set of financially material sustainability topics and their associated accounting metrics for the typical company in an industry.

#### • TCFD Recommendations

- Issued by the Task Force for Climate-Related Financial Disclosures (TCFD).
- Designed to solicit consistent, decision-useful, forward-looking information on the material financial impacts of climate-related risks and opportunities, including those related to the global transition to a lower-carbon economy. Adoptable by all organisations with public debt or equity in G20 jurisdictions for use in mainstream financial filings. Structured around four thematic areas that represent core elements of how organisations operate: governance, strategy, risk management, and metrics and targets. Includes supplemental guidance for certain sectors.

#### • CDP and WDP

- Global environmental reporting system collecting data on climate, water and forests through investor-driven questionnaires issued by the Climate Disclosure Project (CDP).

#### • CDSB Framework

- Issued by the Climate Disclosure Standards Board (CDSB).
- Sets out an approach for reporting environmental and climate change information in mainstream reports, such as annual reports, 10-K filing, or integrated reports.

### 2. Other existing / emerging initiatives / management tools / frameworks with relevance to management and reporting on sustainability generally or climate more specifically

**Note: this is not an exhaustive list.**

#### • ISO

- ISO 26000:2010 Social Responsibility Standard
- ISO 14064 Standard on greenhouse gas (GHG) reporting

#### • UN Global Compact

- **Sustainable Development Goals**
- **UN Guiding Principles on Business and Human Rights**
- **OECD Guidelines for Multinational Enterprises**
- **EU Corporate Sustainability Reporting Initiative**
- **ESG Ratings**
  - Assess ESG performance on selected themes against proprietary indicators (often relying primarily on public data) to create a rating, ranking or score which is often used to inform inclusion in an ESG-themed index. Providers include e.g. MSCI, Dow Jones, S&P, ISS, FTSE Russell, Sustainalytics, Vigeo/EIRIS.
- **IRIS+**
  - Issued by the Global Impact Investing Network (GIIN)
  - Offers a generally accepted impact accounting system that impact investors used to measure, manage, and optimise their impact. Individual IRIS metrics are numerical measures used in calculations or qualitative values to account for the social, environmental and financial performance of an investment.
- **TNFD**
  - Task Force for Nature-related Financial Disclosures
  - Formed in 2020 to complement work of TCFD, going beyond climate to cover other nature-related impacts.
- **Natural Capital Protocol (NCP) and Toolkit**
  - Framework designed to help generate trusted, credible, and actionable information for business managers to inform decisions.
  - Offers a toolkit in the form of an interactive database that lists tools to measure and value natural capital. Provides useful elements for risk / impact identification and valuation elements.
- **Future Fit benchmark**
- **CEO Water Mandate**
- **IPIECA (Global oil and gas industry association for advancing environmental and social performance) Climate change reporting framework**
- **IFC's Environmental and Social Performance Standards**

## Appendix 3 – Glossary of terms

**Note to reader:** Unless otherwise indicated, these terms are as they appear in the King Report IV Report on Corporate Governance for South Africa - Glossary

Accountability	The obligation to answer for the execution of responsibilities. Accountability cannot be delegated, whereas responsibility can be delegated without abdicating accountability for that delegated responsibility.
Assurance	The diligent application of mind to evidence, resulting in a statement or declaration concerning an identified subject matter or subject matter information, and that is made for the purpose of enhancing confidence in that subject matter or subject matter information.
Climate Change	A change in the state of the climate that can be identified (e.g., by using statistical tests) by changes in the mean and/or the variability of its properties and that persists for an extended period, typically decades or longer. Climate change may be due to natural internal processes or external forces such as modulations of the solar cycles, volcanic eruptions and persistent anthropogenic changes in the composition of the atmosphere or in land use <sup>10</sup> .
Climate action	Efforts to reduce greenhouse gas emissions through mitigation measures and strengthen resilience and adaptive capacity to climate-induced impacts. <sup>11</sup>
Creation of Value	The positive consequences of the organisation's business activities and outputs on the triple context in which the organization operates, and the capitals it uses and affects.
Governance Outcomes	The positive effects or benefits of good corporate governance for the organisation. These positive effects include: ethical culture, good performance, effective control and legitimacy.
Integrated Reporting	A process founded on integrated thinking that results in a periodic integrated report by an organisation about value creation over time. It includes related communications regarding aspects of value creation.
Material or materiality	A measure of the estimated effect that the presence or absence of an item of information (or identified subject matter) may have on the accuracy or validity of a statement (or decision). Materiality is judged in terms of its inherent nature, impact (influence) value, use value, and the circumstances (context) in which it occurs.
Risk	The uncertainty of events, including the likelihood of such event occurring and their effect, both positive and negative, on the achievement of the organisation's objectives.
Sustainability	The ultimate, long term goal of sustainable development.
Sustainable Development	Development that meets the needs of the present without compromising the ability of future generations to meet their needs.

## Acknowledgment

This Guidance Paper was drafted with the assistance of subject matter experts serving on the King Committee's Subcommittee on Climate Change.

<sup>10</sup> IPCC, 2018: Annex I: Glossary [Matthews, J.B.R. (ed.)]. In: Global Warming of 1.5°C. An IPCC Special Report on the impacts of global warming of 1.5°C above pre-industrial levels and related global greenhouse gas emission pathways, in the context of strengthening the global response to the threat of climate change, sustainable development, and efforts to eradicate poverty [Masson-Delmotte, V., P. Zhai, H.-O. Pörtner, D. Roberts, J. Skea, P.R. Shukla, A. Pirani, W. Moufouma-Okia, C. Péan, R. Pidcock, S. Connors, J.B.R. Matthews, Y. Chen, X. Zhou, M.I. Gomis, E. Lonnoy, T. Maycock, M. Tignor, and T. Waterfield (eds.)]. In Press

<sup>11</sup> UNDP, 2021. Financing Solutions for Sustainable Development: Climate Action [Accessed 26/03/2021]. Available online: <https://www.sdfinance.undp.org/content/sdfinance/en/home/sdg/goal-13--climate-action.html>