American Airlines

US, Transport

Accounting		Climate Assumptions		Audit		Date of analysis: May 10 2021
Judgements	Consistency with other reporting	Visibility	Paris alignment	Visibility in CAMs	Consistency check	Year end: December 2020 Report date: February 17 2021 AGM: June 9 2021
Significant concerns	Significant concerns	Significant concerns	Significant concerns	Significant concerns	Significant concerns	CA 100+ company, so seen by investors as key to driving global net zero emissions

Summary view:
- A leading airline with acknowledged clear exposures to climate change issues, both physical and transition.
- The company has set a vague goal to be net zero by 2050, but this is not reflected in the 10-K narrative reporting, let alone in the financials. This goal is likely to have significant implications for a number of long-lived liabilities.

Background

The Business

- American is one of the US's leading airlines, operating a predominantly domestic US service with smaller operations in Latin America, the Atlantic and Pacific. It is a member of the oneworld alliance, one of the world's three major airline groupings.
- Due to the COVID-19 pandemic, 2020 capacity was reduced by 50% from 2019 levels, and revenue passenger miles fell by 62%. Despite significant government support (both grants and loans), and opex and capex savings totalling $17bn, this led to a net loss of $8.9bn.

Approach to climate change

- American's stated goal is for net zero direct carbon emissions by 2050. While it has not set a pathway nor intermediate targets (it aims to do so once the industry is on a more secure financial footing), the discussion of CORSIA and wider disclosures tend to indicate that it will rely on carbon offsetting to deliver this goal. It highlights a small commitment to a sustainable aviation fuel provider to buy 9m gallons over 3 years (note that even in the depressed 2020 year, overall aviation fuel consumption was some 2.3bn gallons).
- American highlights the airline industry's CORSIA initiative. CORSIA's central targets are that all growth in flights beyond 2020 (from a pre-pandemic 2019 baseline) should be carbon neutral, and that 2050 GHG emissions from the industry should be half of those in 2005, but these targets rely largely on offsetting emissions (and there are significant doubts about the programme[1]). American states that the future costs of complying with CORSIA are uncertain because of questions around future demand, the pricing of carbon offsets and the availability of sustainable or lower carbon aviation fuels. It is not apparent how any additional costs have been factored into company investment plans.
- The company has used the crisis as a moment to retire some older aircraft and so increase average fuel efficiency.
- American acknowledges risks of significant additional costs arising from the physical impacts of climate change, specifically disruption from increasingly frequent severe weather events. Its ESG report sets out detailed physical risks to specific airports from which it operates.

Accounting: judgements and consistency with other reporting

Accounting judgements		Significant concerns

- A US company so subject to US GAAP standards.

[1] See for example *The EU's assessment of the Corsia airline CO2 deal*, Transport & Environment, March 17 2021

- There appears to be no reference to climate change in the notes to the US GAAP financials. It is not apparent that any consideration of climate has been built into the numbers despite the significant value assigned in the accounts to future operational activity and profitability.
- American carries $4.1bn of goodwill on its balance sheet, largely arising from its merger with US Airways. Despite the pandemic challenges, this was not subject to impairment in 2020 (note that American has a single reporting unit so this goodwill is assessed across the business as a whole). Certain climate scenarios would leave this sum liable to potential impairment.
- Aircraft, engines and parts have estimated useful lives of 20-30 years and are amortised on a straight-line basis to a residual value of 10% of the original. Buildings have lives up to 30 years. All other PP&E have lives only up to 10 years, depreciated on a straight-line basis.
- The early retirements of A330-200, Boeing 757, Boeing 767, A330-300 and Embraer 190 and certain regional aircraft led to an impairment charge of €1.5bn reflecting the change to useful life assumptions. American notes that there is a risk of further impairments if demand for air travel is lower than expected; such a risk “has been significantly heightened” by the effects of the COVID-19 pandemic on its flight schedules and business.
- American has significant long-term financial commitments which assume ongoing growth in air travel, including both leases and firm commitments to buy aircraft. It does not appear that climate change issues have been taken into account with regard to these future expenditures.
- The company has 641 leased aircraft, with remaining terms up to 12 years, with a weighted average remaining term for operating leases (the bulk of the total) of 7.4 years. $3.3bn of its total $10.6bn lease liabilities extend to 2026 and beyond. The company is committed to $1.7bn of fresh lease liabilities for 19 aircraft to be delivered in 2021 with lease terms of 10 years. In addition to the $1.5bn impairment on retired aircraft, the company also took a $109m cash charge related to those subject to lease agreements.
- American has aircraft and engine purchase commitments amounting to a total of $11.3bn, with $3.4bn due in 2025 and $1.7bn in 2026 and beyond. This is in respect of a total of 202 aircraft, 50 of them currently due in 2025 and 30 in 2026 and beyond.
- Furthermore, it is committed to payments totalling $11.3bn in capacity purchase agreements with regional carriers. $1.5bn is due in 2025 and $3.6bn in 2026 and beyond.

Consistency with other reporting		Significant concerns

- The company publishes its 10-K separately from other reporting. The proxy statement was produced more than 8 weeks later. The latest available ESG report was for the 2019-20 year.
- Beyond non-specific references to CORSIA, the 10-K narrative reporting reveals no undertakings or goals in relation to climate change. The ESG report – which is where the net zero by 2050 goal is stated – is mentioned but explicitly excluded from being incorporated in the 10-K by reference. The 10-K narrative reporting also acknowledges existing exposures to physical climate change risks, arising from weather-related disruption.
- The significance of these issues for future profitability does not seem consistent with the absence of any reference to climate change within the financial statements and notes.

Climate assumptions in accounts: visibility and Paris alignment

Visibility of climate assumptions in accounts		Significant concerns

- There are no apparent climate-related assumptions. There is thus no sensitivity analysis.

Paris alignment		Significant concerns

- With no visibility, there can be no alignment with the goals of the Paris Agreement.

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Audit: visibility in CAMs and consistency check

Audit firm: KPMG LLP	Responsible partner: Randolph Paul Green
Audit standards: PCAOB standards	

Visibility in Critical Audit Matters		Significant concerns

- There is no explicit reference to climate change in the auditor's report.
- There are 2 CAMs identified: (i) estimate of mileage credits not expected to be redeemed; and (ii) deferred tax.
- The latter CAM, termed as about the realisability of operating loss carryforwards, depends on estimates of future flying activity and profitability, and so is likely to be impacted by climate change and any carbon constraints or pricing that might be imposed. It is thus concerning that there is no appropriate reference to climate change issues in the discussion of this CAM.
- The sole reference, in this CAM, to the use of advice from specialists refers only specialists in tax, not those expert in climate change or CO2 markets.

Consistency check		Significant concerns

- PCAOB audit standards require the auditor to read other information that is presented together with financial statements and the auditor's report thereon. The auditor's report is silent on the outcome of the review, which implies that no material inconsistency was identified in the other information within the 2020 10-K.
- The significant implications of carbon constraints for the airline industry, and American's net zero commitment in line with the industry-wide approach, do not appear to be reflected in the financials, which include a significant weight of long-term financial commitments.

The Climate Accounting Project is an independent investor-led project to reinforce the statements of the IASB and IAASB that material climate change issues are incorporated within their standards. This analysis seeks to understand the extent to which companies and auditors are delivering against this aspect of these standards and similar local standards.		**Key**
		Good practice
		Few concerns
		Some concerns
		Significant concerns

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