Power Assets

Hong Kong, Electric Utilities

Accounting		Climate Assumptions		Audit		Date of analysis: May 20 2021
Judgements	Consistency with other reporting	Visibility	Paris alignment	Visibility in KAMs	Consistency check	Year end: December 2020 Report date: March 17 2021 AGM: May 12 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:

- Power Assets faces substantial climate risks, above all from the use of coal and other fossil fuels in power generation, but also the impact of the energy transition on transmission and distribution, as well as physical risk to operating assets.
- Although the narrative reporting in the Annual Report and the Sustainability Report acknowledge these climate risks and outline numerous initiatives across their associates and joint ventures, the audited financial statements of Power Assets do not appear to have taken climate issues into consideration in any way.

Background

The Business

- Power Assets Holdings (formerly Hongkong Electric Holdings) is a vertically integrated electric utility and energy holding company, with stakes between 20% and 50% in associates and JVs in multiple jurisdictions. In 2020, the UK contributed 40% of net income, Australia 22% and Hong Kong 15%. Following certain divestments, Mainland China contributed less than 2%. Power Assets also has interests in Canada, the Netherlands, New Zealand and Thailand. It has investments in power generation (thermal and renewables), electricity generation and distribution, gas and oil transmission, and gas distribution, totalling almost 10GW of power generation and over 500,000km of transmission networks.
- Power Assets is incorporated and listed in Hong Kong. The parent company of Power Assets, with a 35.96% stake, is Cheung Kong Infrastructure Holdings, which is controlled by Hong Kong business magnate Li Ka-shing.
- Scopes 1&2 GHG emissions in 2020 were 6.8m tCO2e and 1.2m tCO2e respectively (given the holding company structure, calculated using the Equity Method). This marked a 20% drop from 2019, apparently due to a significant shift from coal to gas generation by Hong Kong Electric and the ending of two Chinese coal-fired power station JVs. Power Assets does not disclose Scope 3 emissions.
- Power Assets faces a number of climate risks across its operating assets. The most significant risk must relate to the on-going use of fossil fuels, and above all coal, for power generation. Although the shift to other fuel sources, especially natural gas, will see CO2 emissions fall, coal and oil-fired generation still contributed 42% of generation capacity at end-2020. The energy transition will also impact other assets, such as distribution and transmission, as electricity usage is anticipated to increase but policy-makers and consumers require more stringent reductions of carbon emissions, including a longer-term shift from natural gas to renewable energy sources. Power Assets also faces physical risks as extreme weather events could disrupt operations or end-consumer demand.

Approach to climate change

- Power Assets is clearly cognisant of climate risk, as reflected in its plans to reduce coal consumption and numerous other initiatives across its operating assets to respond to the energy transition. Narrative reporting in the Annual Report acknowledges Climate Change as a Risk Factor facing the company, although it is stated in high-level terms and the emphasis is on physical risks while transition risks are mentioned only briefly. Although highlighting commitments by the governments of the UK, Australia and Hong Kong to reach net zero by 2050, climate risk and related regulations are not mentioned under another Risk Factor for the company, Impact of Local, National and International Regulations.

- Stated plans by Power Assets to decarbonise its portfolio are a tacit acknowledgement of the material transition risks that the company faces. The company has committed to reduce coal-fired generation from "about 50% of our generation portfolio in July 2017 to about 22% post-2023". Over one-third of this reduction has already taken place. This is being achieved primarily through a shift to gas consumption for generation in Hong Kong and Canada, and an exit from two coal-fired assets in China.
- The Sustainability Report acknowledges that electricity generation is the world's largest source of GHG emissions, but coverage of decarbonisation plans by Power Assets is more anecdotal than systematic, listing numerous initiatives at the operating companies. This may reflect the structure of Power Assets as a holding company of associates and joint ventures, with a statement that "Besides assessing at the Group level the material impacts of climate-related risks and opportunities, each business also carries out its own climate impact assessment". However, there is some impression that the company is at a relatively early stage in formulating its thinking on climate issues, with a reference that one of its goals is to "develop Climate Strategy". Initiatives at the operating assets include expanding renewable energy, waste-to-energy and carbon capture and storage. Power Assets will also work to accommodate the projected influx of renewable energy sources and a surge in electricity demand from the uptake of electric vehicles.
- Power Assets emphasises the potential use of hydrogen, actively exploring the use of the company's gas transmission and distribution networks for hydrogen, and hydrogen blending.

Accounting: judgements and consistency with other reporting

Accounting judgements		Significant concerns

- Power Assets reports under Hong Kong Financial Reporting Standards (HKFRSs) as issued by the Hong Kong Institute of Certified Public Accountants (HKICPA).
- There is no reference in the notes to the financial statements that accounting judgements have been impacted by climate-related considerations.
- As a holding company for interests in associates and joint ventures, Power Assets records most income as Share of profits of joint ventures and Share of profits of associates, rather than as the group's own revenue. Likewise, almost all non-current assets are the company's Interest in joint ventures and Interest in associates, while the PP&E of Power Assets is minimal. By implication, some accounting judgements and estimations that should be impacted by climate considerations are made initially at the operating asset level and feed through to the accounts of Power Assets. Although the Sustainability Report refers to each company carrying out its own climate impact assessment, there is no indication in the audited financial statements of Power Assets that the accounts of the underlying assets have been impacted by climate considerations in any way.

Consistency with other reporting		Significant concerns

- The narrative reporting in the Annual Report highlights certain climate risks, albeit briefly, while the other reporting – including the Sustainability Report – discusses measures that the company is taking in some detail. The Sustainability Report specifically mentions that "failure in keeping up with the transition may negatively impact returns or even lead to asset write-downs in the long run". This is inconsistent with the financial statements that appear to be silent on climate considerations.
- The standalone 2020 Sustainability Report, the first the company has published, was issued at the same time as the Annual Report.

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.
- Although the goal of limiting global warming to well below 2ºC is mentioned in the Sustainability Report, the implications of this are not explored.

Audit: visibility in KAMs and consistency check

Audit firm: KPMG	Responsible partner: Yip Ka Ming, Alice
Audit standards: Hong Kong Standards on Auditing (HKSAs)	

Visibility in Key Audit Matters		Significant concerns

- There is no reference to climate change in the auditor's report.
- There is only one KAM identified, which concerns converting financial information from associates and joint ventures outside of Hong Kong in to HKFRSs. This does not appear to have any relation to climate risk.

Consistency check		Significant concerns

- The apparent absence of climate considerations in the audited financial statements does not appear to be consistent with the extensive discussion of climate issues in the narrative reporting.
- There is no indication that the Sustainability Report was assured in any way, either by KPMG or by any other firm.

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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