ESG reporting: Past the tipping point

5 takeaways for Canadian executives and corporate directors on sustainability-related financial reporting

Things are moving fast.

Really fast. In the past six months alone, multiple regulators and standard setters—including the Canadian Securities Administrators (CSA), Securities and Exchange Commission (SEC), and International Sustainability Standards Board (ISSB), to name a few—have issued separate proposals on environmental, social, and governance (ESG) reporting. While they do overlap, it can be difficult to keep track of their differences, even for those who've had time to wade through the hundreds of pages being proposed. To help, we've summarized five key takeaways that we believe Canadian executives and corporate directors should be aware of, including what steps to take next.

Many regulators have issued proposals on ESG reporting, making it difficult to understand the intricacies

1 Corporate reporting is more of a revolution than an evolution.

Luca Pacioli created the concept of double-entry accounting in 1494. The true brilliance of his system wasn't the reporting that it gave rise to, but the changes in business decision-making it compelled. Suddenly, profitability and economic returns could easily be factored into assessments of what investments to make, which markets to enter (or avoid), which suppliers to use, and so on. There are a lot of parallels with today as stakeholder capitalism redefines the purpose of business. Cash (alone) is no longer king. Instead, profitability is now being weighed along with long-term resiliency, or how well people, the planet, and prosperity are embedded into a company's strategy, business model, and risk management. That's important context for two reasons. First, it implies that reporting is a means (to enable better internal and external decision-making) rather than an end. Second, it suggests that profitability (financial reporting) and long-term resiliency (ESG reporting) will be inextricably related.

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2 If you think it doesn't affect you, you're probably wrong.

There are a lot of reasons companies might think ESG reporting doesn't apply to them (yet, at least). We're private. Or we're listed, but only in Canada, where the proposals may be less onerous than elsewhere. What this type of thinking misses is that ESG reporting isn't only about an individual entity—it looks through the entire value chain. For that reason, it's also worth considering:

- The reporting requirements of major customers and suppliers and what information they might need from you
- Sources of capital and the fact that some investors and lenders have already said they won't invest without Task Force on Climate-Related Financial Disclosures (TCFD), Sustainability Accounting Standards Board (SASB), or other compliance disclosures—even today
- Potential interactions with financial reporting, such as impairment tests and other areas that require forward-looking estimates that are increasingly affected by ESG considerations

3 Getting even voluntary information right is important.

One of the biggest risks today is so-called greenwashing, which involves making claims about the environmental friendliness of a company's products or activities that are later found to be overstated or untrue.

The SEC's recent crackdown on funds and advisers that misleadingly market themselves as having an ESG focus offers a glimpse of the future. While there are companies whose claims may be ill-intentioned, a large part of the challenge is that ESG guidelines are rapidly evolving, so consistent rules, definitions, and so on have yet to take hold. For companies wanting (or required) to report on ESG information, these are compelling reasons to treat it with the same rigour and governance as financial information, especially if it would be likely to affect stakeholders' decision-making.

It's worth keeping in mind that external reporting is only one of the reasons that this information is subject to internal controls, governance, and audits. It's also important to have confidence in the information used to drive decisions within the business itself. For now, some regulators are proposing only limited (negative) assurance or phased-in approaches over time, but the need for confidence may lead some to seek assurance sooner than required.

Decision making with a committment to ESG will help your business thrive

4 It's going to happen fast.

Large-scale implementations take time. They require initial gap assessments, the identification of all sources of data, the development of models, strategy, processes, and systems, and plans for reporting, talent, training, testing, communication, and so on. That's a lot to do, especially with several proposals calling for reporting as early as next year. While final timelines may be longer, it's also worth considering that in many cases, past transitions, such as the International Financial Reporting Standards (IFRS), took three or more years to get over the line.

5 There are three things every company should do today.

Companies need to, as the old saying goes, plan the work and then work the plan. Given that proposed requirements will differ from existing ones, this applies even to those that already have sustainability teams and solid reporting. It involves a handful of key steps:

1. **Assess stakeholder needs and identify a target state by:**

- Identifying key stakeholders (investors, lenders, customers, suppliers, regulators, etc.)
- Determining all the requirements that could apply if operating in multiple jurisdictions, such as foreign subsidiaries
- Understanding how ESG will affect decision-making and what information might be required
- Developing an ideal future state—where you need and want to get to—that considers the objective of the entity's ESG reporting (compliance-only, best in class, or anywhere in between).

2. **Developing a gap assessment and implementation plan that includes:**

- Key activities (e.g. identifying sources of data, developing models for measurement, processes, governance, systems, internal controls etc.)
- Stakeholder representatives from all affected areas across the organization
- Timelines that meet both required 'go- live' reporting and any testing and validation needed beforehand.

3. **Clarify your short-term needs and any other areas that are likely to evolve to identify where to get started today and where and how often to monitor. Be prepared to pivot as things continue to unfold.**

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