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ESG reporting in Canada:
Preparing for the future

Recently, there's been a lot of focus on when regulators and standard setters—the Canadian Securities Administrators (CSA), US Securities and Exchange Commission (SEC), European Union (EU), International Sustainability Standards Board (ISSB), etc.—are likely to finalize their environmental, social, and governance (ESG) reporting requirements. For now, such reporting remains largely voluntary, though it's worth noting that nearly all Canadian public companies already externally report ESG information today. That's because key stakeholders, such as investors, lenders, employees and customers, have already begun to incorporate it into their decision-making. Some investors, such as CPP Investments and BlackRock, have publicly declared their willingness to walk away from deals if potential investees don't meet targets or take ESG reporting seriously. With these rising stakes, companies are not only thinking about what ESG information to report, but also how, by whom, and with whose oversight. We believe audit committees and finance functions should—and will—play a central role for three key reasons:

1 As more and more stakeholders pay attention, the risks are increasing

While it might seem obvious, the difference between voluntary and mandatory reporting is an important one given the incremental rigor the latter often attracts (e.g., internal controls, management certifications, and internal and external audits). This is stressed even more when considering the increasing number of challenges that can arise. In the United States, the SEC's Climate and ESG Task Force within the Division of Enforcement has already charged multiple top-tier banks for failing to follow policies and procedures, and for making misstatements and omissions around ESG investments and related reporting; similar charges have been laid against companies in other industries, such as mining, automotive, and consumer products. In Canada, the Competition Bureau is starting to issue fines for "greenwashing," including one recently levied against a major coffee company for making false claims about the recyclability of its coffee pods. While the financial penalties may be serious (typically in the millions), the potentially severe and long-lasting impacts on a company's brand, reputation, and value are even more concerning.

2 Finance and audit committee aligned to bring natural synergies and benefits

Today, there's considerable variability in terms of which executives are being tasked with producing climate and sustainability disclosures, as well as the committees of the board responsible for overseeing them. For instance, the former often includes the chief sustainability officer, chief financial officer, chief legal officer, and investor relations, while the latter may include the sustainability committee, compensation committee, governance committee, and so on. There are good reasons to expect these responsibilities to migrate to finance and the audit committee over time, including:

- One of the audit committee's current primary roles is to provide oversight of financial reporting and of audit and internal controls (in other words, to ensure the reliability of external reporting).
- Such migration would accelerate the development of reporting by leveraging existing infrastructure, processes, and governance and controls within finance, rather than building them separately elsewhere in the organization.
- ESG and financial reporting are inextricably linked, so embedding both in a single function is better than reconciling between multiple ones.

The last point is especially important. So much so, in fact, that securities, prudential, and audit regulators alike—the CSA, Office of the Superintendent of Financial Institutions (OSFI), and Canadian Public Accountability Board (CPAB), etc.—have been pressing on this last point. Their interest is primarily in understanding how ESG commitments and estimates align with the assumptions that underpin financial estimates, like goodwill and impairment assessments. The relationship between these is also what led the SEC to include the following in its proposed climate-related disclosures: specific footnote disclosures in the audited financial statements about the impacts of climate-related risks thereon, a requirement to identify a climate-related risk expert who is a member of the board of directors, and attestation requirements for climate-related reporting consistent with those required for financial statements and internal controls over financial reporting today.

3 Reporting, internal controls, and auditing are important ESG skills

While it's true that most audit committees and finance teams aren't ESG experts, the same could also be said for areas like valuation, taxation, and systems. And, similarly, experts in those areas tend not to be proficient in audit, internal controls, and reporting (nor do they generally strive to be). Instead of delegating ESG experts to take on the entirety of the process of gathering, compiling, controlling, and ultimately reporting, the responsibility and oversight of ESG reporting is actually deepened by involving them as specialists. After all, reliable reporting is as much about what is being reported on as it is about how the reporting is produced. Understanding things like frameworks, requirements, internal controls, and governance are all tenets of high-quality reporting. Today, that leaves companies with a choice: either replicate these requirements within the ESG function or leverage the ESG experts by driving reporting to them in areas such as finance.

While requirements in the Sarbanes-Oxley Act and International Financial Reporting Standards (IFRS), for example, gave multiple years for organizations to comply, many have already begun to make disclosures voluntarily. Additionally, some of the soon-to-be-finalized requirements will call for more new disclosures as early as next year. That's not a lot of time to get smart on things like data, systems, processes, and controls (to name a few).

The long and short of it is that implementation timelines and the fact that companies are already being held accountable to reporting mean things need to evolve fast. One way to do that is by leveraging finance and audit committees. Not only do they already play roles in producing and ensuring the reliability of external reporting today, but doing so would also allow those with ESG knowledge to focus on areas that others can't.

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