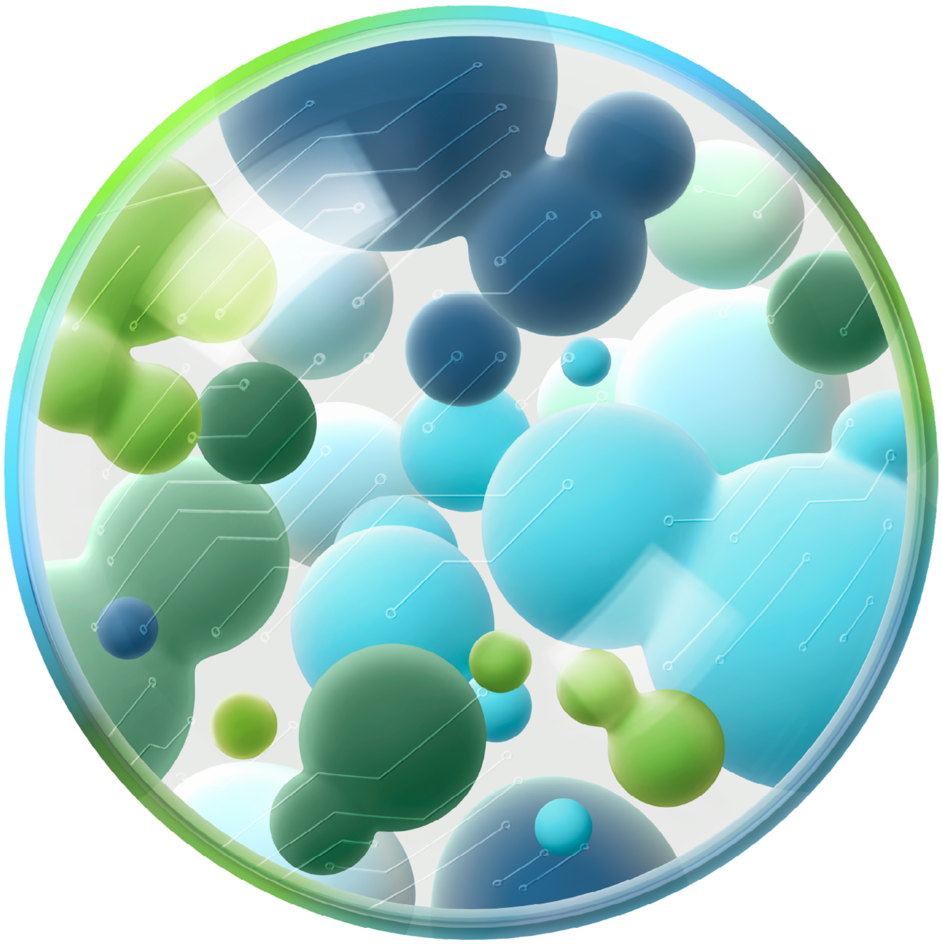


Sustainability reporting and audit committees

Evolving expectations, current pitfalls, and questions to be asking today

A year of change

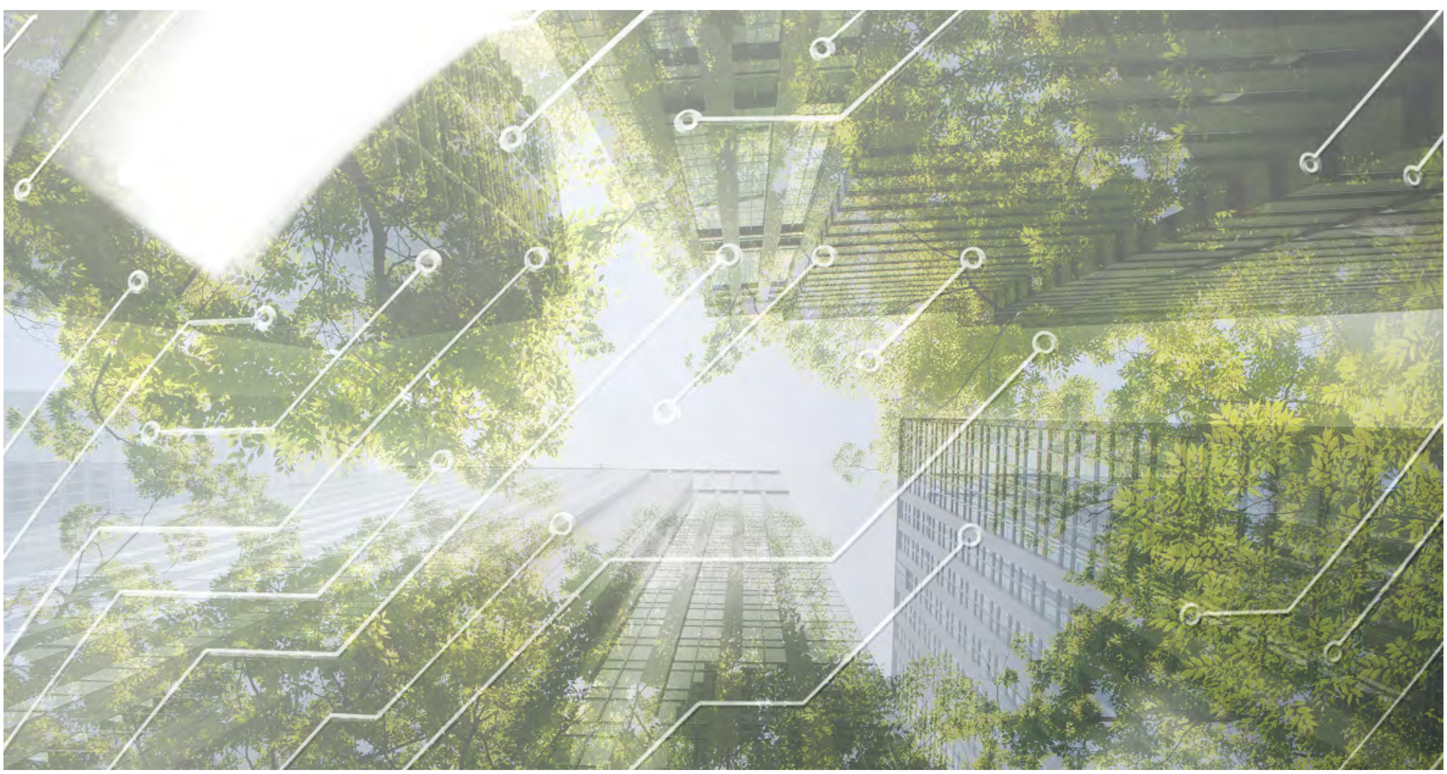
So far, 2023 has been a big year. In February, the Government of Canada announced that its major suppliers would need to start setting emissions targets and reporting progress on them nearly immediately. Then in March, the Office of the Superintendent of Financial Institutions (OSFI) put out a guideline requiring climate-related disclosures by all federally regulated financial institutions starting as early as next year. This summer, the European Commission (EU) endorsed the European Sustainability Reporting Standards (ESRS), and the International Sustainability Standards Board (ISSB) issued the first two of its long-anticipated global standards for sustainability reporting.

The ISSB standards are broadly expected to form the basis of future reporting by public companies in Canada and it's worth noting that, while they're not yet applicable here, they go beyond traditional emissions and other sustainability measures to introduce financial quantification of sustainability risks. Not only does that solidify the linkage between sustainability and financial reporting, but it will also put it within the audit committee's purview, at least to some extent. With all this in mind, it's safe to say that things are moving along swiftly, even as we await further guidance from the Canadian Securities Administrators (CSA), Canadian Sustainability Standards Board (CSSB), US Securities and Exchange Commission (SEC), and others.

Evolving expectations

It isn't only new frameworks and regulations that are developing either. As we transition from voluntary to mandatory reporting, more and more emphasis is being placed on the accuracy of information, even for the reporting that's being done on a voluntary basis today. In Canada, securities commissions have already required some companies to make adjustments and the Competition Bureau has flagged greenwashing as a high priority, with enforcements and investigations already underway. Meanwhile, in the United States, the SEC set up the Climate and ESG Task Force within the Division of Enforcement, which has already filed actions against some of its largest registrants across a wide array of industries. On both sides of the border, questions are increasing about the alignment between assumptions in sustainability reports and those that underpin financial statements. As all this comes on top of increasing reputational risks, shareholder activism, and lawsuits, there's little doubt the stakes have changed.

The shift in expectations about the reliability of sustainability reporting is an important one because, for the most part, companies have built it apart from the functions responsible for financial, regulatory, and other mandatory reporting. And many sustainability teams have worked tirelessly without the same infrastructure those other areas have. While this made sense at the time, expectations are increasing for companies to have the same level of rigor when it comes to internal processes, governance, and controls around sustainability reporting as they do for financial reporting. In fact, OSFI's guideline goes so far as to require it explicitly, and the Committee of Sponsoring Organizations of the Treadway Commission (COSO) recently introduced a framework for achieving internal control over sustainability reporting (ICSR) to parallel its framework for financial reporting.



Current challenges

As audit committees and finance teams ask questions about the controls and data used for reporting today, some are choosing to limit new disclosures or pare back existing ones to allow time to adapt. Some of the more common issues we see include:

Incorrect scoping

Resulting in emissions or other information for certain entities within the group's operational boundary not being included in reporting (e.g., controlled subsidiaries).

Missed emissions

Due to inaccurate application of organizational and operational boundary requirements.

Alignment of scenarios

Inconsistent consideration of qualitative scenario planning supported by quantitative scenario assessments aligned to financial reporting.

Errors in data (internal and third party)

Such as hard-coded spreadsheet errors and unverified or incorrect data sourced internally or externally that was not subjected to procedures to validate the data quality attributes.

Excluded information

Leading to misstatements due to reliance on incomplete datasets (e.g., where certain timeframes or types of data were being tracked manually or in separate systems and incremental data was neither sourced nor estimated).

While the issues above may seem uncomplicated from a reporting perspective, in each case they led to material adjustments, including to historical periods in some cases. Of course, determining materiality can itself be challenging in the context of sustainability reporting.

Questions to ask today

With all these challenges and expectations in mind, the top five questions worth asking by audit and risk committees today are:

1. How have we assessed which parties are relying on the sustainability information we're reporting on today, for what purposes are they relying on it, and what risks could that give rise to?
2. How are we ensuring that sustainability reporting, including alignment with financial statements, is fairly presented in all material respects (e.g., through well-documented scoping, processes, governance and controls, internal audit, independent assurance, etc.)?
3. If we're obtaining independent assurance, what errors, if any, have been adjusted because of the work performed and what process changes or additional resources may be needed?
4. Which areas of our current and future reporting (including both required and planned voluntary disclosures) are subject to the highest risk of misstatement, and are there any that should be pared back?
5. Considering our corporate strategy, what do we expect our sustainability reporting model and related board governance to look like in three years, and what's our plan to get there?

Preparing for the future of sustainability reporting is complicated. If discussing your unique circumstances and questions with a member of the team would be helpful, please reach out to one of our sustainability reporting leaders: **Livia Arrigoni, Nura Taef** or **Chris Wood.**

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