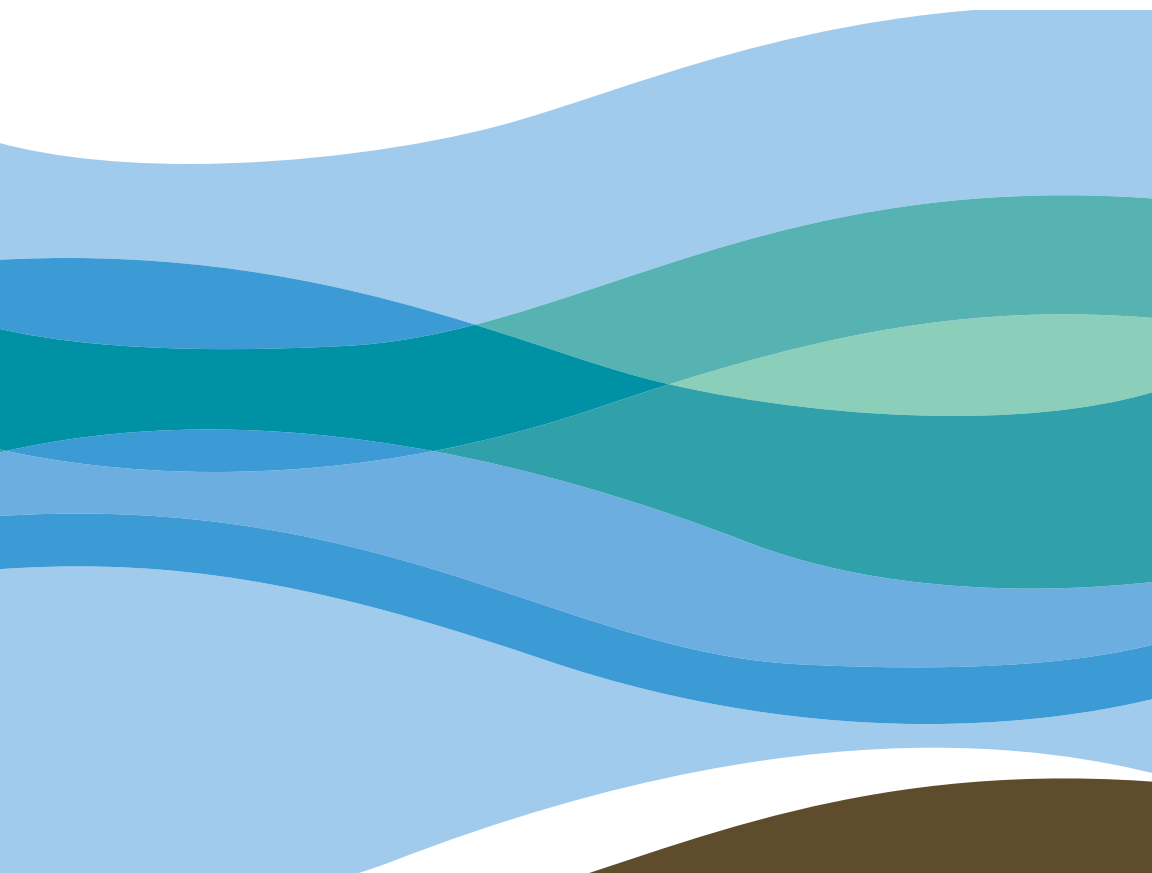


EXECUTIVE BRIEFING

**CLIMATE CHANGE AND
RELATED DISCLOSURES**



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Preface

The Knowledge Development group of the Canadian Institute of Chartered Accountants (CICA) commissioned this briefing to increase awareness among Canadian executives of the business and public company reporting issues raised by climate change.

The business implications of climate change will affect all companies, public and private. This document addresses climate change in terms of mitigation, adaptation, and the operational and financial impacts on companies.

Climate change also has significant implications for disclosures by public companies, both as a result of regulatory obligations and due to increased shareholder interest. This briefing reviews disclosure of corporate information relating to climate change in the financial statements and Management's Discussion and Analysis, as well as the implications of CEO / CFO certifications and civil liability.

This document provides a short discussion of the above issues, together with five key questions for executives to consider regarding climate change and related disclosures. For those who want to know more about some of the issues discussed, this Briefing also provides an appendix with sources of additional information.

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Dave Pollard, CA
Vice President, Knowledge Development

What are the business implications of climate change?

Consider:

- the Government of Canada introduced mandatory requirements for facilities in a range of industries to provide information on 2006 greenhouse gas emissions by May 31, 2008.
- the Government of Canada set out a regulatory framework requiring facilities in a number of industries to reduce 2006 greenhouse gas emissions intensities by 18% by the end of 2010.
- the Government of Canada set out a regulatory framework to establish a national greenhouse gas emissions trading system, open to all non-regulated activities.
- Alberta enacted climate change regulations effective July 1, 2007, setting emissions intensity limits on greenhouse gas emissions of certain facilities.
- Quebec instituted in 2007 a carbon tax on fuel distributors, impacting a broad group of corporations.
- British Columbia announced in its February 2008 budget its intention to institute a carbon tax on fuel consumption, impacting users of fuel.

Climate change impacts many aspects of life—it influences crops grown, the productivity of forests, the spread of disease, the availability of water and energy, the health of ecosystems, the patterns of weather, and the stability of infrastructure and transportation—upon all of which people and businesses depend.

Climate change is a pressing global issue. At a company level, it is also a business and shareholder value issue, affecting strategy, risk management and financial performance.

Investors want to be able to assess the impact of climate change on the future earnings of a company and the competitive advantage of one company over another. They want to be able to identify the winning and losing industries and the winners and losers within industries.

This Briefing offers a short discussion of climate change issues relevant to business, together with five key questions for executives to consider regarding climate change and related disclosures. For those who want to know more about some of the issues discussed, this Briefing also provides an appendix with sources of additional information.

Business Implications of Climate Change

There are two distinct aspects of climate change for companies to address:

- mitigation (what is to be done to reduce greenhouse gas emissions, acknowledged as being the cause of climate change) and
- adaptation (what is to be done to adapt to the impacts and expected impacts of climate change).

Companies will need to adapt to the effects of climate change, regardless of global progress on steps to mitigate climate change. It will become increasingly important to implement adaptation measures along with mitigation actions.

Mitigation

Mitigation involves acting to reduce greenhouse gas emissions.

A first step in mitigation is for a company to measure the greenhouse gas emissions directly attributable to its global operations and also possibly to its suppliers, products and services. There are recognized methodologies¹ to inventory greenhouse gas emissions. There are also recognized methodologies for providing assurance about reported information on greenhouse gas emissions.²

Reducing emissions has become increasingly important because governments around the world have begun to put a price on greenhouse gas emissions. For example, some governments have instituted carbon taxes; some have established emission reduction targets³ or emission caps; some have introduced emission trading systems.

Financial statements will reflect the price that companies are increasingly paying for their greenhouse gas emissions.

Adaptation

Adaptation involves taking action to minimize and respond to the effects of climate change.

Companies that are not large emitters of greenhouse gas emissions would be mistaken in thinking that they do not need to assess climate change impacts.

Climate change impacts, such as extreme weather events, water and energy scarcity, changes in sea levels, impacts on transportation, forests, agricultural crops, marine life, wildlife and human health, are all expected to bring a range of challenges and benefits.

1 ISO (International Organization for Standardization) standard 14064 and the Greenhouse Gas Protocol Initiative provide quantification guidance for GHG emissions. In December 2007, ISO, the World Resources Institute and the World Business Council for Sustainable Development signed a memorandum of understanding to jointly promote the ISO 14064 standards and the GHG Protocol standards.

2 e.g. ISO 14064 Part 3. In addition, the International Auditing and Assurance Standards Board (IAASB) has announced a project to develop a new international standard for *Assurance Engagements on Carbon Emissions Information*.

3 In Canada, for example, Alberta's *Climate Change and Emissions Management Amendment Act* was passed on April 20, 2007. The *Specified Gas Emitters Regulation* took effect July 1, 2007 and was accompanied by the *Administrative Penalty Regulation*.

For companies, adapting to these phenomena will involve identifying their current and potential impacts on business, reducing vulnerability to them and taking advantage of any potential opportunities they present. Some geographical areas and some industries may be impacted more than others by adaptation issues.

Companies will increasingly address adaptation as aspects of their business strategy and risk management. Actions taken to minimize and respond to the effects of climate change will ultimately be reflected in financial statements.

Operational and Financial Impacts on Companies

Mitigation and adaptation will impact organizations' operations, financial decision making and reporting in a number of ways:

- **New Capital Expenditure Considerations:** The ability to create and sell emission reduction credits creates a new dimension to capital expenditure decision-making and may make capital investments attractive where otherwise they would not have met hurdle rates.
- **Increased Global Operating Challenges:** Companies that operate globally may have to deal with a variety of emissions regulations and emission trading systems, each with different rules, risks and opportunities.
- **New Considerations in Mergers and Acquisitions:** Mergers and acquisitions, never simple, contain another layer of complexity with climate change risk, opportunity and valuation considerations.
- **New Liabilities and Assets:** There will be new liabilities and assets, new expenses and revenues to be recognized in financial statements.

For example, regulations may involve emission reduction targets which companies cannot exceed without penalty. This creates liabilities and expenses that will need to be recognized in financial statements as emissions occur. Purchasing emission reduction credits (emission reductions achieved by non-regulated activities) to meet regulatory targets creates new assets that will need to be recognized in financial statements.

- **New MD&A Disclosures:** As discussed in the next section, companies are expected to report material climate change matters to their shareholders in their MD&As.

Climate change issues will impact the operational and financial performance of some companies more than others, but it is likely that all companies will need to assess the nature and magnitude of existing and potential impacts.

Questions for CEOs and other executives to consider:

1. How will the need to reduce greenhouse gas emissions, adapt to climate change effects and respond to existing or expected climate change regulations affect the company's strategies, opportunities, risks, and financial performance?
2. What is the company's plan for responding both to climate change impacts and climate change regulations (existing or expected)? How does the company's plan compare with that of its competitors?

Corporate Disclosures

As previously mentioned, climate change matters will increasingly be reflected in financial statements. In addition, Canadian Securities Administrators' National Instrument 51-102 *Continuous Disclosure Obligations* requires companies to disclose any material facts, risks and uncertainties relating to their operations in their Management's Discussion and Analysis (MD&A) reports as well as in Annual Information Forms (AIFs).

Financial Statements

With carbon taxes, regulatory emission reduction targets, emission caps and emissions trading there are transactions that need to be recognized in financial statements.

However, there is currently a lack of clear guidance on how to account for greenhouse gas transactions under emissions trading systems, leading to a variety of accounting approaches being used.^{4 5} The inconsistency in accounting practices, depending on materiality, may be problematic for internal and external users of financial statements in evaluating cash flows, reported earnings and financial condition.

Management's Discussion and Analysis

Is it necessary to make disclosures about climate change matters in the MD&As of public companies?

Securities regulators require companies to disclose in their MD&As:

“important trends and risks that have affected the financial statements, and trends and risks that are reasonably likely to affect them in the future”⁶

Regulators also require that MD&As:

“discuss material information that may not be fully reflected in the financial statements”⁷.

A company's financial statements will not fully reflect the strategic and risk considerations involved in climate change. So the crucial question is whether climate change issues are material and therefore require disclosure. The securities regulators' definition of materiality asks:

“Would a reasonable investor's decision whether or not to buy, sell or hold securities in your company likely be influenced or changed if the information in question was omitted or misstated?”⁸

To day and momentum traders climate change will not be material to their investment decision making. But it is becoming increasingly difficult to argue that climate change matters are not material to institutional investors.

4 PricewaterhouseCoopers and IETA, *Trouble-Entry Accounting – Revisited*, September 2007.

5 In December 2007, the International Accounting Standards Board (IASB) added a project on *Emission Trading Schemes* to address this issue.

6 Form 51-102F1, Part 1(a).

7 Form 51-102F1, Part 1(a).

8 Form 51-102F1, Part 1(f).

Mainstream institutional investors are driving improvement in the adequacy of climate change disclosure, outside Canada and within. Climate change issues are appearing increasingly in shareholder resolutions, and are gaining increasing numbers of votes at annual general meetings.⁹ Investment firms such as Goldman Sachs¹⁰ have issued policies regarding climate change. CIBC World Markets created the Carbon Cap Composite Vulnerability Index, ranking companies by industry based on their exposure to risk from a regulated carbon cap-and-trade system. The insurance sector with over \$16 trillion in global invested assets¹¹ is requesting better disclosures from companies in which it invests.¹²

Not only are long-term investors pressing for better disclosures. So too are some companies, such as those who are beginning to exert pressure on corporate supply chains to disclose key climate change information.

Securities regulators have indicated that they are going to pay more attention to MD&A disclosures about climate change and other environmental issues in their reviews of corporate filings.¹³

Executives would be well advised to consider the adequacy of climate change disclosures in their financial reporting—both financial statement and MD&As.¹⁴ Executives should also anticipate directors' enquiries about the adequacy of such disclosures before the audit committee and board approve the financial statements and MD&A.

CEO/CFO Certifications

For public companies, securities regulators require chief executive officers (CEOs) and chief financial officers (CFOs) to certify as to the fairness and completeness of the disclosures in financial statements, MD&As and AIFs¹⁵. CEOs and CFOs of non-venture issuers must certify also that their disclosure controls are appropriate to produce timely and reliable information—this applies to all information that should be provided in regulatory filings, including climate change disclosures.

Some companies have invested significantly in establishing reliable information systems related to greenhouse gas emissions. But many have not.

9 <http://www.incr.com/NETCOMMUNITY/Page.aspx?pid=855&srcid=198>

10 See Appendix for the link to the Goldman Sachs policy.

11 Ceres. *From Risk to Opportunity 2007 Insurer Responses to Climate Change*. October 2007. Page 33.

12 ClimateWise. *Reducing the Risk for Tomorrow*—see http://www.climatewise.org.uk/media/669/factsheet_final.pdf

13 For example, Alberta Securities Commission, *Continuous Disclosure Review Program 2006 Report*, page 10, OSC Staff Notice 51-706 *Corporate Finance Branch Report 2007*, November 1, 2007, page 21 and OSC Staff Notice 51-716 *Environmental Reporting*, February 27, 2008.

14 See CICA Discussion Brief, *MD&A Disclosure About the Financial Impact of Climate Change and Other Environmental Issues*. October 2005. http://www.cica.ca/download.cfm?ci_id=35203&la_id=1&re_id=0

15 AIFs are not required for venture issuers.

Civil Liability

For public companies, executives and directors (among others) need to consider the potential for lawsuits in Canada whereby they can be at risk for providing misleading public disclosures or failing to make timely disclosures. Documenting disclosure decision-making processes is extremely important in this disclosure environment.

There is potential exposure for executives and others in locating climate change information only outside regulatory securities filings, perhaps in sustainability reports or in responses to surveys such as the *Carbon Disclosure Project*¹⁶. If information contained therein is considered material to investors, then securities regulations require such disclosures to be also in the MD&A.

Questions for CEOs and other executives to consider:

3. Are climate change issues, as they affect or may affect the company, likely to influence the company's investors or prospective investors in their investment analysis and decision making?
4. If yes, that is to say climate change issues are likely to be considered material to investors, are there appropriate disclosures in the MD&A and/or financial statements, as well as in other locations such as the CEO's letter to shareholders?
5. What systems, processes and controls have been put in place to gather reliable and timely climate change information for management analysis and decision making purposes and for disclosure to investors as well as in mandatory government reports about greenhouse gas emissions?

¹⁶ See Appendix: Additional Sources of Information.

Conclusion

Adapting to and mitigating the effects of climate change can significantly affect a company operationally and financially. Executives need to take concrete steps to address the impact of climate change and related regulations on the company's strategies, risks, opportunities and financial performance. Determining the company's greenhouse gas emissions and potential exposure to the effects of climate change are therefore essential first steps. Leadership in addressing and acting on climate change sooner rather than later may in various ways create competitive advantage for a company.

Finally, CEOs and CFOs need to ensure that MD&A and AIF disclosures to capital markets about climate change risks, related strategies and potential financial impacts meet securities regulators' requirements and investors' expectations for such information.

Appendix: Additional Sources of Information

Benchmarking Corporate Governance and Climate Change

CERES. *Corporate Governance and Climate Change: Making the Connection Summary Report*. March 2006. This publication scores 100 companies in the 10 most carbon-intensive sector industries in America on 14 governance steps that companies can take to proactively address climate change.

http://www.ceres.org/pub/docs/Ceres_corp_gov_and_climate_change_sr_0306.pdf

Disclosures About Climate Change

Calvert Investments, CERES, Carbon Disclosure Project. *Climate Risk Disclosure by the S&P 500*. January 2007. This report analyzes the breadth and quality of disclosures provided by S&P 500 companies to investors on climate-related risks and opportunities.

<http://www.ceres.org/pub/docs/CeresSP500.pdf>

Canadian Institute of Chartered Accountants Discussion Brief, *MD&A Disclosure About the Financial Impact of Climate Change and Other Environmental Issues*. October 2005. This publication discusses the need for and nature of MD&A disclosures about the financial impact of climate change issues.

http://www.cica.ca/download.cfm?ci_id=35203&la_id=1&re_id=0

CERES. *Global Framework for Climate Risk Disclosure: A Statement of Investor Expectations for Comprehensive Corporate Disclosure*. October 2006. This publication outlines the information that institutional investors require in order to analyze and assess a company's business risks and opportunities resulting from climate change.

<http://www.ceres.org/pub/docs/Framework.pdf>

Financial Statement Accounting

PricewaterhouseCoopers and IETA, *Trouble-Entry Accounting Revisited*, September 2007. This publication sheds light on the various practices currently employed for accounting for emissions allowances and trading in the European Union.

http://www.pwc.com/uk/eng/ins-sol/publ/pwc_trouble_entry_sep07.pdf?utr=1

GHG Measurement Methodology

World Business Council for Sustainable Development and World Resources Institute. *The Greenhouse Gas Protocol Corporate Standard Revised Edition*. This publication provides standards and guidance for companies and other organizations preparing a GHG emissions inventory.

<http://www.ghgprotocol.org/files/downloads/Publications/ghg-protocol-revised.pdf>

Investor Interest in Climate Change

Carbon Disclosure Project Reports. These reports summarize the responses by major corporations to an annual survey sent on behalf of global investors about climate change performance, policies and strategies.

<http://www.cdproject.net/cdp5reports.asp>

CERES. *Managing the Risks and Opportunities of Climate Change: A Practical Toolkit for Corporate Leaders*. January 2006. This publication provides a toolkit for developing and implementing corporate climate strategy and tracking and reporting progress.

http://www.ceres.org/pub/docs/Ceres_corporate_toolkit_012006.pdf

Goldman Sachs Environmental Policy Framework. This publication sets out how climate change issues influence this company's investment advice, decisions and actions.

http://www2.goldmansachs.com/our_firm/our_culture/corporate_citizenship/environmental_policy_framework/docs/EnvironmentalPolicyFramework.pdf



277 Wellington Street West
Toronto, ON, Canada
M5V 3H2

For further information, please contact:

Lucia Ng
416-204-3395

www.cica.ca

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