

The Impact of Climate Change on Businesses

The green evolution is impacting businesses worldwide. With pressure from governments and consumers to measure and reduce their carbon footprint, businesses have been forced to address how climate change will impact their own businesses. Regulations introduced by various governments to help reduce greenhouse gases (GHGs) in the environment are affecting the way companies do business and their bottom lines. While climate change itself has been a catalyst for new business opportunities, it is becoming apparent that companies need to understand and assess climate change regulations and risks in order to maximize their business performance.

A Need for Regulations

Climate change regulations are necessary to drive business innovation today and in the future. According to **Julie Desjardins**, an **independent consultant and advisor** to the **Canadian Institute of Chartered Accountants (CICA)**, some of the new building codes being introduced will create market opportunities for companies who take advantage of them first. For example, there will be opportunities with green leases, retrofitting buildings and new buildings built to LEED (Land Environment Economics and Development) standards. She not only sees opportunities in the construction industry but also in the automotive industry where there are plenty of opportunities for those companies who have been creative or innovative in their fuel efficiency standards.

Alan Willis who is also an **independent consultant and advisor** to the **CICA** sees climate change as a catalyst for creating new business opportunities in the area of renewable energy technologies like wind turbines and solar power. He believes that "there are a number of medium and small companies developing these alternative technologies."

Despite the new business opportunities created by climate change, the lack of regulations in Canada has discouraged companies to innovate in areas linked to climate change. According to Desjardins, the feedback she received from small and medium sized privately owned companies is that they want climate change regulations to help them better reposition their businesses:

"Water is inextricably linked to climate change. It makes sense when you have a lot of small, medium sized businesses that may have terrific processes for water and storm sewage systems who are saying let's put the regulations in and we will come up with the innovations that are required to meet the new needs now."

Since publishing "*Turning the Corner: Regulatory Framework for Industrial Greenhouse Gas Emissions*" in March 2008, the Canadian federal government has been at a standstill with their national climate change regulations. There have not been any national requirements other than a single national regulation that requires certain facilities to report their 2006 GHG emissions by May 31, 2008. In contrast, countries like Brazil are far more innovative when it comes to **GHG emissions reduction**. According to Desjardins, "Brazil is on the right track where 40% of their fuel comes from the right kind of biofuel [fuel derived from organic matter instead of from fossil products]." However, when it comes to Canada, she warns that innovation might not come to market if Canada doesn't create and implement the appropriate regulations.

Climate Change Risks

While it is important to have climate change regulations in place to drive innovation, it is also important to understand and assess the risks associated with climate change. According to the CICA's document "*Building a Better MD&A – Climate Change Disclosures*", there are essentially four areas of climate change risks that can impact a business: **physical, regulatory, reputational and litigation**.

The **physical risks** of climate change can affect businesses and their supply chains. For example agricultural businesses can be affected by the frequency of extreme weather events like flooding or extended droughts, and that in turn would affect seasonal crop yields and increase costs to food distributors and ultimately consumers.

The **regulatory risks** brought on by current and expected regulations relating to GHG emission limits, cap-and-trade systems, carbon taxes, energy efficiency standards, building codes and environmental permits can affect the long-term health of companies. For example a construction company who promotes and follows green building standards would likely thrive by building energy efficient buildings to reduce greenhouse gases in the environment and help consumers save on energy costs; on the flipside, **General Motors** failed in assessing the actual impact of climate change on its own business and in its decision to continue to build gas guzzling vehicles while its competitors were already building fuel efficient ones.

With more consumers looking for environmentally responsible companies, **reputational risks** are becoming increasingly important. In an effort to establish itself as a more environmentally friendly retailer, **Walmart** has been asking its suppliers to measure their carbon footprint and to find ways to reduce it since September 2007. In Europe, consumers are demanding that consumer product labels include carbon footprint information. And in today's global economy, this can impact businesses' competitiveness. For example, "if you are a farmer in Canada that supplies the food industry in Europe, you will have to supply your carbon footprint information as well" explains Desjardins.

The impact of other countries' climate change regulations on Canada is undeniable, especially with the United States. If the *American Clean Energy and Security Act of 2009* in the United States goes through, "there is the threat of border tariffs [on Canadian products and services] if Canada is not diligent or perceived to be as diligent in its regulations as the United States," says Desjardins. With the United States being Canada's largest trading partner, there is a willingness to harmonize with the U.S. system to make things easier for Canada and to avoid the possibility of border tariffs. However, "Canada is going to need thoughtful economic policies going forward since the Canadian economy and Canadian businesses are quite different from those of the United States," stresses Desjardins.

When it comes to **litigation risks**, large GHG emitters are at the top of the list. In September 2007, the New York Attorney General, Andrew Cuomo, sent subpoenas to five major U.S. energy companies seeking information about the companies' analyses of financial risks of their GHG emissions and the disclosure of such risks to their shareholders. The investigation was to determine if these companies were in violation of providing selective and/or misleading climate change information. Without admitting or denying any wrongdoing, two of the companies under investigation, **Xcel Energy and Dynegy**, agreed voluntarily to expand and continue to provide a discussion of climate change and future potential risks in their 10-K filings with the U.S. Securities & Exchange Commission.

In the case of Kearn Oil Sands Mining and Extraction Project in Alberta, "**Imperial Oil** was delayed in its regulatory approvals because it had not done a sufficiently robust job of analyzing the greenhouse gas emissions related to the project," explains Desjardins. And according to Willis, the longer a project is delayed, the more costs a company incurs i.e. interest charges and a whole host of other unproductive charges.

Transparency and Disclosures

These examples emphasize the need for greater transparency and disclosures of climate change information by publicly accountable enterprises. Currently, Canadian reporting issuers are required to file

Management's Discussion and Analysis (MD&A) reports to securities regulators along with their quarterly and annual financial statements. According to Desjardins and Willis, the major institutional investors in Canada want improved disclosures on climate information, from how climate change would likely impact a company's strategy; to how it would fit in its company's strategic plan; from company risks in this area; to how to establish appropriate management and information systems to deal with those risks.

However, the information that appears to be the most difficult to provide is the **GHG emissions data**. While institutional investors want to see this information, the problem has been that companies do not have the systems or processes in place to deliver reliable data. "If companies do decide to disclose emissions data in their regulatory filings, it may take a couple of years to get the information systems and controls in place to ensure the delivery of reliable data," says Desjardins.

Beyond companies' disclosures on strategies, risks and emissions, the potential future financial impact of climate change risks and regulations along with the kind of governance around the whole process are also important to institutional investors. According to Willis, "the advocacy for good MD&A disclosures for investors is mirrored south of the border and internationally. The big driver behind this is investors' interest in getting companies to do these kinds of disclosures in a more robust and meaningful way," explains Willis. While Canada is slow in developing climate change policies, it is now emerging as a leader in the area of disclosure and transparency as the work of the CICA is featured prominently in the **Climate Disclosure Standards Board's (CDSB's)** first exposure draft published in May 2009.

Minimizing Risks and Liabilities

In order to minimize companies' climate risks and liabilities, Desjardins recommends that companies thoroughly understand what the existing regional regulations are and what the anticipated regulations are going to be. From there, companies should assess those regulations for risks and opportunities to their own businesses. She also recommends that companies and individuals take a look at their own carbon footprint and do what they can to minimize it; and lastly, companies should ensure that their Board of Directors are educated at a high level about how climate change might impact their strategies, risks, financial results and information systems and controls.

Educational Resources

With limited educational resources on climate change currently available to Canadian businesses and the accounting profession, the CICA has recently published a new briefing document for directors on climate change that will provide some guidance for them in this area. In addition, the CICA has published other documents available on their website (www.cica.ca/climate) that include how to build a better MD&A and an executive briefing to help companies situate climate change and related issues.

With climate change impacting companies' business strategies, companies will need to understand, assess, and manage the risks involved along with their potential financial impact. In addition, Canadian publicly accountable enterprises will need to provide climate change information in an unbiased and transparent manner through well presented MD&A reports to attract institutional investors. As more climate change regulations are implemented, there will be a price put on carbon and transactions directly linked to climate change issues will be reflected in mainstream financial statements that could be audited. With the profession's deeper involvement in the reporting and auditing aspect of this, there will be an increasing need and demand for more educational resources in the climate change area to provide guidance to Canadian businesses and the Canadian accounting profession.

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