Challenges and Changes

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Directors today operate in a world of constant change. Business models, corporate structures, regulatory requirements, external drivers and investor expectations are constantly shifting. Directors face a challenge to keep up with, or ideally get ahead of the changes, determine their implications for the business and ensure they are incorporated into a solid program of corporate governance.

As Chair of the Risk Management and Governance Board of the Canadian Institute of Chartered Accountants (CICA), I am in a position to see how changes are affecting Canadian directors and what challenges they are facing. Our goal is to identify issues of importance to directors and to develop practical guidance to help them fulfill their oversight responsibilities. It is from this perspective that I will be writing a column from time to time for ICD *Director,* with the goal of helping directors deal with current and emerging issues affecting corporate governance in Canada.

The Challenge of Climate Change

One of the major issues facing directors today is the potential risks and costs arising from the climate change debate. Climate change is a business and shareholder value issue, affecting strategy, risk management and financial performance. It therefore demands both boardroom and management attention.

Companies are facing climate change pressures from different areas, including:

- federal, provincial and international regulations;
- increased disclosure requirements;
- concerns of investors; and
- actions by environmental activists.

A resource I recommend to help directors understand their responsibilities regarding climate change is an Executive Briefing written for the CICA by Julie Desjardins, CA and Alan Willis, CA. This document provides a concise discussion of climate change issues relevant to business. It also identifies key areas of climate change disclosure. The authors pose some critical questions for directors to consider and discuss. For further board education, there is an excellent list of additional sources of information.

Climate Change Developments

- The federal government has introduced regulatory requirements regarding reporting on greenhouse gas (GHG) emissions. It has also set up a framework to address emissions intensity reductions and to establish emissions trading. Regulations supporting this framework are currently under development. Several provincial governments have already enacted climate change regulations; Alberta's involves GHG intensity targets, while others involve carbon taxes.

- Securities regulators have indicated that they are going to pay more attention to disclosures in Management's Discussion and Analysis (MD&A) about climate change and other environmental issues in their reviews of corporate filings.
- Some institutional investors are seeking improvement in the adequacy of climate change disclosure. Climate change issues are appearing in shareholder resolutions.

Business Implications of Climate Change

Directors should ensure that the company's climate change strategy includes two key elements:

1. Mitigation - what is to be done to reduce GHG emissions, and
2. Adaptation - what is to be done to adapt to the impacts of climate change to the extent that they impact corporate operations or future strategies.

Acting to reduce GHG emissions is increasingly important as governments around the world are putting a price on emissions in the form of carbon taxes, emission caps, reduction targets or trading systems. Over time, financial statements will reflect the price that companies are paying for their GHG emissions.

Adaptation involves taking action to minimize and respond to the effects of climate change. Impacts of climate change such as changing weather patterns, water and energy usage, and effects on transportation, forests, agricultural crops, marine life, wildlife and human health may lead to a range of challenges affecting the way business is conducted.

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

- new capital expenditure considerations related to the reduction of GHG emissions and the ability to earn offset credits;
- increased global operating challenges as companies may face a variety of emissions regulations and emission trading systems;
- new considerations in mergers and acquisitions as climate change risk, opportunity and valuation considerations add another layer of complexity; and
- new liabilities and assets, expenses and revenues to be recognized in financial statements.

Corporate Disclosures Regarding Climate Change

Some elements of a company's climate change activities, such as those relating to carbon taxes, emission reduction targets, emission caps and emissions trading will be reflected in the financial statements. The authors of the Executive Briefing point out a problem: there is currently a lack of clear guidance on how to account for GHG transactions under emissions trading systems, leading to the use of a variety of accounting approaches. The inconsistency in accounting practices may lead to comparability problems in evaluating the reported earnings, cash flows and the financial condition of companies. Additional guidance may be on the way, as in December 2007, the International Accounting Standards Board added a project on *Emission Trading Schemes* to address this problem. In the meantime, directors should remain aware of the issue in their review and approval of financial statements.

There will also be climate change disclosures in the MD&A. Securities regulators require companies to disclose important trends and risks that have affected the financial statements, and trends and risks that are reasonably likely to affect them in the future, as well as provide discussion of material information that may not be fully reflected in the financial statements.

It may be insufficient to disclose climate change information only outside regulatory securities filings, perhaps in sustainability reports or in responses to surveys such as the *Carbon Disclosure Project.* If information is considered material to investors, then these disclosures must be in the MD&A.

Directors must ensure that climate change disclosures in both the financial statements and the MD&A are adequate. This will help fulfill the corporation's obligation to make timely disclosure of all material information. Documenting disclosure decision-making processes is extremely important in the current disclosure environment.

Implications for Directors

Climate change should be considered not just as a threat, but also as an opportunity. Adapting to and mitigating the effects of climate change may ultimately affect a company operationally and financially. What should also be noted is that leadership in addressing and acting on climate change may create competitive advantage for a company.

Directors must ensure that they are receiving sufficient information to accurately assess the impacts of climate change on the company and its strategy. They must also monitor the company's progress and ensure that concrete steps are being taken to mitigate and adapt to the effects of climate change while meeting all disclosure obligations.

Questions Directors Should Ask

Here are some questions for directors to consider, as suggested by the authors of the Executive Briefing:

1. How will the need to reduce GHG emissions, adapt to climate change effects and respond to 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? How does the company's plan compare with that of its competitors?
3. If climate change issues are material to investors, are there appropriate disclosures in the MD&A, financial statements, and other corporate communications?
4. What systems, processes and controls have been put in place to gather reliable and timely climate change information for analysis and decision-making as well as disclosure purposes?

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