Sustainability Assurance & ESG Regulation

Implications for Accountants

Presented By

BDO Canada LLP

Three Key Take-a-ways

1. Caribbean will follow the Global Sustainability agenda

2. Regulation is coming; start incorporating climate and sustainability risks and opportunities into business planning

3. Accountants will need to audit financial and non-financial reports; understand how climate risk impacts financial statements

Overview of Today's Presentation

1 ESG 101

2 Climate Risk & Financial Statement Impacts

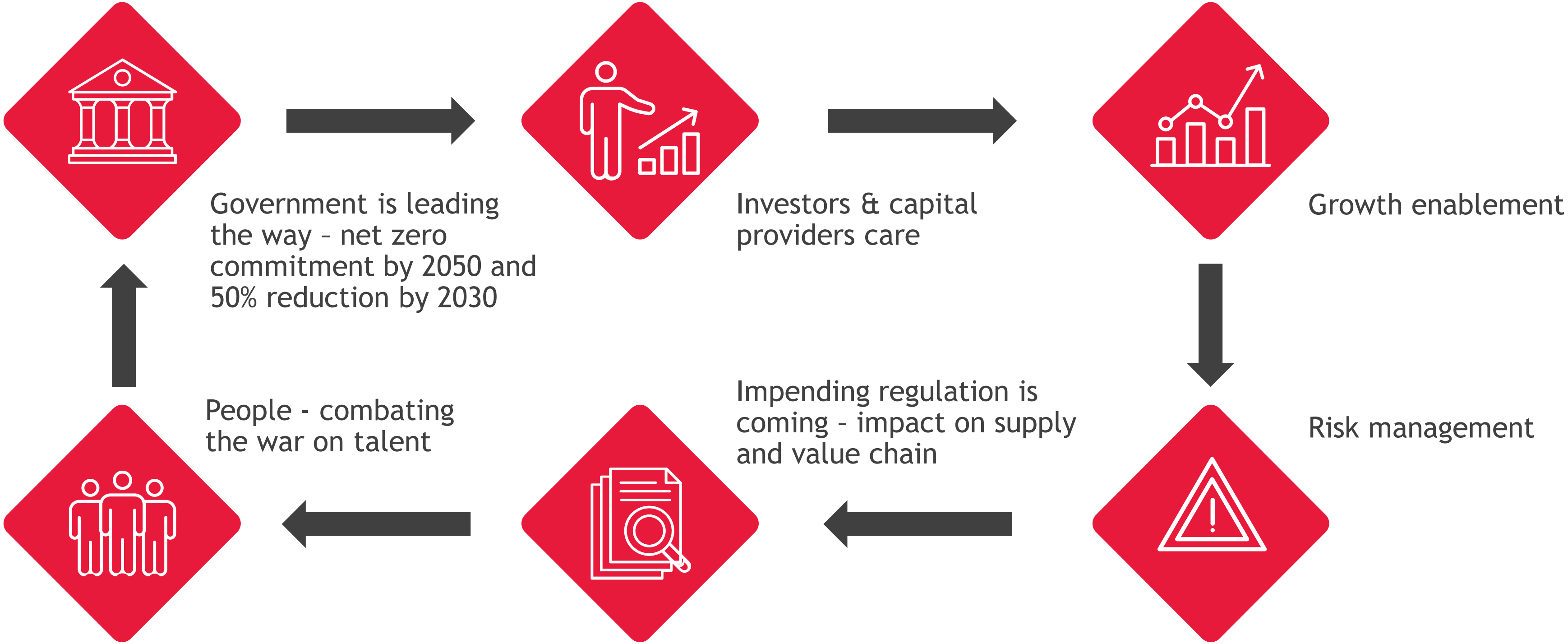
3 Sustainability Regulation & Supply Chain Impacts

4 Assurance

5 How Should Businesses Prepare?

ESG 101

The Driving Market Forces Behind ESG



ESG Enables the Measurement and Management of Sustainability

Environment

- GHG emissions
- Air Quality
- Energy Management
- Water Management
- Waste Management
- Ecological Impacts

Social

- Customer Privacy
- Human Rights & Community
- Data Security
- Access & Affordability
- Product Quality & Safety
- Customer Welfare
- Selling Practices
- Labour Practices
- Employee Health & Safety
- Employee Engagement, DEI

Governance

- Supply Chain
- Product Life Cycle Management
- Business Model Resilience
- Materials Sourcing & Efficiency
- Physical Impacts of Climate Change
- Business Ethics
- Competitive Behaviour
- Legal & Regulatory
- Incident Risk Management
- Systemic Risk Management

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CLIMATE RISK

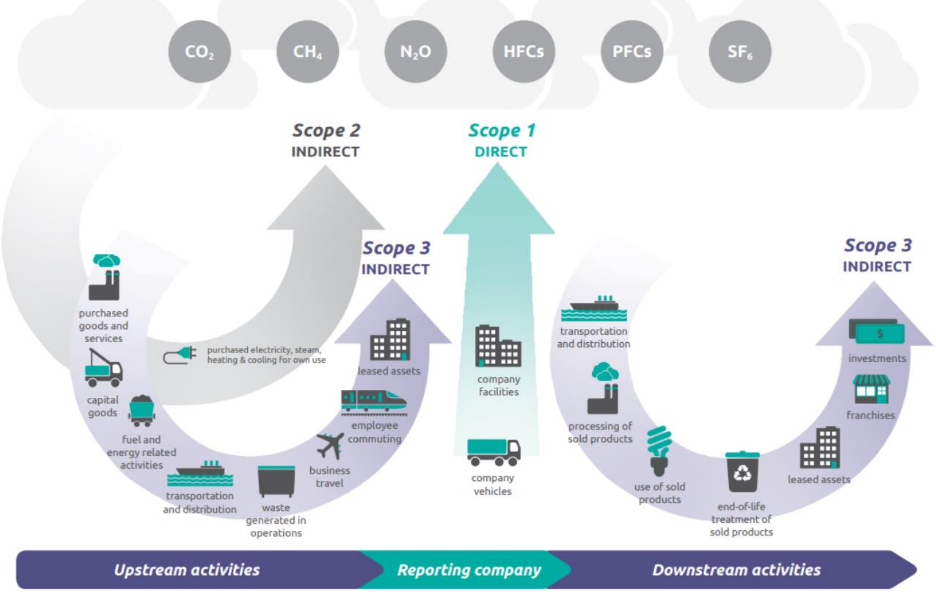
Elements of a Carbon Footprint

Overview of GHG scopes and emissions across the value chain

SOURCES OF DATA

- Building & Facilities
- IT Data
- Travel Data
- Procurement & Finance

Source: GHG Protocol | Corporate-Value-Chain-Accounting-Reporting-Standard



What is Physical Risk?

Can Affect Financial Stability of Financial and Non-Financial Statements

Physical Risk	Risk Event	Potential Impact or Loss
Increased frequency and severity of weather events	**Credit Risk**: Damage to collateral for bank loans	**Credit Impact**: Higher loan to value and loss given default (LGD) due to reduced collateral value; leading to higher capital requirements
	Market Risk: Physical damage and a perception of heightened risk that can affect the market value of investments	**Market Loss:** Mark-to-Market (MTM) investment and/or trading losses
	Insurance Risk: Insurance claims consistently exceed insurance company expectations	**Insurance Loss**: Increased insurance losses and increase cost to reinsure
	Operational Risk: Physical damage to premises; outage of critical services or functions (e.g., bank branch, insurance claims department)	**Operational Loss**: Losses due to physical damage and/or outage; potential reputational damage

Source: *Guideline B-15 - Climate Risk Management (osfi-bsif.gc.ca)*

What is Transition Risk?

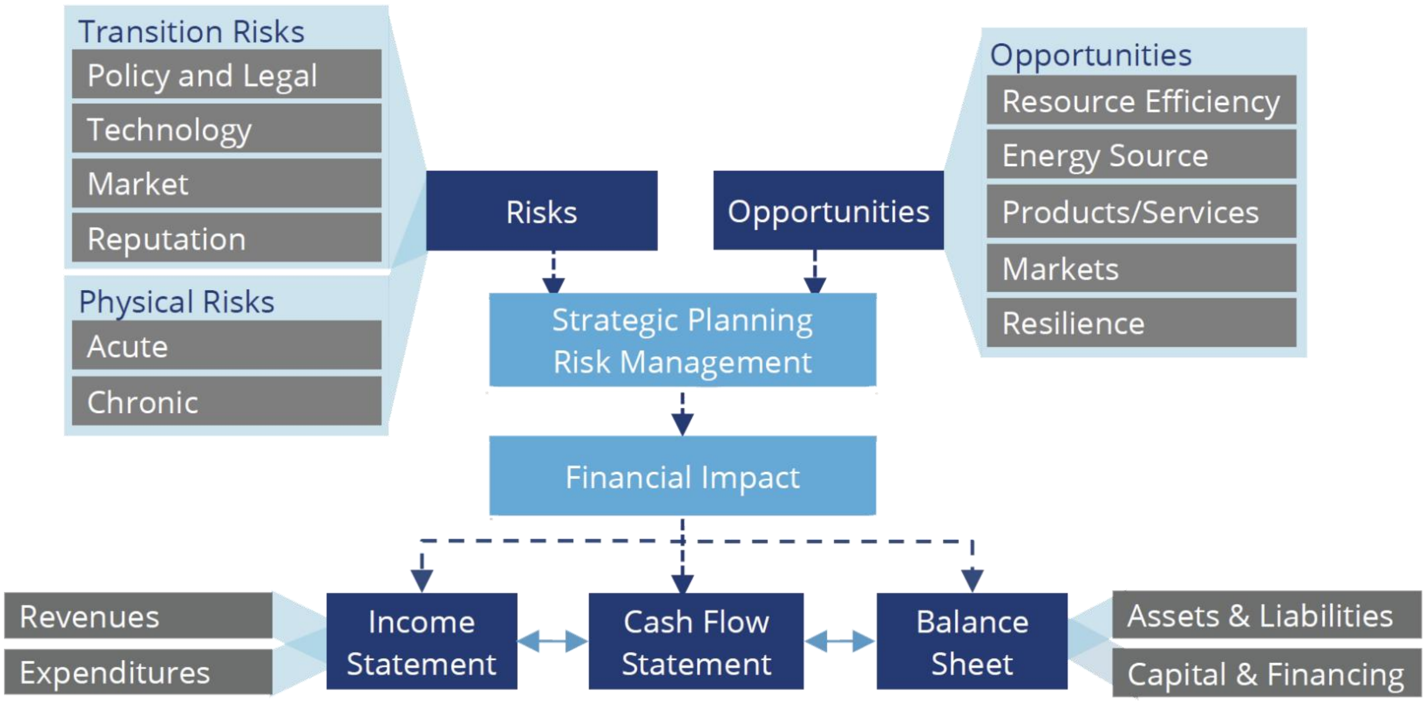
Can Affect Financial Stability of Financial and Non-Financial Statements

Transition Risk	Risk Event	Potential Impact or Loss
Increased regulation related to GHG-intensive industries	**Credit Risk**: GHG-intensive borrowers face higher costs of doing business and/or lower revenues reducing profitability	**Credit Impact**: Increased probability of default due to pressures on the borrower and LGD due to stranded assets, which could lead to higher capital requirements for the FRFI
	Market Risk: Unexpected valuation change in debt and equity securities issued by impacted firms	**Market Loss:** Investment and/or trading losses linked to securities issued by impacted firms
	Liquidity Risk: An institution with a GHG-intensive portfolio may experience diminished demand for its funding instruments in wholesale debt markets as its assets become more illiquid	**Liquidity Impact**: Potential challenges rolling over debt or raising capital
	Liability Risk: The Board of the FRFI may not be seen as fulfilling its legal obligations and appropriately accounting for and managing its climate-related risks	**Legal Impact**: Possible legal action against the FRFI Board; potential reputational damage to the FRFI

Source: Guideline B-15 - Climate Risk Management (osfi-bsif.gc.ca)

WHAT IS THE RELATIONSHIP TO FINANCIAL STATEMENTS?

Risks, opportunities, and financial statements



Source: Task Force on Climate-related Financial Disclosures

Capital Providers are Committed to Net-Zero

Organizations may be asked for their carbon footprint to access capital.

LLOYDS BANK

RBC

BARCLAYS

BAC CREDOMATIC

BANCO PICHINCHA

- Transition investment portfolios to align to net-zero by 2050 or sooner; commit to net-zero approaches relevant to insurance
- Within 18 months of joining, set 2030 targets (or sooner)
- Annually publish and disclose progress against a board-level reviewed transition strategy

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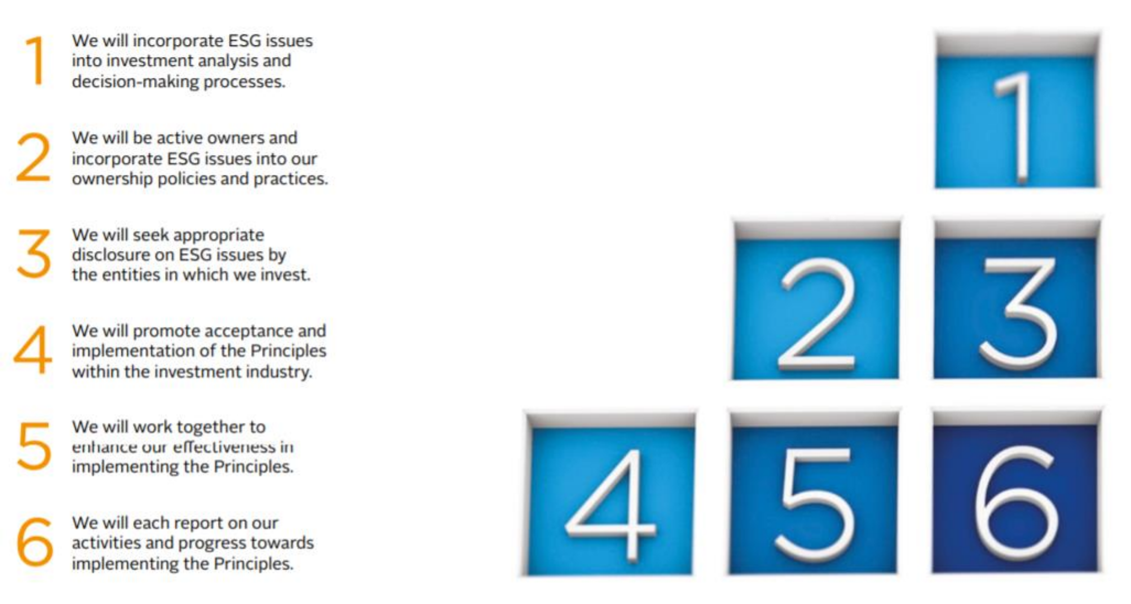
Private Equity Committed to Net-Zero

ESG is shifting investor expectations and disrupting private investment criteria.

- Signatory to the Principles of Responsible Investment (PRI)
- PE is incorporating ESG into the due diligence process
- Focus is increasingly not “if” they should integrate ESG but “where, how, and is it feasible?”



Source: PRI

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SUSTAINABILITY REGULATORY REQUIREMENTS

Primary ESG Regulations Worldwide

CANADA

- Banks/insurance companies and crown corporations holding more than $1 billion in assets to adopt TCFD requirements beginning in 2024
- Impending ESG reporting and climate regulation for public entities expected in 2025
    - Mandatory reporting will put pressure on the entire supply chain (Scope 1,2 & 3 GHG emissions)

USA

- SEC proposed rule on climate change disclosures (published on 21 March 2022)
- Proposed Climate Disclosure Requirements for Federal Contractors, published on November 10, 2022

UK

- TCFD (Task Force on Climate-Related Financial Disclosures) mandatory for large companies

EUROPE

- CSRD (Corporate Sustainability Reporting Directive)
- CSDD (Corporate sustainability due diligence)
- EU Taxonomy
- SFDR (Sustainable Finance Disclosure Regulation)

JAPAN

- JFSA (Japan's Financial Services Agency) public statement - listed and unlisted companies to report climate-related information

CHINA

- Law passed 8 February 2022 – listed and some unlisted companies to disclose environmental information

INDIA

- Business Responsibility and Sustainability Report - top 1,000 listed entities for reporting on a voluntary basis for FY 2021–22 and on a mandatory basis from FY 2022–23

The International Sustainability Standards Board (ISSB)

Mandatory reporting requirements will put pressure on the entire supply chain to disclose both climate and sustainability-related information.

Nov. 2021

At COP26, the IFRS Foundation Trustees announced the creation of the ISSB

Task Force on Climate-Related Financial Disclosures

TCFD | TASK FORCE ON CLIMATE-RELATED FINANCIAL DISCLOSURES

Governance	Strategy	Risk Management	Metrics and Targets
Disclose the organization’s governance around climate-related risks and opportunities.	Disclose the actual and potential impacts of climate-related risks and opportunities on the organization’s businesses, strategy, and financial planning where such information is material.	Disclose how the organization identifies, assesses, and manages climate-related risks.	Disclose the metrics and targets used to assess and manage relevant climate-related risks and opportunities where such information is material.

Source: Task Force on Climate-related Financial Disclosures

Private Company Implications

- Organizations will be required to meet **"Supplier Codes of Conduct"** to maintain the business relationship
    - If they cannot meet this criteria, this could result in an inability to sell to those organizations

- **Climate Risk Management:**
    - Disclose Scope 1, 2 and 3 emissions (phased in)
    - Public Company's Scope 3 = Private Organization's Scope 1 & 2
        - Organizations will be asked to disclose their carbon footprint to access capital

SUSTAINABILITY ASSURANCE

Goals of an External Audit

Ensuring the quality, credibility and relevance of the sustainability report

- Goal: The successful verification of sustainability claims for conformity with the selected criteria based on limited assurance.
- The audit is conducted in such a way that the auditor, after critical appraisal, can rule out with limited certainty that the report is flawed in material respects.
- The need for an external audit also arises from the monitoring duties of the Supervisory Board or the Audit Committee (CSRD requirement).

Correctness and completeness of the data

Conformity with reporting principles and standards

Effective internal control system for the process of data collection and consolidation

Audit by an independent third party

Requirements for a credible sustainability report

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The ESG Assurance Process

- Akin to a financial audit or review, but it covers ESG data

- Scope: Can range from a single metric (i.e. GHG emissions) to a full sustainability report
  - Limited (review)
    - CSRD: Limited Assurance – full report
  - Reasonable (future requirement)

- Generally issued in accordance with the International Standard on Assurance Engagements (ISAE) 3000 promulgated by the International Auditing and Assurance Standards Board.

Auditing Standard ISAE 3000

Sustainability audit

Standard setter:
International Auditing and Assurance Standards Board (IAASB) under IFAC

Purpose:
General international standard for all audits except annual financial statements and quarterly reports

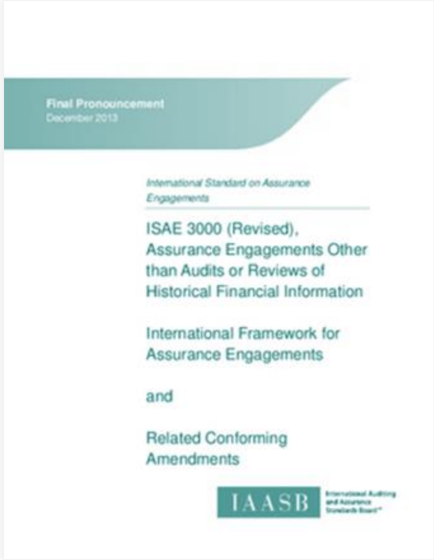
Concept:
Verification of the reliability of the information using appropriate criteria

Criteria:
No specified criteria; criteria must meet characteristics:

- Relevance
- Reliability
- Comprehensibility
- Completeness
- Neutrality

In practice:
By far the most widely used sustainability assurance standard

IFAC International Federation of Accountants


Final Pronouncement
December 2013

International Standard on Assurance Engagements

ISAE 3000 (Revised), Assurance Engagements Other than Audits or Reviews of Historical Financial Information

International Framework for Assurance Engagements

and

Related Conforming Amendments

IAASB

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Limited vs. Reasonable Assurance According to ISAE 3000

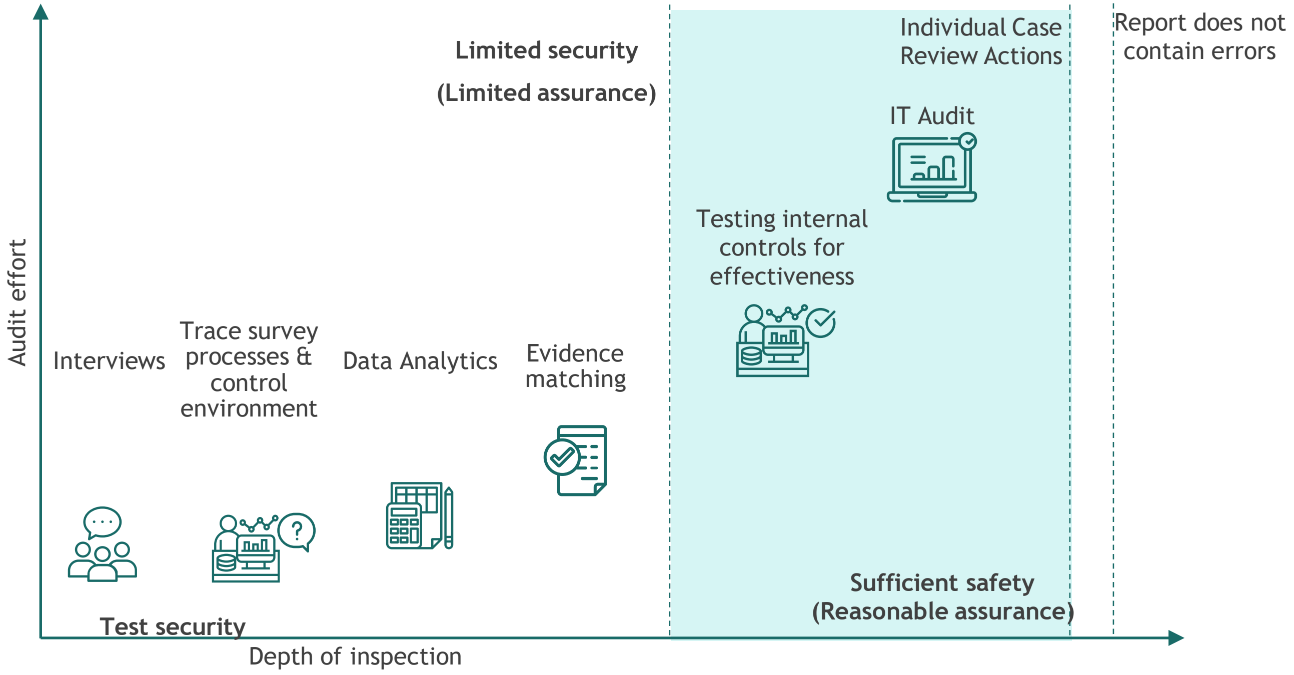
Differences in audit procedures

Limited assurance

- Questioning and analytical assessments with focus on plausibility of information
- Higher degree of freedom regarding site inspections and sample sizes

Reasonable assurance

- Extension of audit procedures to control and IT environment, as focus on accuracy of information
- Less degrees of freedom due to specification of higher coverage, e.g. due to larger sample size or extended site inspections
- Efficient audit through effective internal control system for reported non-financial information



CSRD: Audit Requirement

All companies within the scope of the CSRD must obtain "limited assurance" on the sustainability information submitted

Understanding of materiality analysis, strategy, concept and management approaches.

Analytical testing of quantitative and qualitative data

Review of assumptions and estimation parameters in data collection and evaluation of evidence.

Overall assessment of the sustainability reporting process

Responsibility of the Board of Management, Executive Board and Supervisory Board

- Management's Responsibility for Sustainability Reporting
- Supervisory Board's monitoring duty remains in place
- Audit committee must monitor sustainability reporting, systems and processes

Medium-term target: Introduction of an EU audit standard & increase of audit assurance to "Reasonable Assurance".

WHERE TO START

How Should Organizations Prepare?

1. **Stakeholder Engagement**
    - Capital providers, supply chain, customers, employees
    - Must conduct materiality process accurately
        - CSRD: No mandatory disclosures – everything is dependent on the materiality analysis – must disclose all findings

2. **ESG Risks & Opportunities**
    - Industry specific

3. **Calculate your Carbon Footprint**
    - Scope 1 and 2 GHG Emissions to begin; Scope 3 phased-in

4. **Ensure Data is Auditable; adequate process and controls**

DISCUSSION