

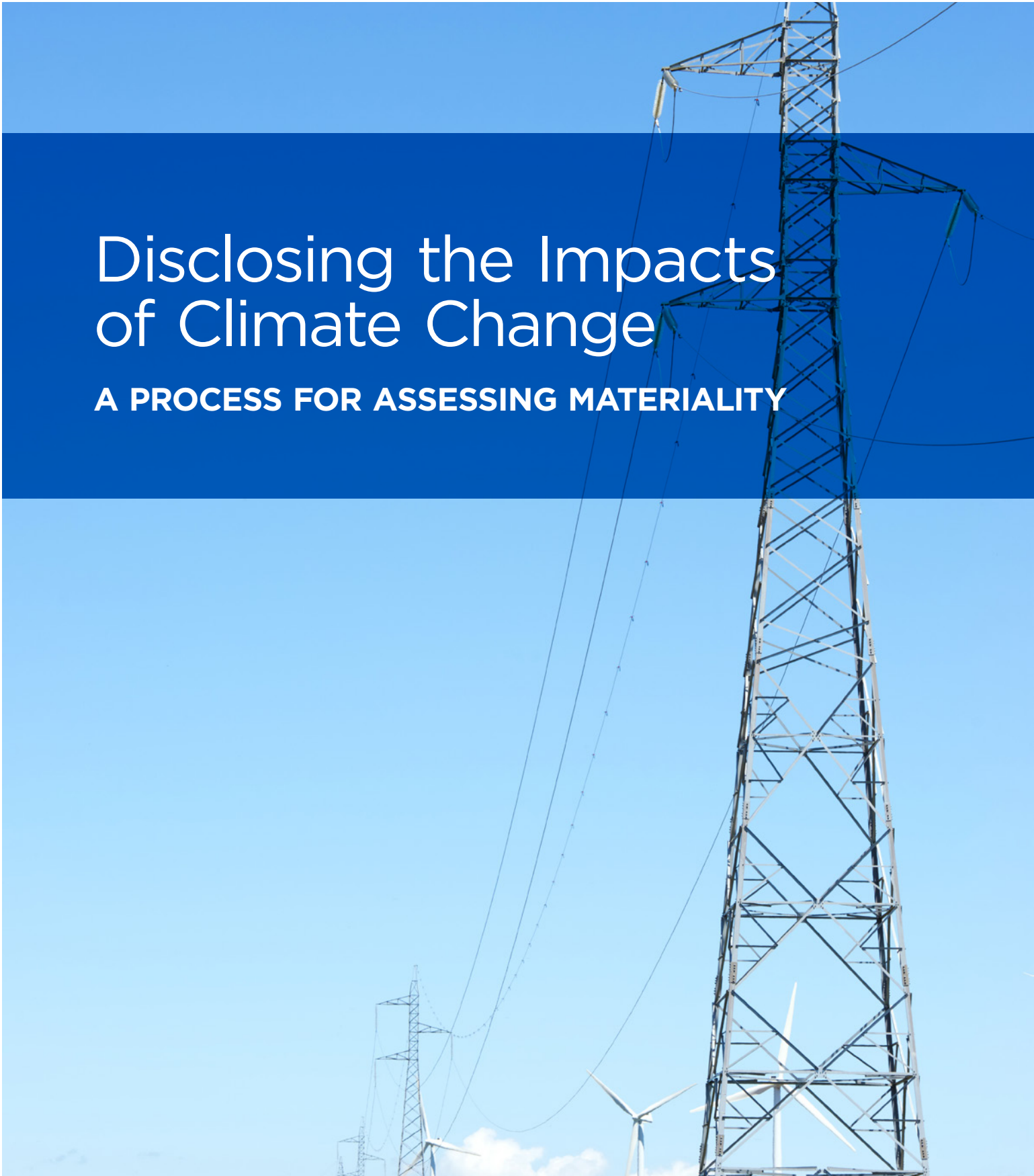


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Disclosing the Impacts of Climate Change

A PROCESS FOR ASSESSING MATERIALITY



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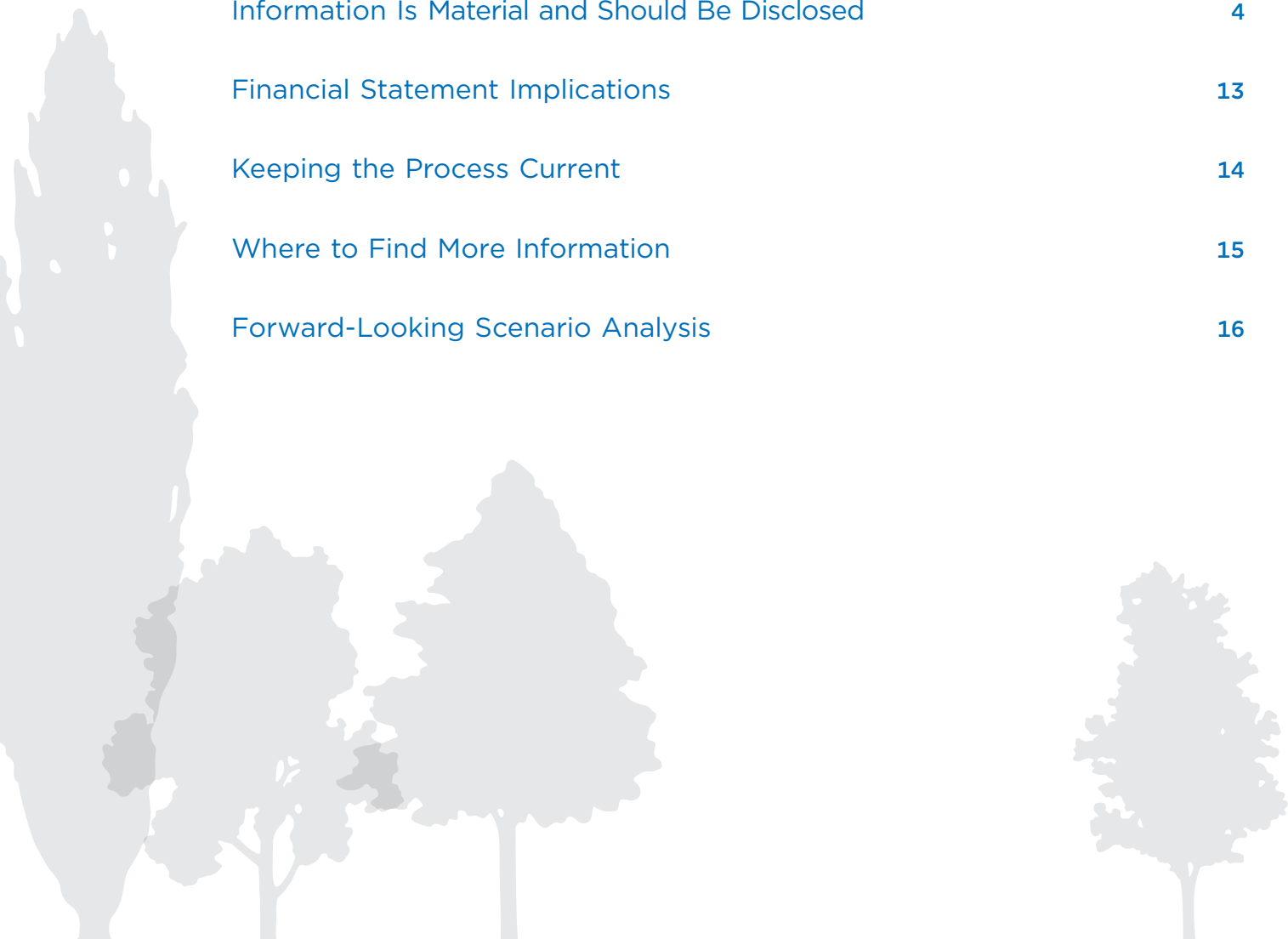
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Introduction

Over the last few years, the implications of climate change for the global capital markets have become widely recognized. The Bank of Canada has identified climate change as one of the six largest vulnerabilities to the Canadian economy.¹

As a result, investors have an increased focus on the effects of climate change during their reviews of current or potential investees.² In many cases, the implications (positive or negative) of climate change on corporate valuations are not yet readily apparent in corporate filings or may be underestimated. Climate change has the potential to significantly impact a company's business model and long-term prospects for value creation.

Purpose of This Publication

Companies often find it challenging to determine what climate-related information should be included in their reporting. Materiality determinations are highly subjective and require significant professional judgment and consultation with a variety of professionals. This publication sets out a process and considerations to assist companies in making this determination for climate-related matters.

This publication does not attempt to comment on what may constitute compliance with securities law or with other legal requirements in any circumstances and should not be used as a substitute for consultation with professional advisors.

1 Bank of Canada 2019 Financial System Review.

2 www.cpacanada.ca/en/business-and-accounting-resources/financial-and-non-financial-reporting/mdanda-and-other-financial-reporting/publications/investor-interviews-on-climate-disclosure

Scope and Users



The scope of this publication includes reporting by Canadian public companies to investors in regulatory filings (i.e., Management Discussion & Analysis (MD&A), Annual Information Filing (AIF) and other documents filed with the securities commissions under continuous disclosure requirements). This publication is intended for those responsible for preparing, reviewing, approving and overseeing regulatory reporting. The intended audience includes CPAs and others in external financial reporting roles, CFOs, CEOs and boards of directors of Canadian public companies.

Investors are focused on information that should be factored into their investment decisions. As such, they are concerned with the potential negative effects (i.e. risks) that climate change may have for a company, as well as any potential positive effects (i.e. opportunities) - and how these effects may impact the company's business model, future cash flows and share valuations.

Companies also report on climate change issues in corporate social responsibility (CSR), sustainability and other voluntary reports. These reports typically have a broader audience than investors, such as employees, customers and other stakeholders. As a result, the definition of materiality applied in voluntary reports differs from regulatory filings.³ For the purposes of this guidance, voluntary reporting is out of scope.

³ The Corporate Reporting Dialogue's Statement of Common Principles of Materiality compares materiality definitions and approaches by various bodies including IASB, FASB, GRI, IIRC and others. <http://corporatereportingdialogue.com/publication/statement-of-common-principles-of-materiality>.

What Is “Material Information”?

For purposes of disclosures by public companies to investors, the most relevant definitions are those used by the Canadian Securities Administrators (CSA) and International Financial Reporting Standards (IFRS Standards).⁴

Under Canadian securities law,⁵ information is material if a reasonable investor’s decision whether to buy, sell or hold securities of the issuer would likely be influenced or changed if the information was omitted or misstated.⁶

In October 2018, the International Accounting Standards Board (IASB) updated its definition of material information as follows:

Information is material if omitting, misstating or obscuring it could reasonably be expected to influence the decisions that the primary users of general purpose financial statements make on the basis of those financial statements, which provide financial information about a specific reporting entity.⁷

The above definitions are consistent. Both focus on whether information would affect financial decisions by investors if it was omitted or misstated. This determination is a matter of judgement and depends on the facts involved and the specific circumstances of the entity. Each company must determine what is material for investors – this applies to climate change information in the same way that it does to the disclosure of other information. However, companies should have a longer-term orientation in their climate

In considering materiality, management should consider whether the impact of a climate change issue might reasonably be expected to grow over time, in which case early disclosure of the matter might be important to long-term investors. This would be particularly relevant where the company is in an industry with a longer operating or investment cycle or where new technologies are likely to be required.

4 Listed public companies in Canada are required to report using IFRS. Cross-listed companies on US exchanges also report under US Generally Accepted Accounting Principles (US GAAP). US GAAP is not in scope for this publication.

5 Form 51-102F1 *Management’s Discussion and Analysis* and Form 51-102F2 *Annual Information Form*; National Policy 51-201 *Disclosure Standards* and CSA Staff Notice 51-333 *Environmental Reporting Guidance* contains guidance on assessing materiality.

6 Materiality must be evaluated in context. Securities legislation imposes a different test for materiality in contexts outside of the AIF and MD&A.

7 www.ifrs.org/news-and-events/2018/10/iasb-clarifies-its-definition-of-material



change disclosures and not just focus on the presence or absence of known short-term implications. In this vein, they should lean toward more disclosure rather than less of potentially significant impacts.

A Process to Determine What Climate Change Information Is Material and Should Be Disclosed

The following process is derived from the IASB's Practice Statement 2: *Making Materiality Judgements*.⁸ Practice Statement 2 provides non-mandatory guidance on making materiality judgments when preparing general purpose financial statements and provides a systematic process for doing so. This four-step process can also be useful for companies in assessing what climate change information is material and should be disclosed.

8 www.ifrs.org/issued-standards/materiality-practice-statement

Four Step Process – Overview

The four steps to assessing materiality of climate-related information could be as follows:

1. **Identify** climate-related factors (including information about the regions or sectors in which the companies operate) and impacts (short and longer term) that have the potential to be material.
2. **Assess** whether the climate-related matters identified in step 1 are, in fact, material to the company.
3. **Organize** the climate-related information in a way that communicates the information clearly and concisely in the most relevant filings, particularly those intended to address risks.
4. **Review** the draft climate-related disclosures to determine whether all material information has been identified and materiality has been considered from a broad perspective, as well as at a detailed level.

The following considers each of the four steps in greater detail, in each case commenting on how the guidance in the IASB's Practice Statement 2 could be applied to climate-related disclosure specifically.



Step 1. Identify

Step 1 is a rough filter to identify types of climate-related information users might need. The information identified will be examined in greater detail in Step 2 to determine what is truly material.

Sources of potentially material types of climate change information may include:

- regulations, reports and guidance issued on climate change and/or environmental issues by securities and other regulators (e.g., CSA Staff Notice 51-333 *Environmental Reporting Guidance*⁹, CSA Staff Notice 51-354 *Report on Climate-related Disclosure Project*¹⁰ and CSA Staff Notice 51-358 *Reporting of Climate Change-related Risks*¹¹)

CSA Staff Notice 51-358 *Reporting of Climate Change-related Risks* (issued August 2019) includes a discussion of “guiding principles” for determining materiality, reinforcing and expanding upon the guidance included in CSA Staff Notice 51-333 *Environmental Reporting Guidance*.

- legal and regulatory requirements related to climate change issues (e.g., GHG emissions reporting, carbon price, energy efficiency, building codes)
- predicted physical climate change impacts in operating jurisdictions (e.g., floods, drought, heatwaves, hurricanes)
- sector-specific guidance on climate-related issues and disclosure topics (e.g., Sustainability Accounting Standards Board (SASB) Materiality Map,¹² United Nations Environment Programme Finance Initiative (UNEP FI)¹³)
- reviews of disclosures made by industry peers, investors, lenders and insurers.
- broader expressions of investor interest in specific climate change information, such as:
 - proxy voting guidelines used by investors
 - stated policies and practices of investors on climate-related information (e.g., climate change investment strategy)

9 www.osc.gov.on.ca/documents/en/Securities-Category5/csa_20101027_51-333_environmental-reporting.pdf

10 www.osc.gov.on.ca/en/SecuritiesLaw_csa_20180405_51-354_disclosure-project.htm

11 www.osc.gov.on.ca/en/SecuritiesLaw_csa_20190801_51-358_reporting-of-climate-change-related-risks.htm

12 materiality.sasb.org

13 www.unepfi.org/banking/banking

- investor statements of support for the Task Force on Climate-related Financial Disclosure (TCFD) recommendations,¹⁴ including commitments to adopt these disclosures
- investor participation in collaborations with peers on implementing TCFD recommendations and engaging with companies on climate-related issues (e.g., Climate Action 100+)¹⁵
- guidance from industry associations (e.g., The Mining Association of Canada's *Towards Sustainable Mining* initiative)

Examples of factors that could create company-specific climate change impacts are the industry, geographic location, method of operation and political jurisdiction. In making this determination, some questions to consider include:

- What are the relevant climate change laws and regulations in operating jurisdictions?
- What are the relevant climate change reporting requirements (mandatory and voluntary)?
- What are the predicted climate change impacts in relevant geographic locations, including those for supply chains and key customers?



14 www.fsb-tcfd.org/publications/final-recommendations-report

15 www.climateaction100.org

Investors often compare different companies when making their investment decisions. Companies should consider providing climate-change disclosures that can be compared to those of other companies in the same industry and facing similar climate-change issues. The SASB Standards¹⁶ provide recommended industry-specific disclosures on environmental, social and governance (ESG) issues (including climate change), that are likely to be material to investors. Many investors use the SASB Standards to assess material ESG issues when making investment decisions.¹⁷

Step 2. Assess

Step 2 considers which information identified in Step 1 could reasonably be expected to influence users when making current or future investment decisions. A key aspect of this step is understanding the potential size and nature of the current and expected climate change impacts on the company, which will be affected by the nature, location and activities of the company's specific business(es). This may require considering the potential effects of climate change using variable assumptions about future climate change-driven events, future regulatory regimes and the ability to mitigate these root causes.

Refer to Appendix A for additional information on forward-looking scenario analysis, which is recommended by TCFD as a key exercise for assessing the range of plausible impacts on a company.

Questions to be considered include:

- Which climate-related events and developments could plausibly impact the company, its suppliers and key customers in the short, medium and longer term?
- What is the potential impact if these climate-related events and developments occur?
- How likely are the climate-related impacts to happen under different levels of global warming?
- Are there interconnected causes and impacts that need to be considered in aggregate?

¹⁶ www.sasb.org

¹⁷ www.cpacanada.ca/en/business-and-accounting-resources/financial-and-non-financial-reporting/mdanda-and-other-financial-reporting/publications/investor-interviews-on-climate-disclosure

Step 2 should include both quantitative and qualitative considerations, such as the following:

- direct financial implications (current and future, certain and potential and/or contingent) such as the impact on assets, liabilities, cash flows and future earnings
- impact on reputation and relationships (e.g., license to operate, customer or client reaction, employee attraction and retention)
- impact of low-carbon transition on business model and long-term strategy across different time horizons
- political developments (including likelihood of adoption and retention of climate-related laws and regulations; shifts in national infrastructure investment priorities)

The greater the number of ways in which climate change might impact an entity, the greater the level of specific disclosures that might reasonably be expected to inform the decisions of users.

- predicted physical impacts of climate change based on sector and geographic location of operations, supply chain and customer base (e.g., increased frequency and severity of extreme weather events; slow onset temperature increase impacting critical infrastructure located in coastal areas, floodplains or northern regions)
- exacerbation of existing material risks – also known as the risk multiplier effect of climate change (e.g., a retailer with a global supply chain may have identified price volatility of inputs such as cotton as an existing risk. This risk could be increased by impacts of changing weather, such as droughts or floods in India, on the price and availability of cotton)

In assessing materiality, management should consider whether the impact of climate change issues might reasonably be expected to grow over time, in which case early disclosure is likely to be important to long-term investors, such as pension funds and insurers. Such disclosure would be particularly relevant where the company is in an industry with a longer operating or investment cycle (e.g., extractive industries, manufacturers and infrastructure providers) or where new technologies are likely to be required to meet regulatory or industry pressures (e.g., low-carbon solutions to reduce greenhouse gas emissions).

Some sources the company might consider in determining what climate change information is material to investors include:

- company-specific input from investors, such as:
 - questions and comments received from investors at shareholders meetings, on earnings calls, and at other investor presentations and direct engagement meetings with investors
 - shareholder resolutions and proxy votes on climate change issues and disclosures
 - analyst and media reports
 - direct outreach to stakeholders
 - comments or changing requirements from bankers or other creditors
- internal company information, such as:
 - enterprise risk assessments, including climate-related risks previously identified
 - board of director oversight of climate change matters, including agendas, meeting minutes and frequency of internal reporting on such matters to the board
 - reviews of existing climate change disclosures in other reports issued by the company (e.g., Sustainability/CSR report, CDP response)¹⁸

Task Force on Climate-related Information (TCFD)

The TCFD recommendations were developed at the request of the G20 via the Financial Stability Board. They were released in June 2017 for voluntary use by companies in financial filings.

Increasingly, investors view the TCFD recommendations as the gold standard for consistent, comparable and reliable climate-related disclosures.

“Investors view climate-related risks as pervading all sectors and geographies. As a result, the default view is that climate-related issues are material unless otherwise demonstrated.”

Source: CPA Canada, [Progressive Investors and the Unstoppable Transition to a Low Carbon, Climate Resilient Economy](#).

¹⁸ CDP, formerly the Carbon Disclosure Project, is a climate change focused data collection and assessment tool. For additional information, see www.cdp.net.

Step 3. Organize

Step 3 focuses on ensuring that climate-related information is disclosed clearly and concisely and is not obscured by immaterial information.

It would be easy for climate-related disclosures to become overly generic or boilerplate. For example, a company might set out all possible positive and negative impacts of climate change without relating these to the company's specific circumstances or the potential impact on its assets, liabilities (including contingent liabilities), cash flow, earnings, strategy and operations. Investors are increasingly seeking more entity-specific disclosures with accompanying metrics and targets that quantify (or provide a range of likely outcomes for) the potential impacts of climate change on the company.

The complexity of the different ways in which climate change might reasonably be expected to impact an entity can affect the level of specific disclosures required. The greater the detail that is required, the more important it is to focus on the clarity and understandability of the disclosures individually and as an overall story.

Possible ways to accomplish this include:

- attention to design and formatting in bringing out the relative prominence of different elements
- using charts, tables or other visual aids
- cross-referencing and connectivity - all information may not need to be provided in the same location, particularly where this would only lead to duplication between different documents

Other important factors in clear and effective communication to investors are consistency in the information provided over time so investors can see what has changed since prior reporting and, to the extent possible, reporting on a consistent basis with industry peers so that investors can compare different companies.

Step 4. Review

In Step 4 the company steps back and considers the aggregate climate-related disclosures from a wider perspective. Some questions to consider include:

- Are the relationships between different climate-related disclosures clear (within a given document, between regulatory filings and against other company issued documents, such as voluntary reports)?
- Has some climate-related information been omitted because it is not considered material yet when combined with other information it might be material? Climate change is a significant risk multiplier, potentially impacting other material risks to the company. As a result, the risks could evolve exponentially over time (e.g., lack of availability of insurance, reduced demand for emissions-intensive products).
- Do the disclosures overwhelm the main messages with excessive detail on secondary matters, thereby obscuring the most important information?
- Are the disclosures balanced and objective?
- Has some climate-related information been omitted because the impact and likelihood of the risk is not well understood and/or quantifiable? For example, physical risks are expected to increase in frequency and severity over time; however, it is challenging for companies to obtain sufficient data to quantify the potential impacts of these risks over extended time horizons. In such cases, directional information might be provided, possibly with an expected range of impacts, as well as details on key factors that will drive the impact



“Where climate-related risks could have a significant impact on a company’s operations, information about how this has been factored into impairment calculations would be relevant to the users of the financial statements. In conclusion, as the effects of climate change become more prominent, they will become more and more visible in the financial statements.”

– Hans Hoogervorst, Chair of the IASB, *Climate-Related Financial Reporting Conference*, Cambridge University, UK, April 2, 2019

www.ifrs.org/news-and-events/2019/04/speech-iasb-chair-on-sustainability-reporting



Financial Statement Implications

Climate change may affect financial statements in several different ways.

For example, IAS 36 *Impairment of Assets* requires disclosure of the events or circumstances that led to the impairment and information on key assumptions used to determine the impairment. In addition, companies should consider the disclosure requirements of IAS 37, *Provisions, Contingent Liabilities and Contingent Assets* for site remediation expenses.

In both instances, the uncertainties about the amount or timing of cash outflows as a result of potential climate-related impacts (e.g., impacts of carbon pricing regulations, changing consumer preferences, supply chain disruptions) may impact the recognition, measurement and/or disclosures required.

Keeping the Process Current

As with all aspects of corporate reporting, disclosure that constitutes effective climate-related reporting in one period may rapidly become more or less meaningful as circumstances evolve. As the company's business changes, new laws and regulations are introduced, major climate driven events actually occur (e.g., floods or storms), more accurate climate science emerges, and innovative technologies are launched, the landscape of climate-related risks and opportunities will shift accordingly. These factors could significantly impact a company's materiality assessment over time.

An entity should establish methods for reviewing all four steps of the process - including regularly refreshing its understanding of investor needs and interests, updating its assessment of quantitative and qualitative materiality considerations, and revisiting its approach to enhancing the disclosures themselves.

Where to Find More Information

- www.cpacanada.ca/TCFD
- www.cpacanada.ca/climatedisclosure
- [SASB Materiality Map](#)
- [SASB Climate Risk - Technical Bulletin](#)
- [Converging on Climate Risk: CDSB, the SASB and the TCFD](#)
- [TCFD Implementation Guide - Using SASB and CDSB Framework to Enhance Climate-related Disclosures](#)
- [TCFD 2019 Status Report](#)
- [TCFD Technical Supplement: The Use of Scenario Analysis in Disclosure of Climate-Related Risks and Opportunities](#)

APPENDIX A

Forward-Looking Scenario Analysis

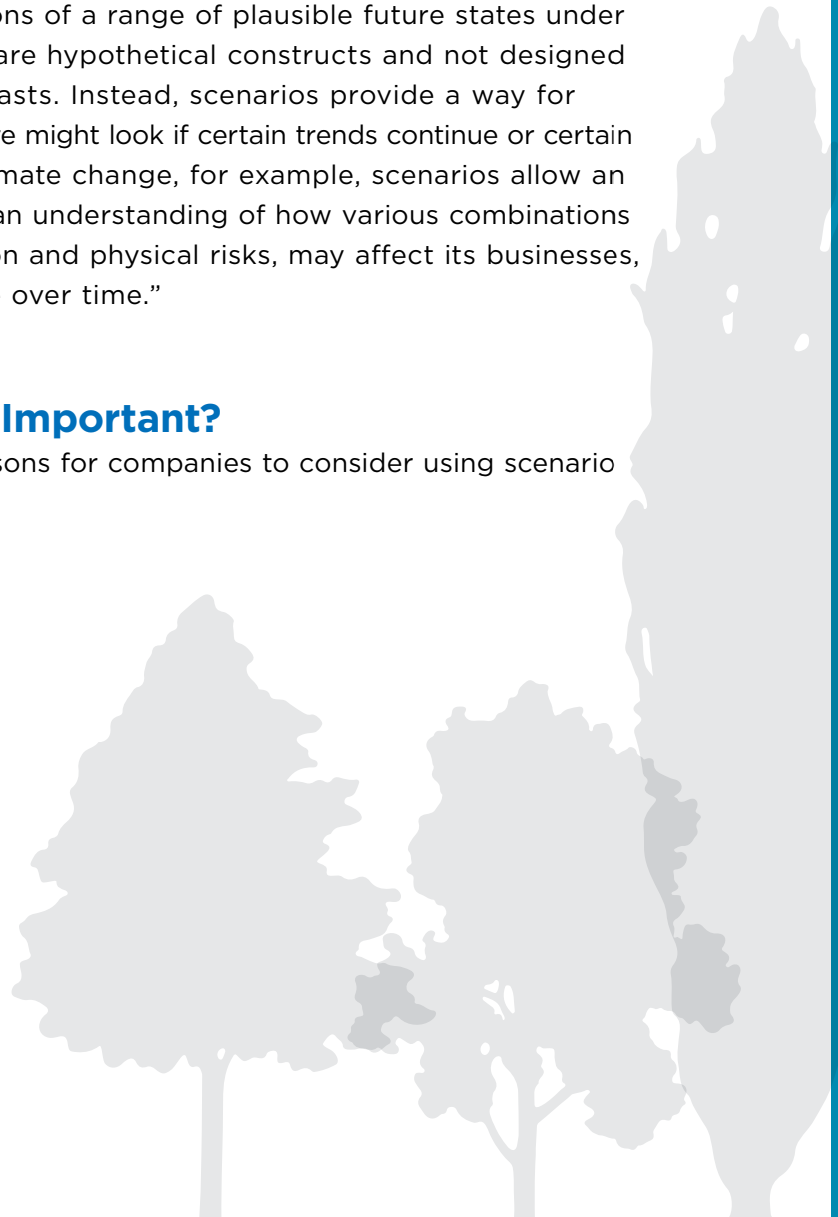
What Is Scenario Analysis?

One of the key TCFD recommendations is for companies to assess and disclose the resilience of their strategy, taking into consideration multiple climate scenarios including a 2 degree or lower scenario.

According to the final TCFD report, “Scenario analysis is a process for identifying and assessing the potential implications of a range of plausible future states under conditions of uncertainty. Scenarios are hypothetical constructs and not designed to deliver precise outcomes or forecasts. Instead, scenarios provide a way for organizations to consider how the future might look if certain trends continue or certain conditions are met. In the case of climate change, for example, scenarios allow an organization to explore and develop an understanding of how various combinations of climate-related risks, both transition and physical risks, may affect its businesses, strategies, and financial performance over time.”

Why Is Scenario Analysis Important?

The final TCFD report identifies 5 reasons for companies to consider using scenario analysis for climate change matters:



1. Scenario analysis can help organizations consider possible outcomes that are highly uncertain, which play out over the medium to longer term and can result in disruptive business impacts.
2. Scenario analysis can enhance strategic discussions about climate change by looking beyond business as usual.
3. Scenario analysis can help companies assess the range of plausible impacts from climate change, helping to identify potentially material risks and opportunities if such scenarios were to occur in the future.
4. Scenario analysis can help companies identify key indicators in the external environment to monitor over time.
5. Scenario analysis can assist a company's investors in understanding the robustness of a company's response to climate-related risks and opportunities on business strategy and financial performance.

Key Considerations in the Context of Assessing Materiality

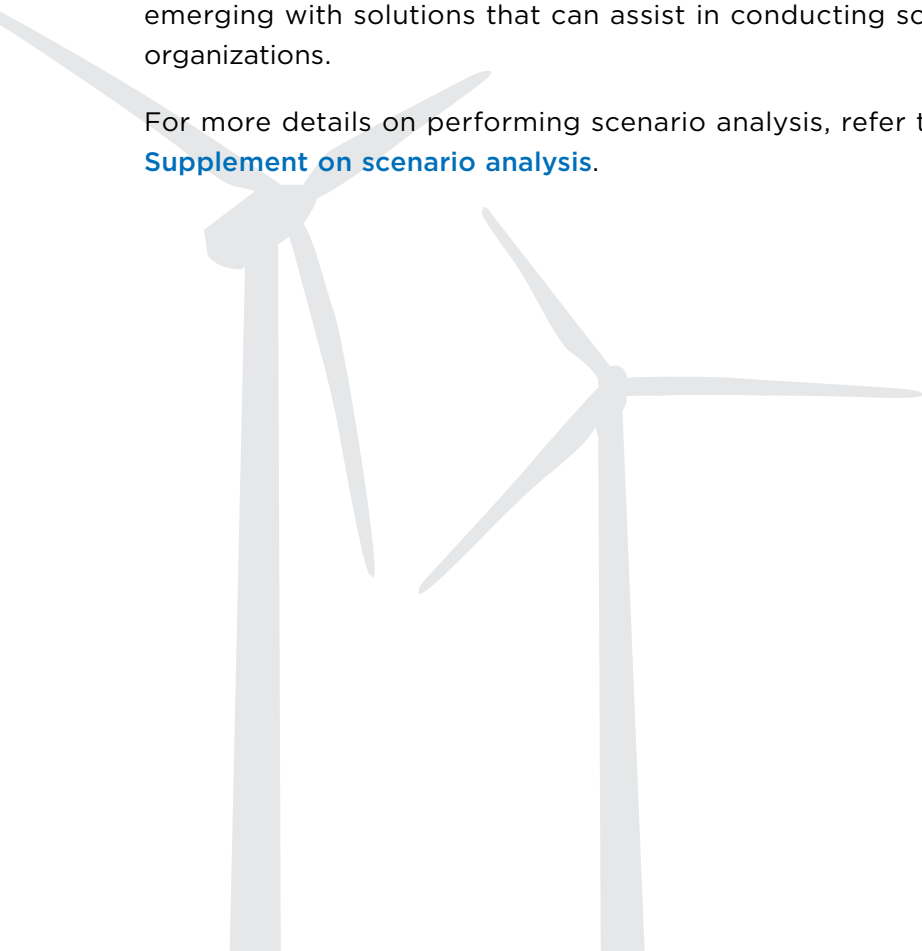
Scenario analysis can be used to inform a company's materiality assessment of climate-related risks.

Typically the scenarios chosen include a low warming pathway (where transition risks from the adoption of policies and technologies to achieve a low carbon economy could be more significant) and a high warming pathway (where physical risks to facilities and supply chains could be more significant). The range of plausible outcomes from these scenarios should be considered in assessing a company's material risks. These risks may include the ability of the company to adopt a strategy that would be resilient under multiple scenarios.

It is important to note that scenario analysis is inherently complex due to the need to integrate climate science, macroeconomic and financial models in fully determining the potential impacts to a given organization. The more potential impacts and risk multipliers for a given company, the more thorough their scenario analysis and corresponding disclosures should be.

Leading companies such as Royal Dutch Shell, BHP Billiton, Statoil, ConocoPhillips and Glencore use scenario analysis to assess how climate change may affect their businesses. Financial institutions use scenario analysis to test the resiliency of their portfolios under different future climate change pathways. Third party vendors are emerging with solutions that can assist in conducting scenario analysis for other organizations.

For more details on performing scenario analysis, refer to the [TCFD Technical Supplement on scenario analysis](#).





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