Foresight: The CPA Podcast

Season 5 Episode 6: Adapting to new sustainability reporting standards

Neil Morrison: Welcome to Foresight: The CPA Podcast, I'm Neil Morrison.

So far this season, we've explored developing and emerging issues that are largely speculative. Whether it's the rise of generative AI or Generation Z, the impact will be felt in the future. Not far in the future but it will be a few years before things really take shape.

On this episode, we're digging into an issue that has already emerged. The change has already arrived and as Shreya Mair says,

Shreya Verma Mair: It's definitely a significant change and will be quite disruptive.

Neil Morrison: Shreya Mair is a senior associate at ESG Global Advisors. And the change she is describing is the launch of the new IFRS sustainability disclosure standards. The International Sustainability Standards Board rolled out the first of these disclosure rules last June. Essentially, these standards lay down the rules for companies to share information about their sustainability practices, as well as, their exposure to climate-related risks.

According to Shreya, the arrival of this new disclosure criteria has created something close to a sense of panic.

Shreya Verma Mair: I would say the panic is likely coming from, traditionally or historically, the way that sustainability information has been reported on has been through standalone reports like a corporate sustainability report. And the finance function has worked separately from the function that typically prepares this report. And so financial reports have typically been published in a very different timing than a sustainability report.

And now panic is coming from how that information needs to be integrated within the financial reports and at the same time, because that is a requirement from the ISSB's published standards. That the timing of sustainability reporting needs to come out at the same time as financial reports are published.

Neil Morrison: And is that just more demanding, that it's more frequent? Why would it matter if it needs to come out in May rather than it used to come out in July?

Shreya Verma Mair: Yeah. So firstly, it's depending on where a company's sustainability journey is, what they're reporting and the information that they're providing to the market. Preparers within a company will need to think about a few things.

Firstly, do they have the internal processes and controls in place to have sustainability related risk and opportunities assessed, monitored, managed, and disclosed in the reports? It will need to go through the same rigor and standard as how financial data is prepared and reported on. And so that makes it a little bit challenging in terms of timing.

Because it will need to be in parallel with financial data being prepared. And if a company is going through an assurance process, it will also need to follow that same timeline. So it puts a little bit of pressure on preparers in ensuring that the data related to sustainability information is being assessed in a timely manner, is monitored, and it's integrated within companies processes.

Neil Morrison: You mentioned earlier on that this is going to be disruptive. But why is it in some ways it feels like it would be less disruptive because it's consolidated. Right now you have three different systems, at least three different approaches to reporting on these things. And now we're just going to unify and everybody's going to be speaking the same language. Everybody's going to be delivering it in the same way. That feels like it would seem that might settle things down rather than be disruptive.

Shreya Verma Mair: I think in the long-term, certainly it will. It's just more so in this transitionary period where these initial costs will come in terms of integrating the process for sustainability risk and opportunities. But also from an upskilling perspective. As CPAs, our bread and butter is understanding regulations and standards, and providing credibility to the information that is being disclosed for primary users of financial and corporate reports. However, there is now a need to upskill in ESG knowledge and information.

So that disruption will really come from understanding how climate risks can impact company value and how sustainability risks such as social governance risks will also impact company value and performance. So for example, if a company has various facilities or manufacturing warehouses near coastal lines, or areas of increasing wildfires, if one of their facilities or warehouses is impacted by this, it could disrupt their operation.

Neil Morrison: The additional risk of a flood or a wildfire near a business's operations from climate change. How do you turn that into numbers?

Shreya Verma Mair: Yeah, that's a good question. And I think it's definitely an area where CPAs again, will probably need to upskill in the knowledge of scenario analysis and modeling. We certainly have the competency when it comes to modeling and forecasting on financial data. But I think where we'll need to upskill is the scenario modeling and understanding how different global warming temperatures can impact a company's operations. And I think it'll also be a matter of working with various other professions like actuaries who have understood how to quantify these risks, and working with them to apply that knowledge into the financial data of a company.

Neil Morrison: Is this a completely new thing or were most organizations who were filing sustainability reports, were they already doing something like this, trying to quantify the risk from things like climate change?

Shreya Verma Mair: Traditionally, companies have been doing that and perhaps more in a qualitative perspective. Because it hasn't necessarily been mandatory, so the drive and pressure to quantify it hasn't necessarily been there. Because companies do understand that there will be a cost to do so. So outweighing the cost and benefit prior, lean towards not necessarily quantifying it. So from a qualitative perspective, it's definitely and certainly been there. But I think where the disruption will come from is the quantitative perspective. It's quantifying the data.

Neil Morrison: And to do that, as you said, they're going to have to start working with other professions, actuaries?

Shreya Verma Mair: And engineers as well. One of the biggest things for IFRS too is, it's very focused on climate related disclosures. And that includes Scope 1, Scope 2, Scope 3 emissions. And Scope 3 emissions as you can imagine, is the beast essentially.

Neil Morrison: What is the Scope 3 emissions?

Shreya Verma Mair: Scope 3 emissions are emissions that are coming from upstream and downstream of a value chain. So it's not necessarily controlled by an operation, it's controlled by another upstream or downstream operations within their value chain.

Neil Morrison: Wow.

Shreya Verma Mair: Yeah, so that's quite big. It'll be a web that a lot of companies will need to quantify their entire value chain. And so in order to do that, it'll be a lot of collaboration with other companies and other professions to be able to measure the emissions. And a lot of engineers have that capability and competency to do so.

Neil Morrison: It's interesting that you mentioned the supply chain. Because whether it was a company's own performance on things like carbon emissions, or the performance of different parts of their supply chain. The primary risk for businesses when it came to ESG reporting was reputational. And how is that going to change with this new approach, this new standard?

Shreya Verma Mair: I think the way it'll change is standardization, that you now have a set of disclosure requirements that are very prescriptive in what you need to disclose and how you disclose it. So I think certainly it will help mitigate a lot of that reputational concerns, and it will help mitigate some of that greenwashing that a lot of companies were previously, or have been, accused of.

Neil Morrison: So in some ways if you're a company that's actually doing well on these standards, you haven't been greenwashing. This is good news for you because it reduces that idea that people can just criticize you for glossing over things. You can actually point to something and say, "No, we're doing it for real."

Shreya Verma Mair: Absolutely. And what's probably critical to underscore here is the internal processes that a company will have to be able to disclose on that data. So very similar to financial data, companies would need to have an internal controls financial reporting process. And so you know that there is rigor and credibility around the data that's being disclosed. So similarly with sustainability related risk and opportunities, it will also need to go in parallel or integrated within that financial reporting controls process. And then the credibility further comes from the ability to assure the data.

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Neil Morrison: In your work, you help organizations to prepare this reporting. What have you noticed is the biggest challenge they face? So first I'm going to talk about the organization and then CPAs within that organization who are preparing this sort of thing. What are the biggest challenges they face?

Shreya Verma Mair: That's a really good question. I think the biggest challenge that we're seeing is firstly around the data, gathering the data internally. And it's also a lot of internal education and awareness on sustainability, and how it can have an impact to company performance. So a lot of times what we do is we work with companies to essentially identify what their most material topics are on ESG sustainability. So things like climate change, health and safety, human capital. And then accordingly, we work with them to set those strategies and the metrics that they'll need to report on for the disclosures.

And I think the second challenge is it's the time and the cost for that reporting process. It is quite timely and it does take a lot of effort to be able to gather that data. A lot of that data sometimes can be done manually if it's not on the same systems or processes as financial reporting.

And then the third thing is probably around the upskilling and education on ESG, just understanding what you're reporting on and how, and the needs of your stakeholders reading this information.

Neil Morrison: New skills, you've hinted a little bit at it. But I'm wondering what new skills are CPAs going to need to develop to be able to meet this new challenge?

Shreya Verma Mair: I think we're really well positioned because we understand the regulatory perspective. We understand how to apply standards. We have a very good solid foundation on financial reporting. So it's a matter of what our knowledge is when it comes to sustainability and its impact to a company's performance. And sustainability, it's got quite a bit of breadth. So you have your environmental risks, you have your social risks, you have your governance risks. So really understanding these specific types of risks that are material to a company and an understanding its impact to financials.

And secondly, it's most likely just understanding how to do the scenario modeling so that you have a good understanding of future scenarios over the short term, medium term, and long-term.

Neil Morrison: It feels like it's something that if you're a CPA and you haven't been operating in this space that you need to get on this, you need to quickly skill yourself up.

Shreya Verma Mair: Yeah. And I'm sure it can be quite daunting for a lot of CPAs that haven't necessarily been focusing in on the space. However, it is something that is very applicable to the CPA profession. And I know there's been a lot of educational awareness out both from the ISSB, from CPA Canada governing bodies, and even within companies just working with not only CPAs but other employees and professions within a company to understand and get a good grasp of this landscape.

Neil Morrison: So looking ahead let's say the next five years or so, what are you going to be watching for?

Shreya Verma Mair: Yeah, it's a good question and certainly a lot to consider. Of course, nobody has a crystal ball.

Neil Morrison: Come on. That's what I'm looking for.

Shreya Verma Mair: Well, I can give some speculations of what I feel would likely be something to watch out for.

Firstly, it's really seeing how jurisdictions and even whether they will mandate applying these standards from the ISSB and its impact to companies. You'd want to understand, particularly for the private market, how it's going to impact their reporting processes. And just given in Canada, a good significant percentage of small, medium-sized businesses contribute to Canada's GDP. And so how it will impact their corporate reporting processes if they ever do choose to go public. They'll need to consider a lot of the regulatory costs related to it.

And for public companies, it's really how they're going to integrate and apply these standards. So within the Canadian context, we have the Canadian Sustainability Standards Board that is working in lockstep with ISSB to ensure interoperability and also to ensure how these standards are going to work in parallel with other IFRS-related standards in the Canadian jurisdiction.

And I think another aspect to watch out for is how Scope 3 emissions will play out. Because right now with ISSB, they've provided a relief where if you apply the IFRS S2 standards in the first year, you won't need to disclose on Scope 3 emissions. And there's a lot of uncertainty on the how and the if, especially around double counting. And so we'll need to watch out for the space as to how companies will wrap their heads around measuring Scope 3 emissions and reporting on it.

Neil Morrison: Yeah, that sounds like it's going to be the tricky one. Okay.

Shreya Verma Mair: Yeah.

Neil Morrison: So we started off saying there's some degree of panic, I think. What's your sense? Is that going to subside? Is it necessary? Just as a parting thought, what would you say to... Well, you probably have clients who you're counseling and talking down from that state of panic? What's your advice to them?

Shreya Verma Mair: Yeah, it's a good question. I think certainly we have time. So with the IFRS standards, they won't be. If they will in fact be mandatory, the earliest it'll probably be is reporting period of about 2024. And that again, is if our Canadian jurisdiction and our regulators in Canada mandate this reporting.

Neil Morrison: That's not far away.

Shreya Verma Mair: No, it's not. And so what my advice would be is to just get started on this journey and the understanding of it. It's better to be prepared in advance and have your systems and your processes in place, and a good understanding of your own sustainability risks and how it impacts your company. Because there's other benefits to it, such as lowering cost of capital, even gaining access to capital, getting customer preferences. As we're seeing a shift in the space overall that folks in society are choosing products and services that are more eco-friendly, and are considering sustainability within operations.

So it's just a matter of just getting started and not necessarily shooting for the moon. But it'll be very much a crawl, walk, run approach. And with the standardization, it's going to be quite helpful given that a lot of companies peers and other reporters will be reporting on the same data and information.

Neil Morrison: So is it recognizing that there's opportunity here? It's going to be a challenge, but there's opportunity here.

Shreya Verma Mair: Yes, there's definitely opportunity for collaboration.

Neil Morrison: I think this has been super helpful, Shreya. Thank you so much for speaking with me about it.

Shreya Verma Mair: Yeah, absolutely. Happy to be here. Thanks for hosting.

Neil Morrison: Shreya Verma Mair is a senior associate with ESG Global Advisors.

And that's it. That's the final episode of season five of the podcast. We have really covered a lot of ground again this season. We've looked at the rise of Generation Z, Generative AI, and the rise of polarization in the workplace. And whether accounting should be part of STEM. And we've also examined the ways that the day to day practice of a CPA is changing with the advent of continuous audit and, as we just heard, new standards for sustainability reporting. It's clear that there's no shortage of change coming to the profession.

If you missed any of those episodes, you can go back and listen anytime. And I encourage you to also look through our past seasons. There's lots of great stories there. If you've enjoyed this season, please leave us a five-star review wherever you get your podcasts. Foresight. The CPA Podcast is produced for CPA Canada by Podcraft Productions. And please note, the opinions expressed by our guests are theirs alone, and not necessarily those of CPA Canada. Thanks so much for listening. I'm Neil Morrison.

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