

## Environmental issues lead OSC, accounting profession to focus on climate change disclosure by reporting issuers

JEFFREY ELLIOTT (jelliott@stikeman.com)

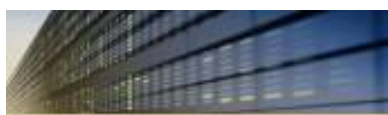
In the last few years, climate change considerations have begun to figure more prominently in the investment decisions of Canadians. This, along with the complexities of complying with the existing regulations (with the prospect of more to come) designed to reduce greenhouse gas (GHG) emissions, has led the Ontario Securities Commission and the accounting profession to focus on the disclosure of climate change issues by Canadian reporting issuers to ensure that investors are fully informed. Two recent initiatives highlight this trend.

### OSC Staff Notice 51-716 - Environmental Reporting

In February 2008, the Ontario Securities Commission (OSC) issued Staff Notice 51-716 - *Environmental Reporting* outlining the results of a targeted review by OSC staff to determine the degree to which reporting issuers were adequately disclosing information about so-called “environmental matters” in their annual financial statements, related management’s discussion and analysis (MD&A) and annual information forms (AIF). The review focused on industries that would, anecdotally at least, be thought of as being most likely to require environmental disclosure – mining, oil and gas, environmental services, steel, transportation services and utilities.

While Canadian securities regulators have not specifically mandated the disclosure of climate change issues in a reporting issuer’s public disclosure record, the requirements of National Instrument 51-102 *Continuous Disclosure Obligations* (NI 51-102) are sufficiently broad so as to capture such issues. A reporting issuer’s MD&A, for example, is required to discuss the effect of “known trends, demands, commitments, events or uncertainties” on the reporting issuer’s “financial condition, results of operations and cash flows”. Moreover, a reporting issuer’s AIF is required to disclose such things as the “financial and operational effects of environmental protection requirements” on its financial position, including capital expenditures. An AIF is also required to detail “social or environmental policies” that are fundamental to the reporting issuer, as well as risk factors such as environmental risks and “regulatory constraints...and any other matter that would be most likely to influence an investor’s decision to purchase” the securities of the reporting issuer.

The OSC noted that the standard (as outlined in NI 51-102) to be met by reporting issuers in determining if environmental matters must be disclosed is whether or not the matter is “material”. Building on the guidance given in NI



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This newsletter was prepared by members of the Securities Group at Stikeman Elliott.

51-102 as to the meaning of “material” in the context of disclosure documents, the OSC stated that information relating to environmental matters is likely material if a reasonable investor’s decision whether or not to buy, sell or hold securities of a reporting issuer would likely be influenced or changed if the information was omitted or misstated. (This concept of materiality is consistent with that contained in the Canadian Institute of Chartered Accountants Handbook.)

The OSC’s Staff Notice provides little in the way of detailed guidance as to (a) the “environmental matters” that should be disclosed in a reporting issuer’s MD&A and AIF, (b) the way in such matters should be teased out of a reporting issuer’s self-appraisal of its business or (c) the way in which such matters should be framed in disclosure documents. That said, some hints are given by the types of disclosure issues focused on by the OSC, which can be summarized as follows:

1. **Environmental Liabilities.** Detailed analysis (beyond boilerplate language) of the cost estimates of environmental contingencies should be contained in the reporting issuer’s MD&A. Moreover, a discussion of “material contingent environmental liabilities” should form part of a reporting issuer’s MD&A and/or AIF regardless of whether the liability has accrued in the issuer’s financial statements or disclosed in the notes to the financial statements.
2. **Financial and Operational Effects of Environmental Protection Requirements.** A qualitative discussion in a reporting issuer’s AIF of the effect on the issuer of environmental protection requirements (e.g. such things as GHG regulations and carbon taxes) should be accompanied by a quantitative assessment of the costs associated with compliance with such requirements.
3. **Environmental Policies Fundamental to Operations.** A reporting issuer should discuss in its AIF the environmental policies fundamental to its operations, including the impact or potential impact these policies may have on their operations. Where a quantification of costs is available, they should also be disclosed.
4. **Environmental Risks.** Included among the risks to be disclosed in an AIF are environmental risks that would be most likely to influence an investor’s decision to buy a reporting issuer’s securities. The review focused on environmental laws material to an issuer’s operations as being “environmental risks” generally necessitating disclosure. Discussion of such risks should include whether or not the reporting issuer is in compliance with such laws, penalties for non-compliance and the cost of compliance.

While detailed guidance from the OSC may be lacking, the very existence of the review does signal to reporting issuers that it is necessary to seriously consider the effect of environmental matters and climate change on their business and to ensure that such matters are adequately disclosed.

## **Canadian Institute of Chartered Accountants – MD&A Climate Change Disclosure Guide**

In late November 2008, the Canadian Performance Reporting Board of the Canadian Institute of Chartered Accountants (CICA) published a disclosure guide “intended to assist MD&A preparers in making decisions about the nature of annual MD&A disclosures regarding the business and financial impacts of climate change issues” (the Guide). The Guide is divided into five parts entitled: (i) Orientation to Business Issues of Climate Change; (ii) What Investors Want to Know About Climate Change; (iii) Developing MD&A Disclosures About Climate Change; (iv) Organizing and Presenting Disclosures; and (v) Overseeing the Integrity of MD&A Disclosures About Climate Change.

### **Orientation to Business Issues of Climate Change**

The first section of the Guide is an attempt to orient reporting issuers to see their business through the climate change lens – something that many, other than those in industries with obvious environmental impacts such as those studied by the OSC in its review, have had little reason to do. The Guide notes that while climate change is, by its nature, an environmental issue, it is one that also has wide-ranging economic and social effects. The business impacts of climate change will require reporting issuers – even those that do not directly produce GHG – to implement strategies to both adapt to the effects of climate change on the reporting issuer’s business and, in other cases, take action to mitigate the extent to which they produce GHG.

While the disclosure of such business impacts will be required only when the securities law threshold of “materiality” has been crossed, as the Guide illustrates, such impacts will likely go beyond the obvious responses to new or existing environmental legislation. For example, access to capital may be restricted for companies with high climate change risks, in some cases business may be interrupted, operations may have to be modified or

relocated, additional capital expenditures may be necessary (with little or no return) and some reporting issuers will be forced to respond to “inter-jurisdictional operating complexities” brought about by operating in jurisdictions with varying GHG emissions rules, offset trading systems, taxes and their attendant risks and opportunities.

### ***What Investors Want to Know About Climate Change***

It is taken as given that quantifiable climate change business impacts characterized by discreet transactions or obligations (e.g. such as those stemming from carbon taxes or carbon offset trades) will be recognized and disclosed in a reporting issuer’s financial statements as appropriate. However, as the Guide points out, investors are increasingly seeking more detailed and nuanced disclosure to understand how a reporting issuer views the impacts of climate change in order to assess its effect on current and future financial conditions, results of operations and cash flows. The source of such disclosure should be the reporting issuer’s MD&A. Again, while only “material” issues need be disclosed, reporting issuers are cautioned that boilerplate disclosure is of no use to investors deciding whether to invest or continue to invest in an issuer.

The Guide outlines five types of information in MD&A that should address climate change issues:

1. ***Business Strategy***. Investors should be presented with an overview of the climate change factors that the reporting issuer has factored into its business strategy – such things as how climate change will affect the issuer’s competitiveness, whether climate change issues present a threat or opportunity to the issuer’s business, the strategy for reducing GHG emissions and other strategic implications for non-capital resources like the development of operating technologies, brand value and reputation.
2. ***Risks***. The physical risks (e.g. changes to weather patterns), regulatory risks (e.g. heightened regulatory oversight and scrutiny), reputational risks (e.g. negative customer perceptions of reporting issuers failing to address climate change issues) and litigation risks (e.g. lawsuits against heavy GHG emitters), for example, of climate change should be spelled out along with related mitigation strategies.
3. ***GHG Emissions***. To the extent that it is material to evaluating the performance and future prospects of a reporting issuer, a reporting issuer’s direct and indirect GHG emissions and related intensity data should be discussed in MD&A.
4. ***Financial Impacts***. The impact of climate change on financial operations, cash flows and the financial condition of the reporting issuer should be discussed along with the future financial implications.
5. ***Governance Processes***. The governance and organizational processes used by the reporting issuer in identifying and managing climate change issues.

### ***Developing MD&A Disclosures About Climate Change***

The Guide recommends that, in general, it is sufficient to provide MD&A disclosures about climate change on an annual basis. Interim MD&A disclosures regarding climate change can be limited to material changes to information reported in annual MD&A.

### ***Organizing and Presenting Disclosures***

The Guide outlines three possible options for the placement of climate change information within MD&A: (i) a separate climate change section; (ii) a subheading within the risk section; or (iii) interspersed within the various sections of the MD&A “to reflect the linkages between climate change and other aspects of the company’s business, such as corporate strategy, capital resources, liquidity, key performance drivers and outlook”.

### ***Overseeing the Integrity of MD&A Disclosures about Climate Change***

The Guide reiterates the fact that both management and the board of directors of a reporting issuer have responsibilities for the reliability and timeliness of corporate disclosures such as MD&A. Management should establish and maintain appropriate information systems to ensure that the effects of climate change issues on the reporting issuer are readily discernable. Management should also be tasked with ensuring that a rigorous and thoughtful analysis of the reporting issuer’s business is regularly conducted to reveal all material climate change issues.

For further information, please contact your Stikeman Elliott representative or any member of our Corporate Finance and Securities Group listed at [www.stikeman.com](http://www.stikeman.com)

#### MONTRÉAL

1155 René-Lévesque Blvd. West, 40th Floor, Montréal, QC, Canada H3B 3V2  
Tel: (514) 397-3000 Fax: (514) 397-3222

#### TORONTO

5300 Commerce Court West, 199 Bay Street, Toronto, ON, Canada M5L 1B9  
Tel: (416) 869-5500 Fax: (416) 947-0866

#### OTTAWA

Suite 1600, 50 O'Connor Street, Ottawa, ON, Canada K1P 6L2  
Tel: (613) 234-4555 Fax: (613) 230-8877

#### CALGARY

4300 Bankers Hall West, 888 - 3rd Street S.W., Calgary, AB, Canada T2P 5C5  
Tel: (403) 266-9000 Fax: (403) 266-9034

#### VANCOUVER

Suite 1700, Park Place, 666 Burrard Street, Vancouver, BC, Canada V6C 2X8  
Tel: (604) 631-1300 Fax: (604) 681-1825

#### NEW YORK

Tower 56, 14th Floor, 126 East 56th Street, New York, USA 10022  
Tel: (212) 371-8855 Fax: (212) 371-7087

#### LONDON

Dauntsey House, 4B Frederick's Place, London EC2R 8AB England  
Tel: 44 20 7367 0150 Fax: 44 20 7367 0160

#### SYDNEY

Level 12, The Chifley Tower, 2 Chifley Square, Sydney N.S.W. 2000 Australia  
Tel: (61-2) 9232 7199 Fax: (61-2) 9232 6908

[www.stikeman.com](http://www.stikeman.com)

**STIKEMAN ELLIOTT**

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