CPAs AND THE NEW SOCIAL CONTRACT

THE RISE OF THE WARRIOR ACCOUNTANT

CPA ONTARIO INSIGHTS | CPAONTARIO.CA

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"All this amounts to a test of stakeholder capitalism. When it's over, companies will be judged by 'what they did during the war', how they treated their employees, suppliers and customers, by who shared and who hoarded."[1]

— Mark Carney, former governor of the Bank of England, in The Economist, April 2020

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INTRODUCTION

We didn't see it coming. A global pandemic, rolling economic crisis and worldwide protest movement combined to make 2020 an epoch-defining year.

Emerging from these dramatic events into 2021, a consensus is building about the need for a new social contract that will see government, citizens and the private sector working together to tackle inequality and achieve justice.

The role of the corporation and the responsibility that businesses have to their employees, customers and the community is increasingly up for debate. Discussions of shareholder primacy have been superseded by solemn promises of stakeholder consultation. Milton Friedman is turning in his grave. CPAs have long had the ability to shape businesses: now they have the capacity to drive real social change.

Business leaders are being asked to consider myriad social issues. From racial pay equity to work from home conditions, from data privacy to tax transparency and human capital—in the post-pandemic era, investors, regulators and the community will increasingly expect companies to measure and improve their impact on society. CPAs are in a unique position to help them do this in a way that is rigorous, thoughtful and bold.

CPA: Social justice soldier?

When the pandemic hit, environmental risk reporting had already been promoted from corporate social responsibility sideshow to core business strategy, at least for large listed companies. Organizations increasingly realize that climate change will have a dramatic impact on the bottom line. Now, social metrics—the S in ESG (environmental, social and governance)—look set to enjoy similar prominence.

Investors are increasingly looking for ways to responsibly invest for both shareholder returns and ESG factors like lowering greenhouse gas emissions, tackling inequality, systemic racism, job creation and sustainable long-term economic growth. And in 2020, the covid-19 pandemic accelerated demand for impact investing strategies.

Responding to pressure from shareholders and customers, more companies are beginning to report on social metrics and set targets for social change beyond what the law requires. Yet a lack of consensus around reporting standards for non-financial information, along with notoriously unreliable data, means that reporting on a company's social impact—and on the material risks that company faces from social upheaval—may be easier said than done.[2] Many feel like they inhabit a "Wild West" of disclosures. According to Gordon Richardson FCPA, FCA, KPMG Professor of Accounting in the Rotman School of Management at the University of Toronto, "there is a need for mandatory and standardized ESG reporting so investors and stakeholders can benchmark firms' performance against sector peers."

Professional accountants and finance experts may then have a valuable role to play in adding rigour, accuracy and consistency to social measurement and reporting, just as they do to financial reporting. Not all are convinced this is an appropriate role, and question whether "impact-washing" is simply the latest corporate fad. But many want to have answers at the ready when the CEO or board directors come calling. To that end, this report aims to provide a resource for Ontario CPAs who want to better understand the rapidly evolving ESG space. The insights in this report are distilled from more than 40 interviews with business leaders, many of whom are CPAs, exploring what the explosion of interest in social impact and risk will have for companies in Ontario and the CPAs who work with and for them.*

Who is driving this interest and why? What metrics currently exist? What social impacts are companies measuring? How do we compare to the rest of the world? And what should CPAs do about it—if anything?

PART 1

THE WARRIOR ACCOUNTANT

"Rarely has the accounting profession had such a potentially momentous role to play in global affairs."[3]

— *Gillian Tett, Financial Times*

In 2020, *Financial Times* columnist Gillian Tett called attention to the "suddenly-not-so-boring" accountants working to harmonize ESG reporting at the World Economic Forum in Davos in January 2020. "The Warrior Accountant," she wrote, will "do more to change the world on green issues than activists".[4]

Tett, along with asset managers pitching ESG funds, an investment category that has boomed since the onset of the covid-19 pandemic, hopes CPAs will tie ESG metrics to business strategy, enabling their organizations to respond nimbly to emerging social shifts. If accountants get involved in determining materiality, developing metrics, setting targets and establishing controls, businesses will be better able to translate and manage their environmental and social impacts and the risks they face from social change.

This will require the "warrior accountant" to shift their stance, from a defensive position where ESG helps to guard against reputational risk, to an offensive posture that is more assertive in putting organizational ESG performance in the public domain.

CPAs who are already involved in ESG issues agree that there is an opportunity for the profession to use its expertise in measuring, disclosing and auditing to bring rigour, consistency and comparability to ESG reporting, says Elizabeth Demers, Professor of Financial Accounting at the University of Waterloo. "We are the ultimate experts in measurement, disclosure and attestation, which is what's needed in the ESG realm. We should be leading," she says. Brian Lawson, Vice Chair at Brookfield Asset Management, agrees that accountants will "absolutely" play a key role in this space. "The financial reporting teams within companies are trained to measure performance and have deep experience in understanding and assessing performance against standards and principles, making them best equipped to measure ESG."

"I don't think the accounting realm has quite grasped yet the opportunity that is coming its way."

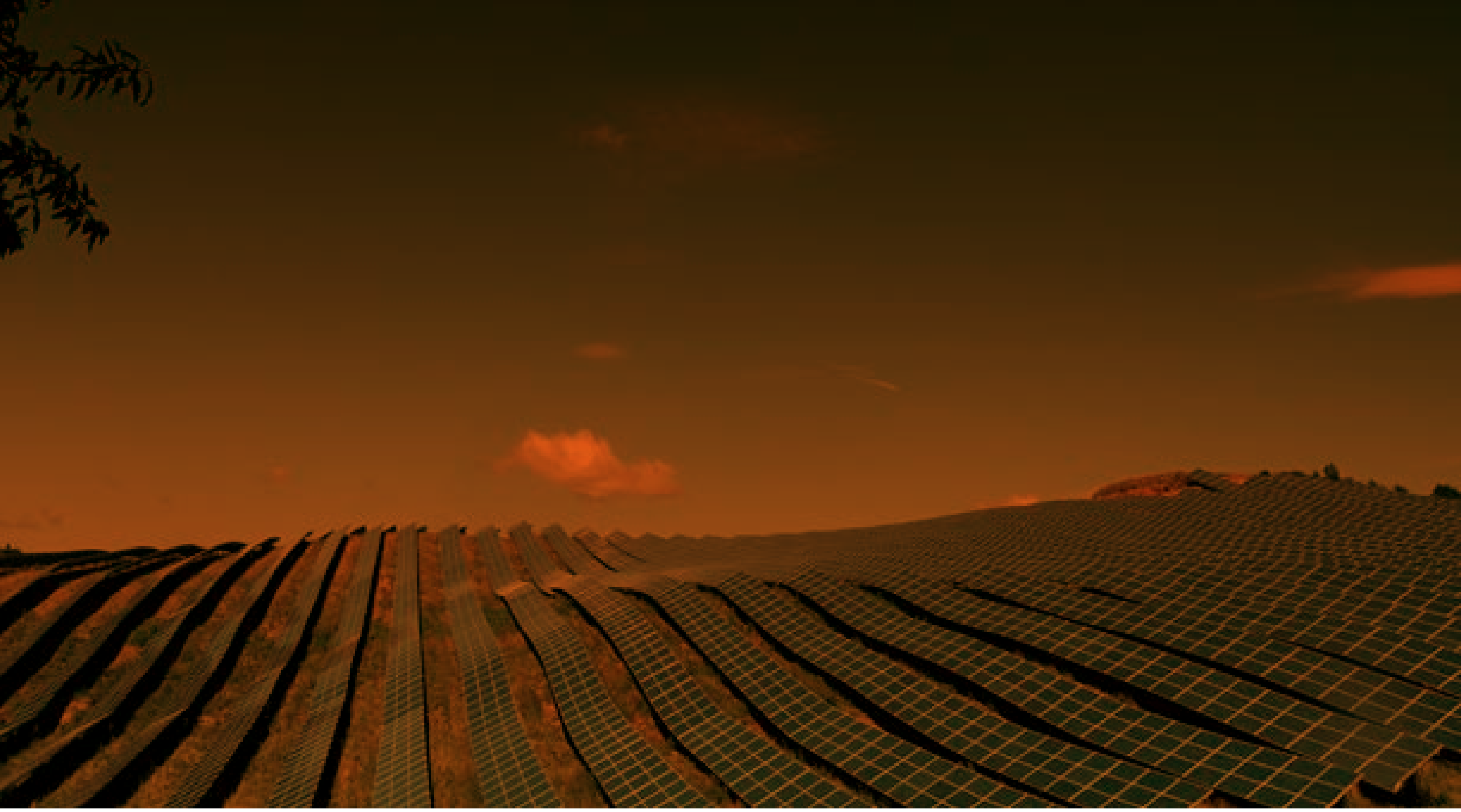
— Todd Coakwell CPA, CMA, Senior Director, Sustainability and ESG, Nutrien

Heather Taylor FCPA, FCA, Chief Financial Officer at the City of Toronto, sees the CPA profession's role as depoliticizing generational issues like climate change and the pandemic so business can address them in a timely way. "The CPA profession has the ability to influence the level and type of disclosures for the business community in a non-political environment... We have to be braver and bolder in getting in front of these issues. And, by introducing information in an incremental way, we can provide insight and guidance while being nimble to the changing environment we operate in."

THE ESG STATUS QUO

Europe, the United Kingdom and Australia are the most enthusiastic adopters of ESG reporting. The United States is something of a laggard, and Canada falls in between. With our close economic ties to the United States, as our major trading partner with co-listed companies, means ESG reporting has not taken off here as it has in Europe. However, American companies are more likely to produce a sustainability report (here, we use the terms ESG and sustainability interchangeably) than their Canadian counterparts, and some institutional investors view Europe's low-carbon transition as unsuited to our economy, which is dependent on natural resources.[5]

As Ontario is home to much of Canada's financial services sector of around $10 trillion in combined assets, the province's finance community is driving the growing ESG disclosure movement. "The Canadian financial sector is leading the charge when it comes to ESG disclosures, including on diversity and inclusion metrics and efforts," says Rosa van den Beemt, VP and Responsible Investment Analyst at BMO Global Asset Management in Toronto. Already, the sector has the highest representation of women on boards and its five top banks are investing $850 billion in sustainable finance, according to Toronto Finance International.[6]



This is significant for the CPA profession, which is concentrated in the finance and insurance sector in Ontario, where sustainability is an increasingly important consideration. CPAs working in large and listed companies, most of which have their head offices in Ontario are the most likely to report on ESG issues. The local mining, energy and utilities, and financial services sectors are the most enthusiastic adopters of sustainability reporting.[7]

"For mining, oil and gas companies, ESG is embedded in their DNA," says Sarah Keyes CPA, CA, Principal of ESG Global Advisors. "Resource companies depend on ESG for their licence to operate, in terms of health and safety and community relations." Energy and financial services companies have also been early adopters of ESG reporting. According to Bonnie Lyn de Bartok, CEO of impact data and analytics firm S-Factor Co, energy companies are often required to disclose project impacts to secure permits and funding, whereas heavy industries and manufacturing companies focus on health and safety in their social reporting. "The next big wave of social contingencies will be supply-chain and labour standards; they're not yet accounted for," says de Bartok.

In Ontario, listed companies are required to disclose information about environmental and social issues that are materially relevant to their financial position within existing guidelines for management discussion and analysis (MD&A) disclosures. They must also disclose the likely impact of social trends on their revenues, expenditures and cash flows, as well as social policies "fundamental to their operations" such as workplace health and safety and community relations.

- The Ontario Securities Commission (OSC) expects voluntary ESG disclosures outside of regulatory filings to "be prepared with the same rigour as regulatory filings".[8]
- TSX-listed companies are required to disclose the representation of women on their boards and in executive officer positions. Since this regulation was introduced, the proportion of women on boards has increased from 11% in 2015 to 17% in 2019. Progress in the C-suite has been slow, with only 4% of companies having a female CEO and 15% a female CFO by 2019.[9]
- After Bill C-25 came into effect in January 2020, companies governed by the Canada Business Corporations Act, many of which are administered at the Ontario provincial level, must disclose information on the representation of women, Indigenous peoples, people with disabilities and members of visible minorities on their board and among senior managers.[10]
- Although it has only been floated as a proposal to date, the Ontario Capital Markets Modernization Taskforce recommends making the Sustainability Accounting Standards Board or Task Force for Climate-related Financial Disclosures reporting frameworks mandatory in regulatory filings.[11]

ONE TO WATCH:

In August 2020, the US Securities and Exchange Commission introduced a requirement for companies it regulates to describe the human capital resources material to their business.[12]

Almost three-quarters of the CPAs working for large companies in Ontario see a role for the accounting profession in considering non-financial information such as ESG data. But it's not only large companies: almost half of CPAs working in small businesses agree.

ARE CPAs UP FOR THE MISSION?

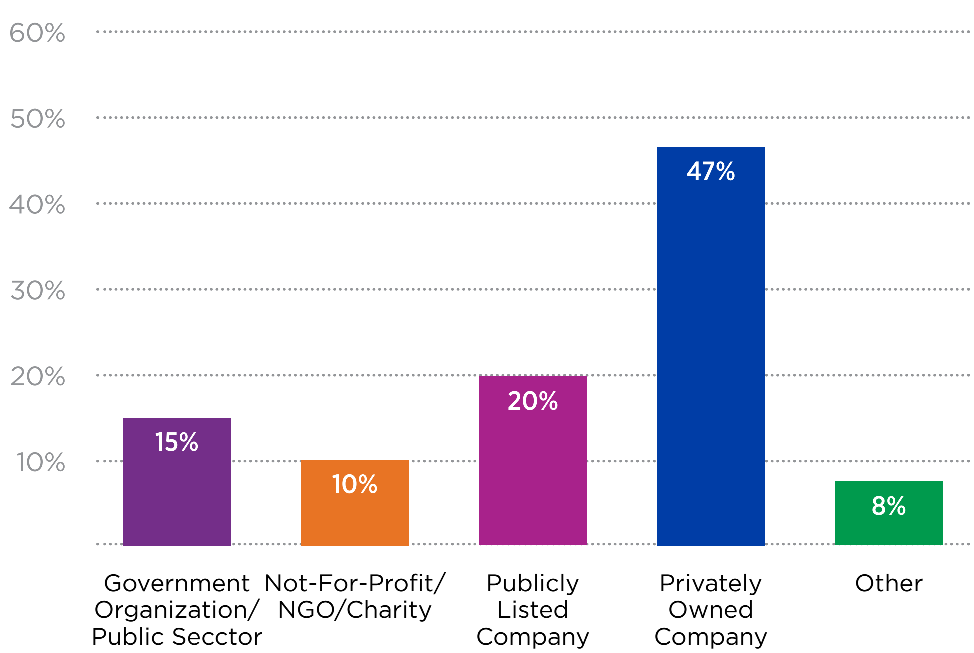
Between August and October 2020, we asked a sample of our members what they think about the opportunity to become more involved in helping the companies they work with and advise them in taking a stronger stand on their ESG performance.[13]

About our survey respondents

Of the Ontario CPAs we asked in an online survey, 44% work in large organizations. The larger the organization, the more likely CPAs are to be interested in ESG issues. This is not surprising: in Ontario and throughout the world, larger companies tend to be more active on ESG than smaller companies.

A fifth of survey respondents work in publicly listed companies. This is an important consideration, as public companies have more stringent regulatory requirements to report on ESG issues.

What type of organization is your role with?

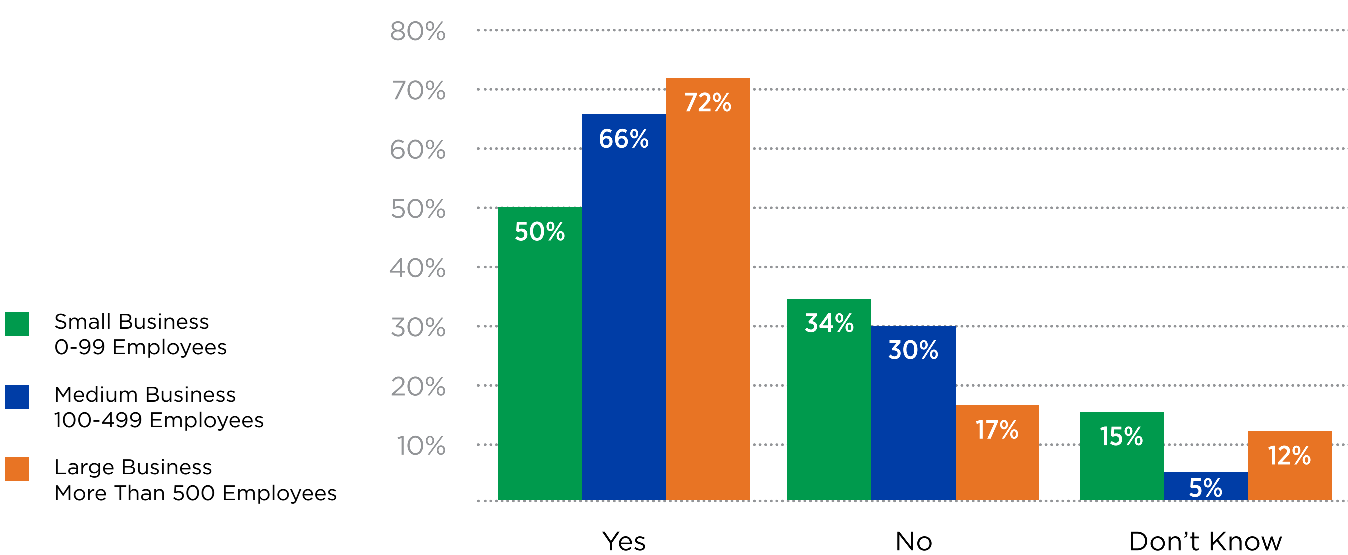


Mission accepted?

Most respondents agree that CPAs should consider and report on information beyond shareholder return. The larger the organization they work in, the more likely our respondents were to agree that CPAs should consider or report on non-financial information.

CPAs working in publicly listed companies are required by securities law to disclose non-financial information, and among them, the majority do believe considering these factors should be part of their role. That means a huge swathe of businesses, particularly non-listed companies, have no regulatory requirement to make ESG disclosures. "Ontario's small and medium enterprises will often be reluctant to pick up the ESG mantle unless their business and retail customers demand it," says Bill Murphy, FCPA, FCA, National Climate Change and Sustainability Leader at KPMG. "Retail customers, for the most part, still won't consistently support more sustainable products and services. This limits progress on ESG and climate change issues for a significant part of the economy."

Do you think CPAs should be considering/ reporting on measures beyond financial information and shareholder return?



Yet, ESG reporting is not just a preoccupation of large, listed companies. Perhaps surprisingly, in our survey a high proportion of CPAs that work in not-for-profits (73%) and the public sector (70%) also see it as part of their role to consider and report on non-financial information. Even half of CPAs working in private companies (58%) agree that CPAs should be considering these issues and want to know more about ESG reporting. Anecdotally, mid-sized private companies in Ontario are also considering these issues but are not inclined to make public disclosures. Similarly, public sector organizations and governments don't typically disclose their ESG performance either, with the City of Toronto breaking ground as the first government in Canada to include disclosure around climate change in its audited financial statement notes.

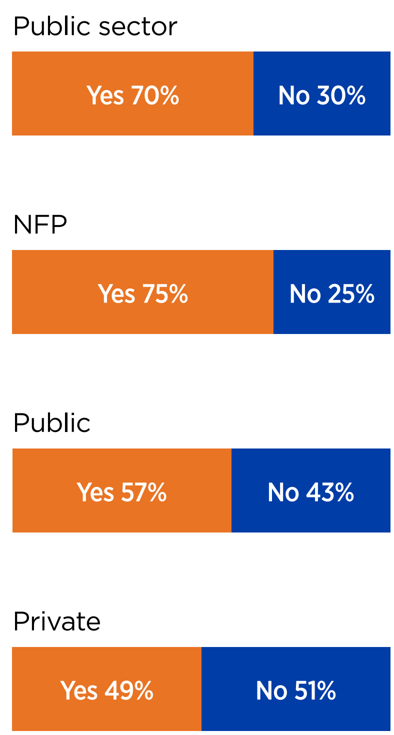
Demand for ESG reporting is small but growing

More than a third of the CPAs we asked said their organizations had already experienced increased demand for ESG disclosures in recent years. And those reporting their ESG performance do so in different ways:

- Around half include it in their annual reports and regulatory filings.
- Only a handful report against dedicated ESG frameworks such as the Global Reporting Initiative (GRI, nine respondents), the Sustainability Accounting Standards Board (SASB, six respondents) or the United Nations Sustainable Development Goals (SDGs, 15 respondents).
- Of the 60 respondents whose organizations verify their ESG disclosures, only nine have this done by an external audit firm.

These findings suggest the market for advising on ESG disclosure is developing. "It's coming down the road," says Sabreen Salman CPA, CA, Manager of ESG Reporting at TD Bank. "Companies will be looking to accounting firms for support with ESG."

Are you interested to know more about ESG reporting?



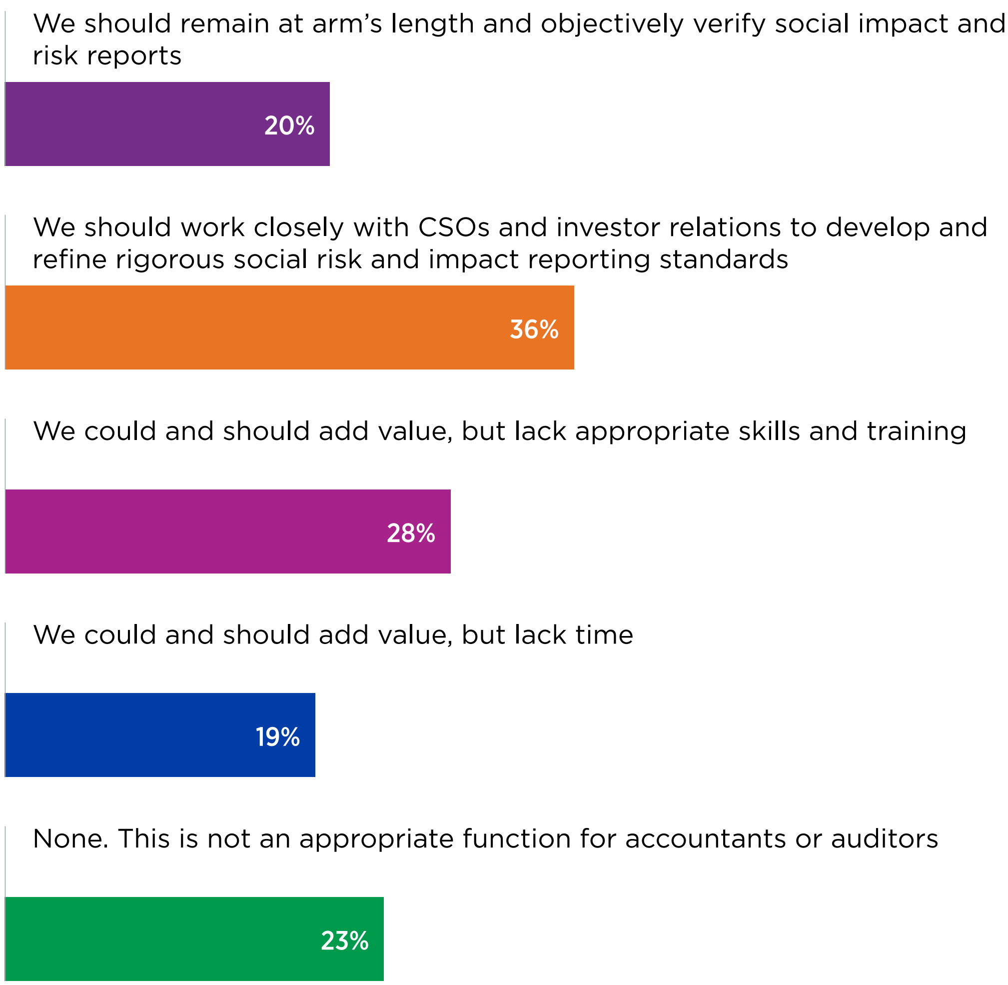
CPAs should develop strategy around ESG measurement and reporting

More than one-third of CPAs surveyed agreed that CPAs should be more closely involved in developing company strategy around ESG measurement and reporting. But one-fifth believe CPAs should remain at arm's length and play an objective role in verifying company ESG data, while another quarter think the profession should stay out of the ESG equation altogether. 27% and 18% respectively note that skills and time pressure are real practical obstacles to CPAs becoming more closely involved in ESG reporting.

Many businesses experience reporting fatigue and the cost of compliance can be high.[14] John McKenzie CPA, CA, CEO at TMX Group, says the Toronto Stock Exchange, which encourages best practice ESG reporting, is also careful not to require onerous sustainability reporting from companies who may find it prohibitive to listing on the exchange, especially TSX venture companies. "TMX is an advocate for fair treatment and appropriate reporting standards for public companies, to ensure they remain viable and competitive. Among the 2,600 listed companies on Toronto Stock Exchange and TSX Venture Exchange, two-thirds are small and medium-sized enterprises, and many simply don't have the organizational resources and capacity to keep pace with escalating standards." McKenzie says that Ontario CPAs would bring great benefit by translating ESG frameworks so they are more easily executable for the Canadian marketplace.

> "CPAs play an important role in the vitality of the Canadian capital markets ecosystem. By establishing best practices around ESG measurement and reporting, we can leverage our well-established professional training and regulatory infrastructure to help companies succeed and investors to make informed decisions."
>
> *— John McKenzie CPA, CA, CEO, TMX Group*

What role should CPAs play in measuring and reporting on ESG impacts and risks?



CPAs need to be trained for the mission

Non-financial reporting requires a specific skill set, and Australian-based Ian Mackintosh, Chair of the Corporate Reporting Dialogue, says, "I don't know that [these skills are] broadly held by the accountancy profession at the moment." PwC Canada's Chief CSR Officer, James Temple, agrees that opportunities exist for CPAs, who are usually data and process-driven, to deliver on objectives and processes that are more nuanced and qualitative. "Becoming comfortable leading through uncertainty is a critical skill set in sustainability. For some, it requires rebalancing their technical skills with an enhanced focus on emotional intelligence (EQ) to dig into data in ways that help to balance corporate reporting with societal expectations."

Even with the skills, building capacity to develop ESG metrics and reporting is both resource- and time-intensive. For busy finance teams in industry, that often feels like too great a stretch. Andrea Jong CPA, CA, a finance VP at an Ontario pension fund, says, "Working in finance can be a bit of a grind when it's forecast after forecast, and month end after month end. So even those motivated to get involved with the sustainability mission struggle to find time."

Yet if technologies like artificial intelligence (AI) take over the more repetitive work that accountants and auditors are currently doing, as we previously asserted they will in our 2019 paper *Evolving Alongside Artificial Intelligence*[15], some CPAs may find their time freed up to develop a broader range of skills and competencies.

The warrior career path must go mainstream

Support for the role of CPAs as “warrior accountants” is already pervasive among new entrants to the profession, and among the more than 22,000 students in Ontario working toward the CPA designation. Our own market research has shown around half of the next generation of CPAs want their careers to make an impact on sustainability issues. But clarity around the pathway through the accounting profession to working in this space is yet to be established.

Young accountants in public practice traditionally start out in financial audit and follow a stable career progression. In comparison, forging a career in non-financial reporting seems risky, with few deliberate connections between finance and sustainability. In the meantime, some CPAs are informally connecting to figure out how to transition into the ESG field, even though it appears to be an untested career path. Advocates like Wim Bartels of the International Integrated Reporting Council encourage the profession to evolve. In 2017, Bartels said, “Accountants need to make sure that disclosure stays relevant, rather than just clinging to an old business model if it isn’t actually telling investors the full story”.[16]

This is precisely what Ontario company Maple Leaf Foods did in 2019 by creating a role for a CPA to bridge the gap between its sustainability and financial functions. Pooja Patel CPA, CA, Maple Leaf’s Manager of Finance Sustainability, reports to the VP Controller, who leads financial reporting, as well as having a dotted reporting line to the VP of Sustainability and Shared Value. Patel explains that her responsibilities are to integrate Maple Leaf Foods’ sustainability data and reporting into the company’s financial reporting and control analysis. “That means ensuring there are controls in place, and that our ESG disclosures are consistent with our annual financial report and MD&A. I also helped to incorporate an internal price on carbon in our capital purchases approval process.”

"If you want to do something to change the world, then become a CPA. It's disclosure and transparency which make markets move. You have to follow the money: that's what makes change."

— Sarah Keyes CPA, CA, Principal, ESG Global Advisors

CPA Ontario supports the mission

Among Ontario's business leaders, there are pockets of skepticism about the role CPAs should play in ESG strategy and reporting, but this view is outweighed by a groundswell of support among members for the accounting profession getting on-board. We believe professional accountants will play an important role in tracking and analyzing the impact ESG issues have on company performance and future returns.

18% of Canadian investors think industry organizations should take the lead in influencing companies to provide better ESG information, according to RBC Global Asset Management.[17] While a higher proportion think shareholders or government should take the lead, RBC's findings show that there is a demand for organizations like CPA Ontario to step in.

"In this fast-moving space no one has all the answers. But, our profession can help move ESG measurement and impact forward, and in doing so, substantively change business and society for the better," says Carol Wilding FCPA, FCA, CEO of CPA Ontario. "The role CPAs can play as "warrior accountants" is in providing more solid forms of measurement to help bridge the gap between finance and sustainability."

"As the regulator and professional body in Ontario we welcome the work of standard-setting organizations including the IFRS Foundation exploring the potential for a formal role for the profession in ESG standards, and alongside their process, we must take steps to advance the "warrior accountant" mission".

As the home and headquarters of many listed companies in the country, Ontario should not shy away from pushing ahead in this space. Toronto head offices have a responsibility to champion these issues throughout the business community—in the province.

ESG may not be the core role for some members of the CPA profession, but demand for CPAs with ESG expertise is growing. For those current and aspiring Ontario CPAs keen to explore this area, the first step is to educate themselves about complex and rapidly evolving ESG issues. "In addition to the foundational training CPAs undertake, we encourage Ontario CPAs to learn more about this topic as part of their professional development in preparation for the next era of corporate reporting. It is likely to cross their desks soon—if it hasn't already," says Wilding.

Across Ontario, employers are looking for sustainability professionals. Tim Faveri, VP Sustainability and Shared Value at Maple Leaf Foods, says that "there are few CPAs in this emerging space, but when a resume comes across my desk with both accounting and environmental experience, I put it in a different pile, because it's so rare."

CPA Canada has published practical resources to help board directors and listed issuers in grappling with these matters.

- A paper by Alan Willis FCPA, FCA, takes governance as the starting point. It sets out the questions company directors should ask their executive teams about incorporating ESG risks and opportunities into their business model and strategy **[VIEW PAPER HERE]**.
- In conjunction with the Toronto Stock Exchange, CPA Canada published a paper to assist listed companies with their ESG disclosures **[VIEW PAPER HERE]**.

PART 2

TRENDS IN ESG AND SOCIAL RISK REPORTING: WHAT CPAs NEED TO KNOW

For those CPAs who are eager to take on the warrior accountant mission but are new to the sustainability area, the following sections of this report offer insight into the ESG landscape and its rapid evolution as a business priority.

NEGOTIATING ESG REPORTING FRAMEWORKS: WHAT GETS MEASURED GETS MANAGED

Businesses are increasingly being asked to measure and report on their ESG performance with the aim of improving their external impacts and relationships with stakeholders. ESG is a complex space, beginning with its very definition. The *E* refers to companies' impact on, and risk from, environmental changes including climate change, pollution and biodiversity loss. The *S* refers to social issues within companies, such as employee health and productivity, as well as societal matters like community interests, inequality and discrimination. *G* refers to corporate governance. Yet, some argue that the three categories are not so clear-cut. Good governance is needed to improve *E* and *S*. Advocates of a holistic approach to ESG explain that climate change is as much a social problem as an environmental one.

SASB measures ESG factors that influence long-term value creation for shareholders. GRI measures stakeholder value and impact on society.[18]

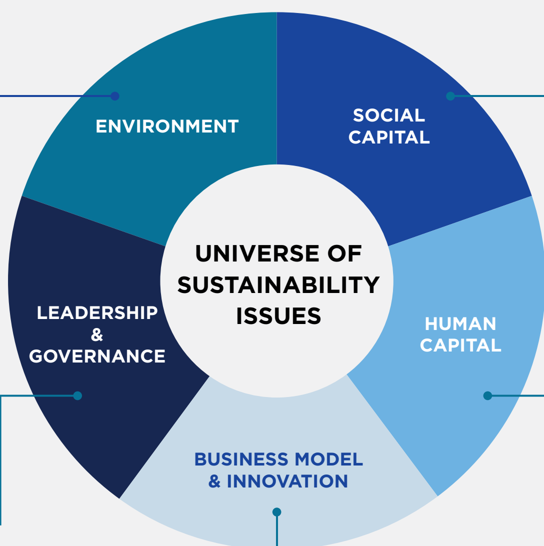
In the absence of a global ESG reporting standard, an “alphabet soup” of voluntary frameworks and guidelines has appeared. Several key frameworks are in common use:

- The **Global Reporting Initiative (GRI)** is principles-based, covering a broad range of ESG factors from climate change to diversity and human rights. It is designed for companies to report to both investors and civil-society stakeholders.
- The US-based **Sustainability Accounting Standards Board (SASB)** framework communicates financially material ESG risks and opportunities. SASB, which offers 77 industry-specific standards, is commonly used in the United States and is preferred by investors.

THE SASB “UNIVERSE” OF SUSTAINABILITY ISSUES UNDERPINNING ITS STANDARD-SETTING[19]

ENVIRONMENT

- GHG Emissions
- Air Quality
- Energy Management
- Water & Wastewater
- Management
- Waste & Hazardous Materials Management
- Ecological Impacts



SOCIAL CAPITAL

- Human Rights & Community Relations
- Customer Privacy
- Data Security
- Access & Affordability
- Product Quality & Safety
- Customer Welfare
- Selling Practices & Product Labelling

LEADERSHIP & GOVERNANCE

- Business Ethics
- Competitive Behavior
- Management of the Legal & Regulatory Environment
- Critical Incident Risk Management
- Systemic Risk Management

BUSINESS MODEL & INNOVATION

- Product Design & Lifecycle Management
- Business Model Resilience
- Supply Chain Management
- Materials Sourcing & Efficiency
- Physical Impacts of Climate Change

HUMAN CAPITAL

- Labor Practices
- Employee Health & Safety
- Employee Engagement, Diversity & Inclusion

- The **Taskforce on Climate-related Financial Disclosures (TCFD)** asks companies to disclose the financial implications of climate risk in their annual financial report.[20] Concerned that climate change poses systemic financial risks, central banks, including the Bank of Canada, are a driving force. Many banks and companies are adopting TCFD recommendations voluntarily, expecting that they will eventually become mandatory.

- The **European Union's Non-Financial Reporting Directive** requires large companies to disclose their ESG impacts. The European Parliament also signed into law the **EU Taxonomy Regulation**, which establishes a regulatory framework for sustainable investment that will classify sustainability or ESG criteria and risks in products and investments claiming to be sustainable.[21]

- The United Nations-supported **Principles for Responsible Investment (PRI)** is an international network of more than 3,000 investors, with a combined US$10 trillion in assets under management, working to incorporate ESG considerations into investment and ownership decisions.[22]

- 11,000 companies, mostly in Europe and Oceania but also in North America and Asia, have agreed to report their strategies for achieving **United Nations Sustainable Development Goals (SDGs)** on issues such as gender equality, workplace practices and poverty reduction, as part of the **UN Global Compact**.[23]

- **The International Integrated Reporting Council (IRCC)** champions integrated reporting which dissolves the demarcation between financial and non-financial reporting on issues such as stakeholder relationships and environmental resources. Take-up has been modest in Canada.[24]

Beyond dedicated ESG reporting frameworks, the **International Accounting Standards Board** is updating its non-mandatory Management Commentary Practice Statement in 2021 to include sustainability disclosures. This is unlikely to include a prescriptive list of ESG issues, and will instead propose guidelines on how to identify and report on ESG matters that could affect entities' futures, including effects on cash flows and economic decisions.[25] The International Financial Reporting Standards Foundation (IFRS) points companies to the SASB and TCFD frameworks to decide what to report on.

ESG STANDARDS: FROM ALPHABET SOUP TO CONSOMMÉ?

Companies, investors and accounting standards bodies all agree that ESG reporting frameworks should be harmonized. Early steps are underway, but critics argue progress is slow. Even if a common standard is agreed upon, and the alphabet soup clarified into a consommé, investors will not build their models around it without the widespread adoption that would typically require regulatory intervention. Ironically, multiple standardization projects are underway at the same time. Everyone supports harmonization, but each player wants to be the chief harmonizer. This "muddling mosaic"[26] creates frustration and reporting fatigue as competing, and sometimes conflicting, standards create confusion for investors hungry for comparable and auditable information.

> "Investors have had a 'Goldilocks problem' with ESG standards. At first, there was a lack of them, and then there were too many, which effectively means there is no standard."
>
> *— Sarah Takaki, Senior Director, Sustainable Investing, Healthcare of Ontario Pension Plan*

Some of the standardization projects being pursued include:

- In 2020, the SASB and GRI announced that they would collaborate to bring clarity and comparability to sustainability reporting.[27] In addition, SASB and the IIRC announced their merger which will form a new organization later in 2021, the Value Reporting Foundation.[28]
- The **Corporate Reporting Dialogue**, comprised of the eight main players in this space including GRI, SASB, IIRC, IASB and the International Organization for Standardization (ISO), has a project to align and rationalize ESG frameworks beginning with climate change reporting.[29]
- Many of the organizations participating in the Corporate Reporting Dialogue, as well as the World Economic Forum and Deloitte, are also collaborating under the banner of the **Impact Management Project**, to try to forge a consensus on reporting standards with input from an advisory group and practitioners.[30]

- The **World Economic Forum** International Business Council convened its own harmonization effort with a nod to developing "a generally accepted international accounting standard" for ESG. This meta-framework in all but name was developed by the Big Four accounting firms in late 2020. Though it combines existing frameworks, critics fear it will not supersede the alphabet soup.[31]

Alternatively, the "Brussels effect"[32] that sees Europe set the regulatory rules of the game may see global businesses fall in line with the **EU Taxonomy Regulation**, just as they have done with the EU's General Data Protection Regulation.

The International Accounting Standards Board has also been called upon to weigh in, as it did in the 1990s to harmonize financial reporting. In late 2020, the IFRS threw its hat in the ring by announcing a consultation process to assess whether it should develop ESG standards and establish a sustainability standards board following the IASB model.[33]

Advocates of this approach include the International Federation of Accountants and IFRS Foundation Trustee Teresa Ko, who said that "a compelling case can be made for the IFRS Foundation to help with the consolidation and the settling of globally comparable, high-quality and auditable standards of disclosure in sustainability reporting, starting with climate-related risks."[34] Yet others are skeptical. "There are lots of commercial interests," warns IASB chair Hans Hoogervorst. "There's also a high degree of hype around the issue... We need to be able to tell companies, if you have sustainability issues and you think it may affect the future value of the company or even the current value of the company, that's a big challenge. You should work on that, and there are standards that will provide information which is useful. We should stay within our scope of providing decision-useful information on financial matters to investors. We should not try to branch out into the question of what do companies do to save the earth."[35]

> "Given its basis in financial materiality, we have had amazing uptake on SASB, with every company we approached open to it. This year, the conversations with them moved quickly from 'we're thinking about it' to 'we're adopting it'."
>
> *— Deborah Ng, Head of Responsible Investing, Ontario Teachers' Pension Plan*

ESG REPORTING IS NOW A STRATEGIC IMPERATIVE

Many companies have voluntarily published and promoted their philanthropic and community engagement for decades. Often driven by marketing, communications or a dedicated corporate social responsibility (CSR) team, these activities aimed to show the company acting in the public interest and were often viewed as a "nice-to-have" addition to core business. In the past two years, this has changed, and as CSR has morphed into ESG it has become a core strategic concern for many companies.

Many asset managers say that ESG considerations have prompted them to reduce their exposure to long-term risks such as climate and social unrest,[36] and they are asking for more information about the risks—and opportunities—that social and environmental changes will pose to the companies they invest in.

The challenge now is to communicate how ESG factors impact financial and operational performance. For many companies, the answer has been to shift responsibility for ESG reporting to legal, risk and compliance teams, and in some cases finance and investor relations. Increasingly, the CFO signs off on ESG reports alongside financial statements. The choice of which departments oversee ESG reporting can greatly influence the quality and direction of ESG output. "Where the ESG function sits within an organization can influence its focus and perception. If it's in risk it may be viewed primarily through a risk lens; if it's in legal it may be viewed as a compliance activity; if it's in investments it may be part of the investment process," says Sarah Takaki from the Healthcare of Ontario Pension Plan.

"We've noticed a momentum shift. There used to be centralized ESG teams and their job was to do ESG for the entire firm. That's obviously quite hard to do in a scalable way. What we're seeing now is firms embedding ESG into their business processes."

— Adam Salvatori, Chief Solutions Officer, Truvalue Labs

"On the climate side, it's moved from five years ago being almost a marketing conversation. Now we often end up talking to a chief risk officer or a chief investment officer and the metrics are going up to the CFO and the board. It's been a bit of a journey as the conversation has moved around these corporates over time."

— Joseph Lake, Chief Operating Officer, The Climate Service

As well as informing risk management strategy, ESG considerations have become proxies for trust and reputation in capital markets. A Donnelley Financial Solutions survey of Canadian institutional investors reported that too few companies are making the link between ESG issues, risk management and overall strategy.[38]

Without this link, investors struggle to integrate ESG data into their analytical models. Elizabeth Demers of the University of Waterloo explains that ESG is often not formally factored into fundamental valuation models (e.g., in terms of cash flows or earnings projections, or even formally in arriving at the discount rate). Rather, it is at best loosely referred to as a consideration in arriving at the discount rate. Fundamental analysts and valuators need to get a lot more savvy in understanding the implications of the firm's ESG activities for the company's overall projected performance and risk, and to bake this into the forecasts that they use for valuation," says Demers.

Companies keen to communicate their sustainability credentials to both equity and debt investors are increasingly aligning their ESG reporting with financial reporting, including data-driven performance metrics and explanations of the penetration of ESG considerations across their business. Last year TD Bank took the tactical step of releasing its ESG report along with its financial reporting before proxy voting opened in advance of its annual general meeting. As companies bundle ESG disclosures with their financial statements and the MD&A, finance teams, many with responsibilities for investor relations, will see the scope of their reporting responsibilities widen.

A Harvard Business Review survey of the world's biggest institutional investors found that "ESG was almost universally top of mind." However, respondents also said that the biggest obstacle to investing was the lack of sustainability reporting aimed at investors rather than NGOs and other stakeholders.[37]

TIMELINE OF E&S METRICS EVOLUTION

LEGEND

ESG | SOCIAL | ENVIRONMENT

1969

The term ‘social impact’ first used in a Yale seminar about the ethical responsibilities of institutional investors.

2000

Global Reporting Initiative launches first guidelines for sustainability reporting

2006

Principles for Responsible Investments launches

2007/08

Global financial crisis: the term ‘social impact’ finds new relevance

2010

Canadian Securities Authority (CSA) issues guidance on reporting material environmental disclosures

Deepwater Horizon oil spill sparks debateabout corporate responsibility for the environment

2011

Sustainable Accounting Standards Board Incorporated

2014

TSX-listed companies required to disclose women on boards and management

2015

Mark Carney, then governor of the Bank of England, gives a landmark speech on climate change and financial stability

2016

Pension funds in Ontario required to include ESG information on Investment policy statements

2017

UK Financial Standards Board commissions the Task Force on Climate-Related Financial Disclosures

2019

Pay Equity Act requires Canadian companies to report gender pay differentials

SASB launches human capital research project

TSC joins ‘Sustainable Stock Exchanges’

IASB issues guidance on climate-related disclosures

2020

Jan 2020: The World Economic Forum’s Davos conference proposes harmonizing ESG

Jan 2020: Companies governed by the Canada Business Corporations Act must disclose enhanced diversity information

March 2020: Covid-19 pandemic begins

July 2020: Protest erupt in the US and around the world in support of Black Lives Matter

Jan 2020: BlackRock CEO Larry Fink commits to sustainable investing in annual investor letter

> "How are businesses going to achieve the broader contribution to society that is now being asked of them and highlighted by the pandemic? Although human capital isn't measured on your balance sheet, your employees' health and safety is a material issue to your business, and you should be tracking indicators that monitor their mental and physical well-being. These, along with diversity and inclusion initiatives, should form part of an overall set of ambitious targets that tie into management performance evaluations."
>
> *— Bill Murphy FCPA, FCA, National Climate Change and Sustainability Leader, and Partner in Governance, Risk and Assurance Services, KPMG*

S IS FOR STAKEHOLDER...

In recent years, climate risk has given momentum to the ESG debate, but social impact and risk reporting is now making its way to boards and the C-suite too. Investors and ESG consultants have seen interest in social factors increase exponentially as politicians and economists start to view inequality, driven by globalization and laissez-faire economic policy, as a handbrake on growth.[39] On the social front, companies are coming under fire for eking out profits from insecure workers without adequate labour protections.

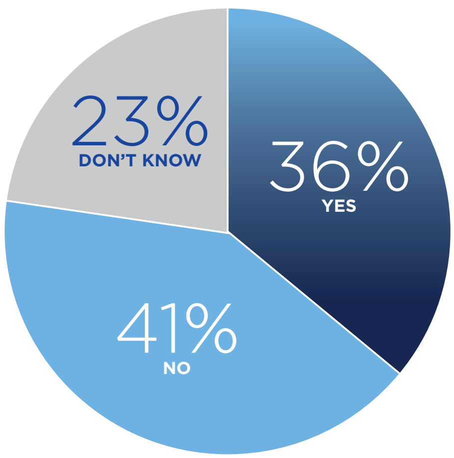
"Purpose over profit" has become the mantra of a stakeholder-capitalist movement that seeks to widen the scope of company value to encompass employees, customers and the broader community. Writing in the *Financial Times*, Leo Johnson, global head of PwC's disruption practice, notes that "an emerging set of substitute regulators are starting to rewire risk and reward, factoring environmental and social costs back into the balance sheets of companies."[40]

In practice, this means measuring and reporting on a company's "human" and "social" capitals. "Human capital" refers to the value a company derives from its employees and other people who support the business. It's the internal social factors a company can control, says Kelli Okuji Wilson, head of the human capital project at SASB. "Social capital" is the value a company derives from its relationships with customers and the broader community. It is the social externalities a company creates, both positive and negative, she says.

Social and human capital metrics paint a broader picture of a company's long-term value creation

Both SASB and the GRI give detailed descriptions of the human and social capital metrics they recommend reporting on. PRI released its own human rights due-diligence framework for investors to assess efforts toward the UN Guiding Principles.[41]

Has your organization experienced increased demand for ESG disclosures in recent years?



Among a sample of CPA Ontario members:

28%
work in organizations that disclose ESG

36%
increased in demand for these ESG disclosures

Of those that do, most use Excel to manage data and report on social risks and impacts including:

- DIVERSITY AND INCLUSION
- EMPLOYEE HEALTH AND SAFETY
- COMMUNITY ENGAGEMENT
- CHARITABLE GIVING AND POVERTY REDUCTION

Source: CPA Ontario survey

The World Economic Forum International Business Council's ESG standards harmonization project, convened with the Big Four firms, proposes core social metrics including gender pay equality and diversity, injury and absenteeism rates and training investment levels. Its expanded social metrics include losses from discrimination litigation, worker injury numbers, participation in well-being programs and skilled employment measures.[42]

Pamela Steer FCPA, FCA, CFA, Chief Financial and Corporate Strategy Officer at Payments Canada, points out that business was historically doubtful as to whether climate change could be measured and quantified, saying it was too hard to get the data. But businesses are now more confident to do so, and she is hopeful they will develop this confidence in reporting on social issues too. "Social issues are measurable, but it comes down to deciding to invest in that process." SASB's Kelli Okuji Wilson expects to see social risk issues coming to the fore within the next 3–5 years. "This is already happening around diversity and inclusion, employee engagement, mental health and understanding culture. It was only 5–10 years ago they were considered too nebulous and difficult to quantify."

Some companies have come up with innovative ways to measure and report on social performance locally:

- **BMO** tracks loans it makes to women-owned businesses and those with Indigenous customers.[43]
- E-Commerce group **Shopify** tracks the economic impact of its merchants in small and rural communities.[44]
- **RBC** published a dedicated diversity and inclusion report in 2019 and says it will add racial diversity metrics to future reports.[45]
- Ontario-founded start-up Diversio has developed a platform for companies to track social inclusion risks. Diversio CEO Laura McGee explains "we track the numbers of reports from employees experiencing harassment or feeling unsafe in the workplace. If those metrics creep higher, companies can see social risks surfacing in their workforce."

An overview of current and emerging social metrics[46]

		ALREADY COMMON OR REQUIRED BY LAW	NEW REPORTING TRENDS EMERGING
HUMAN CAPITAL	DIVERSITY & INCLUSION	• Women at board and senior management level	• Racial and other visible minorities at board, management and trainee level • Pay equity for women and visible minorities
	EMPLOYEES	• Occupational health and safety • Employee turnover	• Income inequality within a company • Sick leave, pandemic leave and medical insurance • Covid-19 safety • Job creation • Employee satisfaction

		ALREADY COMMON OR REQUIRED BY LAW	NEW REPORTING TRENDS EMERGING
SOCIAL CAPITAL	CUSTOMERS	• Customer satisfaction	• Data protection and privacy • Covid-19 safety • Equitable access to essential goods and services • Overt or implicit discrimination against under-represented groups
	SUPPLY CHAIN		• Conditions for workers throughout the supply chain (including contractors, migrant workers and small-business suppliers) • Reporting requirements as part of the proposed Modern Slavery Act (Bill C-423) • Covid-19 safety
	COMMUNITY	• Consultation with (and potentially compensation for) communities affected by projects, for example in mining and construction	• Tax transparency, financial assistance from the government • R&D spending • Investment in communities affected by company operations

ARE ONTARIO COMPANIES PUNCHING BELOW THEIR WEIGHT WHEN IT COMES TO REPORTING AND PERFORMANCE ON SOCIAL ISSUES?

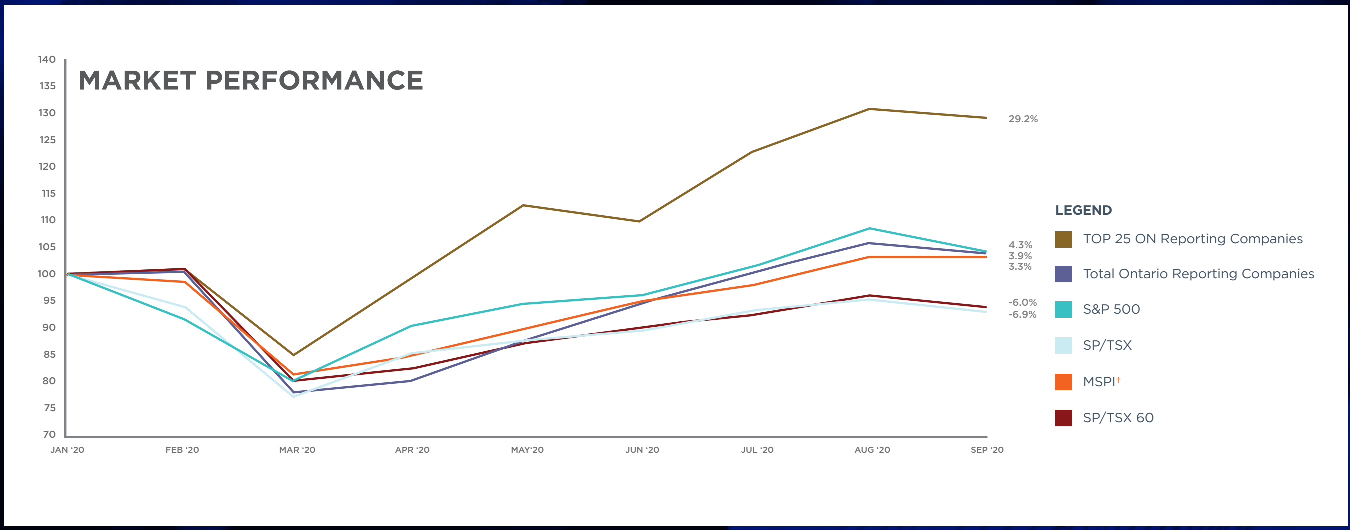
The S-Factor Co. analyzed the "social factor performance" of 911 Ontario-based listed companies between January and September 2020. They found that fewer than half reported their performance on social issues. Among those that did, the most frequently reported social factors were:

- freedom of association and collective bargaining
- health, safety and security
- codes of conduct and social policies
- business integrity
- policies on child and forced labour

The social factors these companies performed the worst on included ethics violations, water, wages and benefits, training and education as well as CEO pay ratio.

On S-Factor's aggregated social performance rating, Ontario companies score 52.5 out of 100, compared with a best practice of 82/100. In particular, they underperform on disclosures of anti-discrimination (34.56/100) and on diversity and inclusion measures (24.13/100). But on board diversity, Ontario companies score a higher 64.28/100, demonstrating the impact that the OSC's regulation has had.

According to S-Factor's CEO, Bonnie-Lyn de Bartok, "Our analysis also found that Ontario companies who were best in class for social reporting and performance tended to outperform the market. They have been the most resilient through 2020's social chaos."



Source: The S-Factor Co. Ontario Public Equities Social Factor Performance, November 2020.

Social risk measures capture material risks to a company from major social trends.

...and S is for socially stranded asset

Another nascent trend is measuring *social risk*. Like climate-risk metrics, those for social risk do not focus on a company's social impact but rather measure the material risks to a company from major social trends. The OSC notes that social risks include the risk of litigation (over things such as unsafe or unfair working conditions), the risk of regulatory changes, and reputational risks.[47]

A trend of ESG-driven litigation is emerging, with Stern Bank financing lawsuits against companies and governments over poor sustainability performance. A group of technology companies based in the United States is being sued over alleged child labour in their supply chains. And ride-sharing companies Uber and Lyft may become high-profile casualties of a backlash against poor conditions for non-standard workers in the "gig" economy, after a Californian court ruled the companies need to classify drivers as employees. The ride-sharing industry spent US$200 million in support of a successful vote exempting their drivers from employee status in 2020. But the case could lead to others being brought in different jurisdictions. Arguably, businesses will turn to social metrics to assess and mitigate this kind of legal and political risk.[48]

Just as oil majors now face the risk of having fossil-fuel assets "stranded" by shifting regulation and consumer preferences, companies across a range of industries may find that, due to the wave of social and legislative changes now happening globally, they hold "socially stranded assets" that cannot deliver the returns previously expected. Insurance companies, says ratings agency Moody's, are one example of the kind of firm facing this risk. Medical insurers and those who provide workers' compensation may be particularly susceptible to political shifts induced by Covid-19 that could have a profound impact on their profitability.[49]

To prepare for the Bank of England stress test and comply with its climate change commitments, Standard Chartered is reviewing its portfolio for climate risk, including for physical and transition risk, says Lucie Mouzin, Standard Chartered's Director of Sustainable Finance in the UK.. "This exercise is also key to engaging with our clients and support their transition to lower carbon business models." A similar type of "social stress test" may yet emerge. "Going beyond this, forward-looking companies have added the examination of potential risk factors from within their company culture to their internal audit processes," says Sarah Chapman, Global Chief Sustainability Officer at Manulife. "From mental health and the #MeToo movement, to diversity, inclusion and Indigenous reconciliation, these social dimensions are entering the traditional risk, compliance and audit realm."

There are no moves afoot yet to create a social risk disclosure regime like the TCFD. The lack of a charismatic advocate, who can play the role that Mark Carney played in elevating climate-related disclosures, is preventing social metrics from coming to the fore, says Ian Mackintosh, Chair of the Corporate Reporting Dialogue. If such a figure were to emerge, social disclosures could follow the same trajectory as environmental disclosures. As it stands, investor pressure, rather than regulatory requirements, is likely to be the most important driver of social risk reporting in the medium term. This was confirmed with Mark Carney's appointment as vice-chairman of Toronto-based Brookfield Asset Management to expand the firm's ESG investments in 2020.[50]

While social risks have been largely reputational until now, a shifting consensus about the "new social contract" will increasingly open companies to political and legal risks.

WHO IS PUSHING FOR GREATER ESG DISCLOSURE, AND WHY?

PUSH FACTORS

INVESTORS

Asset owners such as pension funds, insurance companies, sovereign wealth funds and foundations are pushing asset managers to take ESG factors into account when implementing their investment mandates. **Retail investors** are buying more ESG products: the overall value of global assets under management in ESG-related funds increased from US$22.9 trillion in 2016 to US$40 trillion in 2020. In Canada, professionally managed assets using some form of responsible investment strategy have reached C$2.1 trillion, up 42% over two years.[51]

Larry Fink, CEO of BlackRock, the world's largest asset manager, pushed ESG investing into the headlines when he wrote to clients in January 2020 that "sustainability should be our new standard for investing." BlackRock is asking investees to publish disclosures aligned with SASB and TCFD.[52]

Impact and responsible investors go a step further and want to see funds and companies translate dollars into environmental and social improvements such as reducing poverty and empowering disadvantaged groups.

Pension funds are a key driver of ESG disclosure. The Canada Pension Plan is the largest investor in Canada, and while its investment board is not required to by law, it actively considers ESG factors and works with investees to improve ESG management.[53] The Ontario Teachers' Pension Plan asks companies they invest in from around the world to report according to the SASB framework.

Many companies report increased shareholder engagement around ESG, with investors using voting rights to push management on their ESG performance. **Shareholder proxy companies** such as Institutional Shareholder Services and Glass Lewis have incorporated ESG issues into their Canadian proxy voting guidelines (Glass Lewis specifically incorporates the SASB framework). For many listed companies, the fear of not having answers for shareholders can be a powerful motivator to get their ESG reporting ducks in a row. The **2020 AGM season** in the United States saw several companies face shareholder resolutions related to human capital, covering issues such as human rights in the supply chain and health and safety. Resolutions at the AGMs of Genuine Parts and O'Reilly, which called for the disclosure of employees' racial and ethnic breakdown, passed against management recommendations. Companies may continue to face calls to share the pain of the covid-19 crisis by limiting share buy-backs, cutting dividends and limiting executive bonuses.[54]

PRIVATE EQUITY

Private equity investors increasingly take ESG factors into account,[55] with many signed up to the Principles of Responsible Investment. But as their disclosures are not made publicly, data on the ESG metrics of private companies is thin. Ontarian institutional investors do engage with private companies directly, although they tend to be less stringent on ESG data requirements than they are with public companies.

RANKINGS AND INDICES

More than 100 organizations, ranging from Moody's, Bloomberg and Dow Jones to MSCI and Sustainalytics, produce **ratings and rankings** of "top ESG performers" and "most sustainable" companies. To get in investors' good books, companies seek to improve their ratings. Todd Coakwell CPA, CMA, Senior Director of Sustainability and ESG for Saskatoon-based fertilizer company Nutrien, says, "If corporations don't disclose ESG performance and work to get their ratings up among the indices, they can expect shareholder activism coming down the line." Stock exchanges are increasingly looking to facilitate ESG performance, and in 2019 the TSX joined the **UN Sustainable Stock Exchanges Initiative**.[56]

John McKenzie CPA, CA, CEO of TMX Group, which runs the Toronto Stock Exchange, says TMX has seen firsthand skyrocketing demand for ESG disclosures locally. "As a reporting entity ourselves, we have gone from a handful of investors asking about our ESG report in 2019, to a year later when I was asked in almost every meeting."

GOVERNMENTS AND REGULATORS

Governments such as those of the United Kingdom, the EU, the Netherlands, Japan, China, Australia, India, Taiwan, Brazil and South Africa are increasingly turning voluntary ESG guidelines into mandatory reporting requirements. The push for mandatory reporting is expected to continue and Ontario will likely not be immune. In recent years, the OSC has asked issuers to address inconsistencies between their annual and sustainability reports. The US SEC added a requirement for companies to disclose material human capital resources in August 2020. Even without mandatory rules, companies trading in European markets that have more detailed ESG disclosure requirements may be forced to comply.[57]

Some government programs push ESG reporting by stealth. "Green strings" are attached to federal infrastructure funding in Canada, requiring companies to report on the number of women and First Nations people employed on projects. The Large Employer Emergency Financing Facility, the federal government's covid-19 relief package for business, requires recipients to issue climate-related disclosures consistent with the TCFD. As well as attaching green strings to physical developments like the Ontario Greenbelt Plan, the Ontario government adds "social strings" to infrastructure projects, requiring "community-benefit agreements" that build jobs, education and other social goods for local communities into development plans.[58]

COMMUNITY

Community groups, activists, customers and the media are pressuring large companies to improve their ESG disclosures too. For decades, First Nations communities have engaged with companies on resource developments in Ontario, such as the Ring of Fire mineral belt, to ensure communities benefit from extractive developments on their land.[59] Employees and whistleblowers are exposing unfair or discriminatory work practices, often on social media—the #MeToo movement being a prominent example. "Companies need to be ready for this type of scrutiny and dialogue by having identified, collected and examined data on their ESG risks. And, by being transparent about their results and the progress they're making," says Marc Foran of Rally Assets.

WHO IS PUSHING FOR GREATER ESG DISCLOSURE, AND WHY?

PULL FACTORS

FINANCIAL INCENTIVES

Lenders are beginning to take ESG performance into account, offering lower-cost capital to strong performers. Sustainability-linked loans tie interest rates to ESG measures such as emissions reductions and improvements in gender equity.[60]

In some cases, executive compensation is tied to hitting ESG targets. Associate Professor Nadine de Gannes from Ivey Business School says integrating ESG metrics into executive compensation plans is growing, with 61% of TSX 200 companies reporting this in 2019. “However, only five of those companies integrated those metrics into their long-term incentive plans,” she says.[61]

A GENERATIONAL SHIFT

Young, environmentally aware and purpose-driven workers are increasingly interested in potential employers’ “values” and ESG performance. They are partly behind the shift in investor interest too: millennials are twice as interested in responsible investment as baby boomers.[62] As sustainability-conscious generations Y and Z work their way up the corporate ladder, the pressure from within to report on ESG will increase.

FOMO

Fear of missing out (FOMO) is a powerful incentive for companies operating in competitive markets. Anecdotally, Ontario companies benchmark themselves against the ESG disclosures of their local and international peers, to avoid falling behind or disclosing more than others.

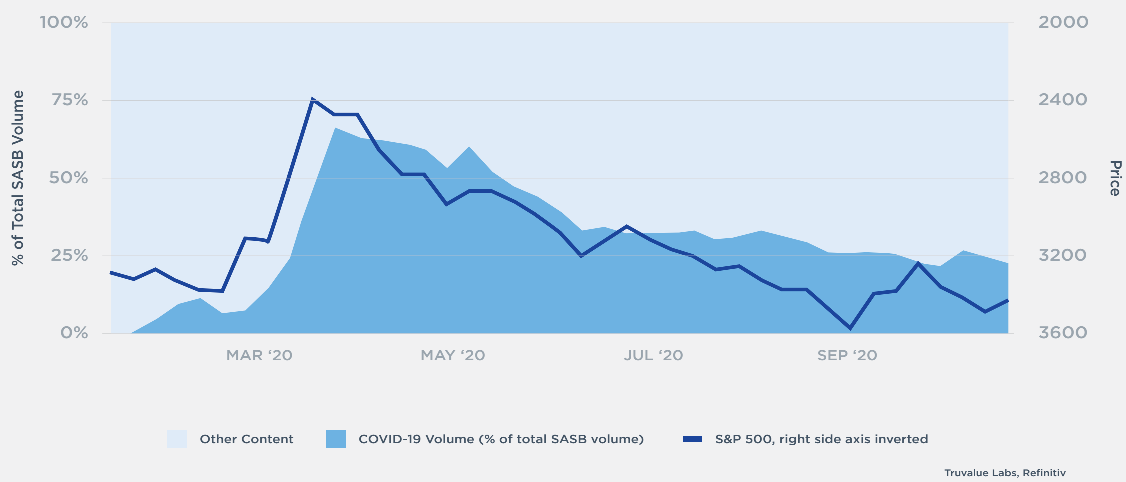
COVID-19: THE SOCIAL RISK NO ONE SAW COMING

The Covid-19 pandemic may prove to be the catalyst for a rapid and substantial shift toward social impact and risk reporting, amplifying calls for a more "inclusive" form of capitalism in the way the Deepwater Horizon crisis did with environmental risk.

Protest movements such as Black Lives Matter are at least partly motivated by the uneven effects of the pandemic. In Ontario, protests over the treatment of migrant farmworkers are a direct response to the safety risks they faced during the pandemic. "Vulnerable workers" such as those on low incomes, contractors, young people and non-unionized workers have been disproportionately affected by the pandemic. Temporary layoffs may yet become permanent.[63]

These social disruptions are reverberating around boardrooms. The pandemic has been a reminder to some businesses that social disruption can have profound effects on company performance, spurring them to take their social responsibilities more seriously and account for their impact on society with greater transparency. Rosa van den Beemt at BMO Global Asset Management says global and local anti-racism protests forced companies to re-examine their diversity and inclusion priorities, including their disclosures on workforce diversity.

COVID-19 CONTENT CAPTURED BY TRUVALUE LABS & THE S&P 500



COVID-related ESG content remains around the 25% mark, and several times in the past month has narrowed to only 22% of the total.

Source: Truvalue Labs

Investors have begun to take notice of these seismic social shifts too. Fund managers saw larger capital inflows to their ESG products, and ESG data firms including Truvalue Labs and Toronto-based The S-Factor Co. reported that clients' interest in social metrics spiked immediately following the outbreak of covid-19. "Global markets did not price a pandemic into their models," says Lauren Rosenfeld of climate-risk analytics firm The Climate Service. "This is what happens if you don't account for that social risk.

Several large asset managers have claimed that their ESG funds outperformed traditional investment funds during the pandemic. The evidence is mixed. A working paper published by Harvard Business School found that when companies made proactive statements about their human capital, supply chain and products and services during the pandemic, their share price was positively affected.[64]

However, a paper by University of Waterloo Professor Elizabeth Demers and her colleagues Jurian Hendrikse, Philip Joos and Baruch Lev, released in August 2020, found that companies with high ESG scores did not outperform their counterparts during the early part of the pandemic. Rather it was firms' innovation-related assets rather than social capital investments that provided greater immunity to sudden, unanticipated market declines. According to the authors, ESG is not a resilience factor for equities in times of crisis.[65]

Build back greener

For many policymakers, corporate leaders and sustainability advocates, the post-pandemic mantra is "build back better". A group of 335 institutional investors with US$9.5 trillion in assets under management signed a joint statement urging businesses to provide paid leave, prioritize health and safety, maintain jobs and supplier relationships, and to be "financially prudent" by limiting share buy-backs and executive compensation. Canada's Task Force for a Resilient Recovery called on the federal government to direct C$50 billion of public funds into green investments to boost the economy post-pandemic. While much of the early focus has been on environmental sustainability, it seems likely that the crisis will be seen as an opportunity to redress social and economic inequalities.[66]

Bailouts and stimulus packages of unprecedented scale mean that governments—and the taxpayers who vote for them—suddenly have a much larger direct stake in the economy. This could have a significant effect on the policy environment in coming years, and profound implications for business.[67] As governments seek to wind back emergency measures and wage subsidies, they may push some of these costs onto business.

Yet at the same time, tight economic conditions could see ESG deprioritized by corporates and investors if prolonged pandemic-driven business restrictions, unemployment and low productivity continue.

Report your response

Businesses should include any risks, costs or actions taken in response to the pandemic in their MD&A, said Oujala Motala CPA, CA of the Ontario Securities Commission in a webinar in July 2020.[68] Costs arising from implementing physical distancing guidelines for employees and customers, changes to salaries and the labour force, operational changes or shutdowns of production facilities and locations, deferral of planned projects and capital expenditures, applications for government wage subsidies and loans, and other government support measures “warrant in-depth discussion”, she said.

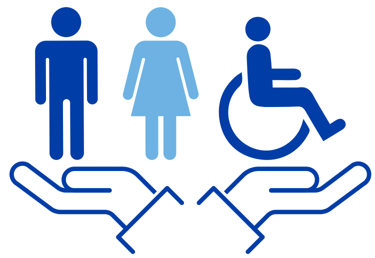
One of the more creative responses to the crisis has been the emergence of “EBITDAC”, earnings before interest, tax, depreciation, amortization and coronavirus. The measure, which adds back earnings lost due to the pandemic to a company’s bottom line, has even spawned a range of coffee mugs. But the United States SEC warned companies not to use the pandemic as cover to include non-GAAP measures in their financial statements.[69] Moody’s, too, said it would “view any move to obscure performance in this way as a credit negative”.

> “There is fierce competition in the financial ecosystem, but when the government announced the Canadian Emergency Relief Benefit, our members came together with us and within in two weeks we had a solution on the bank sites to support a fast, safe and secure way for Canadian employers to receive funding. We became social warriors by accident—we all felt proud of it.”
>
> *— Pamela Steer FCPA, FCA, CFA, Chief Financial and Corporate Strategy Officer, Payments Canada*

SOCIAL METRIC REPORTING IN ONTARIO: **CASE STUDIES**

BELL: MENTAL HEALTH

Bell (BCE Inc.) publishes a stand-alone "corporate responsibility" report prepared in accordance with the GRI, SASB and the UN SDGs.[70] In its 2019 report, Bell provided significant disclosures about mental health in the workplace and community, including both qualitative discussion and quantitative metrics on employee mental health resources, training and initiatives. The report also included metrics on the societal impact of Bell's "Let's Talk" campaign, which focuses on improving community mental health.



TD BANK: FINANCIAL INCLUSION

In 2019, TD Bank prepared an annual ESG report in accordance with GRI standards. Social and economic inclusion is a key focus, and the report includes commentary and quantitative metrics on programs such as home mortgages for low-income people, retrofitting ATMs for people with disabilities, LGBTQ2+ programs, and initiatives to serve Indigenous peoples. TD Bank established objectives for each material ESG topic and reported on corresponding metrics, targets and progress.[71]

GREATER TORONTO AIRPORT AUTHORITY (GTAA): COMMUNITY ENGAGEMENT

The GTAA includes a "Sustainability Management Approach and GRI Index" with its annual report. Corporate responsibility (such as community investment and noise management), passenger experience, safety and people were among its focus areas in 2019. The report includes a performance scorecard on each priority topic, including the percentage of employees trained on human rights policies and gender pay equity.[72]

HYDRO ONE: PARTNERING WITH REMOTE AND FIRST NATIONS COMMUNITIES

In 2019, electricity distributor Hydro One reported using GRI and SASB. As well as reporting against their annual Indigenous hiring goal and Indigenous business procurement spending, Hydro One disclosed specific energy delivery performance to First Nations communities in Ontario's Far North. Metrics included the number of distribution systems operated, the number of customer-owned renewable projects, and the customer satisfaction level in these communities.[73]

LOBLAW: PHARMACY'S IMPACT ON COMMUNITIES

Brampton-headquartered grocery chain Loblaw prioritized community impact in its 2019 corporate responsibility report. Metrics from its pharmacy division included numbers of patients, vaccinations administered, medication reviews conducted and nutrition consultations performed. Loblaw also addressed a social risk with disclosures on their 5-pillar opioid strategy.[74]

SUN LIFE: FINANCIAL SECURITY AND HEALTHIER LIVES

Sun Life's sustainability report is prepared in accordance with GRI and tracks the company's contribution to the SDGs. Sun Life disclosed the number of nudges its digital financial coach "Ella" gave clients as well as the behavioural changes this drove resulting in additional coverage contributions and positive decisions regarding financial security and health.[75]

ROGERS: DIVERSITY AND SUPPLY-CHAIN PERFORMANCE

Rogers' 2019 CSR Report follows the GRI framework. Rogers discloses at least one key performance indicator for each material topic in its control as well as extensive quantitative metrics on procurement and supply-chain performance. These social metrics included the number of certified diverse suppliers Rogers works with and the dollar amount the company spends with them.[76]

CANADA POST: EMPLOYEE RIGHTS

Ottawa-headquartered Canada Post publishes a stand-alone sustainability report, using the GRI framework with reference to the SDGs. In 2020, the company developed a SASB "materiality assessment" after consultation with stakeholders including employees, unions, customers, shareholders, suppliers, government and NGOs. Canada Post's 2019 report includes significant discussion about human rights and labour relations.[77]

The transition from reputation management to risk management is pushing ESG into the orbit of finance departments.

PART 3

SOCIAL METRICS: A REALITY CHECK

DO GOOD INTENTIONS EQUAL RESULTS?

While environmental metrics are becoming more rigorous, there are still significant problems with the way social impact and risk is measured. A study by NYU Stern found that existing social metrics overwhelmingly focus on a company's efforts, not their impact. Of the 1,700 social indicators measured, only 8% evaluated a company's genuine social impact. The vast majority measured commitments.

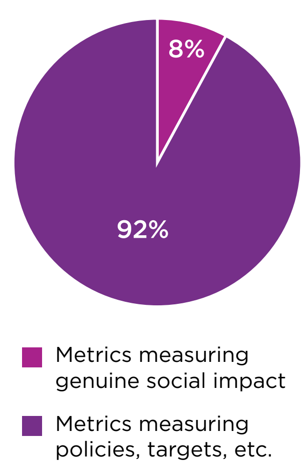
Poor-quality data, a lack of consensus about which metrics to measure, and increasingly widespread "impact-washing" suggest that social measurement has some way to go before it can be considered a reliable indicator of a company's performance. Unlike climate risk, the material social risks to a company remain challenging to quantify.

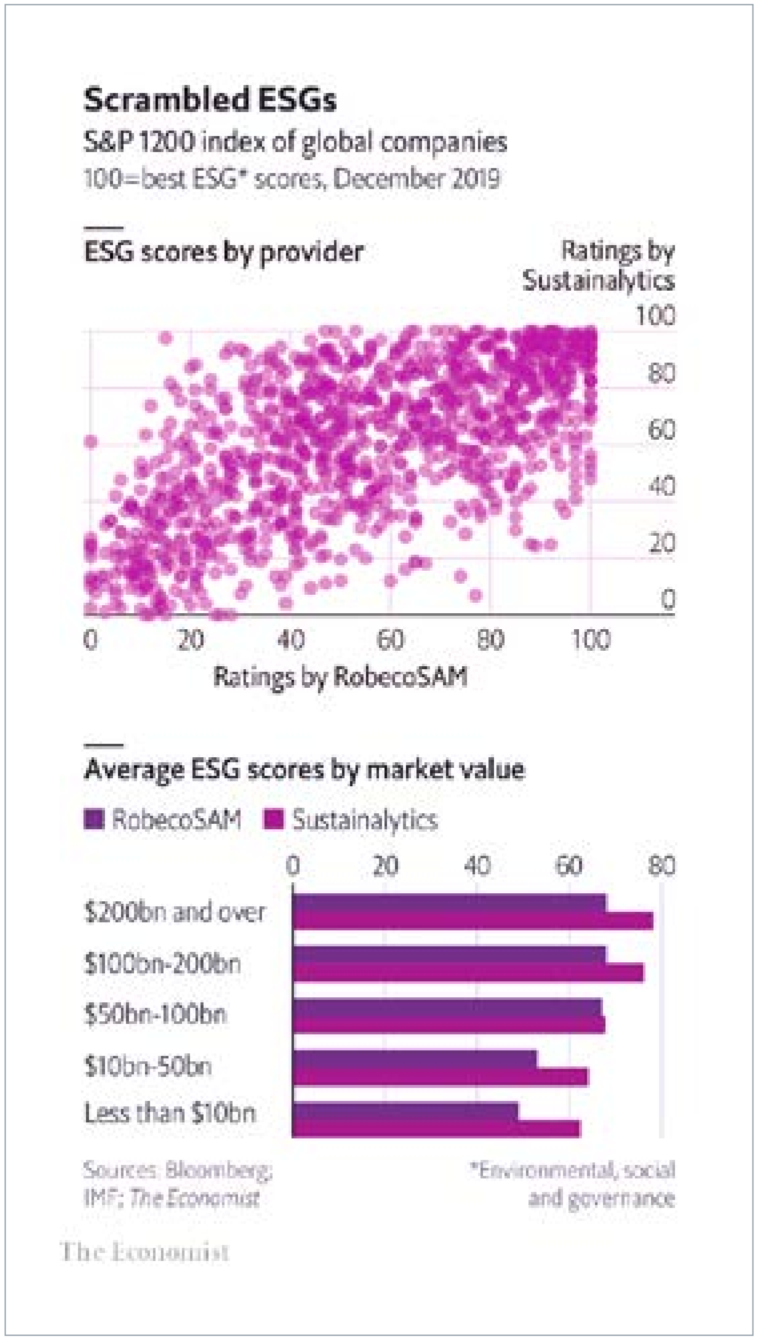
It seems that in the realm of social metrics, saying you plan to do good is as good as actually doing good and measuring proxies is as good as measuring the real thing. Compounding this, company social disclosures are often qualitative and not tracked over time, and inconsistencies between companies make benchmarking difficult.[78]

Companies may report the percentage of women in management or on the board, "but numbers alone don't tell the whole story. Company policies that encourage more equality are needed," says Marc Foran of the impact-investing firm Rally Assets. "Investors are looking to see strong policies paired with tangible practices that are supported by evidence before concluding that it's actually making a difference in the organization, something I can tangibly measure." Anthony Scilipoti FCPA, FCA, CEO of Veritas Investment Research, explains that "ESG measurement is in the eye of the beholder, with too little emphasis on how it is being calculated… Just because a company has high or low ESG scores doesn't mean it's a good investment."

NYU STERN STUDY:

Most social metrics measure efforts not results




Scrambled ESGs
S&P 1200 index of global companies
100=best ESG* scores, December 2019
ESG scores by provider
Ratings by Sustainalytics
100
80
60
40
20
0
0
20
40
60
80
100
Ratings by RobecoSAM
Average ESG scores by market value
RobecoSAM
Sustainalytics
0
20
40
60
80
$200bn and over
$100bn-200bn
$50bn-100bn
$10bn-50bn
Less than $10bn
Sources: Bloomberg; IMF; The Economist
*Environmental, social and governance
The Economist

ESG ratings agencies apply their own proprietary (and undisclosed) methodology to create a score that is potentially arbitrary and hard to verify. This means that one agency can rate a given company highly on a particular social metric while another rates the same company poorly on a similar metric. For example, Tesla came out on top in MSCI's sustainability index, and at the same time was ranked the worst carmaker on ESG by FTSE. Companies that devote more resources to responding often score better.[79]

Yet companies say they are bombarded with surveys and requests for data to populate these indices, and many suffer reporting fatigue. "It can feel like drinking from a fire hose," says Tim Faveri of Maple Leaf Foods, "with so many questionnaires, indices and recommendations, it's important to know how to filter out the noise." This is why experienced ESG reporters selectively complete surveys, spending their time on only those ratings companies they consider most strategically beneficial from an investor relations point of view.

Andrea Jong CPA, CA, explains the challenge of translating good intentions into meaningful metrics. "As a finance person, I want to understand how we track data on complex interpersonal factors like improved decision-making resulting from inclusivity. It requires putting workflows or technology in place to measure and consistently report on the metrics we set."

FROM GREENWASHING TO "SOCIAL-WASHING"

Companies can choose which social metrics they report, giving them wide latitude to paint a complimentary picture of their social impact. In 2019, 181 CEOs pledged via the U.S. Business Roundtable to exemplify a new kind of stakeholder capitalism. However, an academic study published in 2020 found that companies who signed the pledge committed environmental and labour violations more frequently than their peers who did not. Amazon, for example, was criticized for risking employee safety by not providing adequate sick leave during the pandemic. Software company Salesforce also faced fire, laying off 1,000 workers after earlier pledging to avoid cuts.

Perhaps predictably, the one year anniversary of the US Business Rountable statement in 2020 was marked by a rash of opinion pieces questioning its ultimate value.[80] Were the CEOs well-meaning but blindsided by the pandemic? Or was the statement an attempt at "social-washing": overstating the companies' socially responsible credentials to attract interest in the burgeoning ESG-investment market?[81]

"We should not have exaggerated expectations about sustainability reporting as an agent for change," IASB chair Hans Hoogervorst warned in 2019. "Let us not forget that full transparency did little to curb excess in corporate remuneration. Equally, we should not expect sustainability reporting to be very effective in inducing companies to prioritize planet over profit. Greenwashing is rampant."[82] Social-washing may be the new greenwashing.

AUDITABILITY

External assurance is thought to be an answer to poor-quality social data, yet auditing may not be as simple a solution as it seems.

97%

of investors believe sustainability disclosures should be audited

67%

of investors believe ESG audits should be completed with the same rigour as financial audits

Infographic: Source: McKinsey, 2019.[83]

While most companies provide very limited assurance of a few social measures like diversity metrics, employee engagement scores and community investments, whereas environmental measures like emissions can be given a level of reasonable assurance.[84]

"Last year, we expanded our external assurance to include a metric on financial literacy," says Sabreen Salman of TD Bank. "Only limited assurance was provided at that point, because reliance on external parties to validate the data made the task challenging. We realized there is more work needed on the calculation and validation of social metrics. That's the next step". Having worked in sustainability and accounting for two decades, Usha Sthankiya CPA, CA, ESG and Responsible Investment Lead at Deloitte in Toronto, agrees: "The issue today is more about data management, transparency and quality rather than the endpoint of assurance on it." Auditors will need to adopt sophisticated audit technology to assure measures like fair labour standards in supply chains. There could be hundreds of supplier contracts that need to be verified and manual verification may be unfeasible.[85]

> "Before companies can get assurance for sustainability disclosures, they need to understand the data they're collecting, how reliable it is, what is or isn't being included and what assumptions they're making."
>
> *— Usha Sthankiya CPA, CA, ESG and Responsible Investment Lead, Deloitte*

Currently, North American companies lag behind their European peers in obtaining external assurance over ESG disclosures. According to the Centre for Sustainability and Excellence, this is likely because of the restrictions imposed on attestation standards and auditors in the USA and Canada. Mandated ESG assurance is unlikely to be imminent, considering regulators do not require assurance on MD&A disclosures. At present, it is a big ask for external auditing firms to take on the risk and liability involved with reasonable assurance engagements on social information. But some firms, such as EY, do offer guidelines to help companies prepare for external assurance of their ESG measures.[86]

WHAT'S NEXT? KEY TRENDS

Diversity and inclusion: Tackling racism will be top of the agenda in 2021

In 2020, when Bill C-25 came into effect, Canada became the first jurisdiction worldwide to require diversity disclosure beyond gender. This predates the global surge of interest in racial diversity sparked by the pandemic and the now-global Black Lives Matter protests. Employers and policymakers are listening. In Ontario, a Premier's Council on Equality of Opportunity was set up to advise government on helping young people overcome social and economic barriers. Some companies have set race-based targets: 300 Canadian CEOs, including CPA Ontario's CEO, Carol Wilding have joined the BlackNorth Initiative, which recommends companies fill at least 3.5% of senior executive and board positions with Black employees by 2025. The Royal Bank of Canada says it wants to increase the proportion of non-white executive hires from 20% to 30%, and PwC aims for 50% of its partners to be women or from racially/ethnically diverse backgrounds, although neither explicitly states what date it plans to achieve these goals by.[87]

Pressure from investors is also starting to build. In the same month that Institutional Shareholder Services wrote to companies asking them to voluntarily disclose the background of their directors and senior managers, Moody's said that Lloyds Banking Group's program to promote more Black employees to senior roles is "credit positive". According to the *Financial Times*, this is the first time a ratings agency has explicitly linked a company's ethnic diversity policy to its credit score.[88] Yet, despite these good intentions, there are risks that the push to improve racial diversity will be undermined by poor data that measures policies and tokenism rather than actual outcomes.

Human and social capital accounting: only for the most committed

Social and human capital accounting—defining, measuring, valuing and evaluating the impacts and dependencies of a business on social and human capital—is an emerging but not yet widespread trend. At the time of writing, only four Canadian companies are using it so far. For example, Manulife measures the value of employee training programs and Brookfield calculates the financial value of the company's human capital. Among our sample of Ontario CPAs, few were aware of human and social capital accounting. Only five reported using it, and two-thirds had never heard of it or didn't think it worthwhile.[89]

Accounting for Sustainability (A4S) and the Social & Human Capital Coalition have published guides on integrating social and human capital accounting into internal decision-making. Valuation can be qualitative, quantitative and/or monetary in terms of shareholder or societal value. Brian Lawson explains the utility of this approach for Brookfield: "Our business is about allocating capital, and in this instance, when we're looking at human capital, we want to understand whether the capitalized value of investments in our people are being directed toward the right priorities in the organization." This sophisticated approach is still nascent, with few CPAs across it. But some have found this quite sophisticated process challenging. It requires companies to be transparent about their valuation process, rigorous in their collection of data and careful in deciding when monetization is appropriate. Moving from the traditional financial performance lens to managing ongoing social and human capital risks and opportunities will be a new challenge for accountants.[90]

Data is the new oil

Anecdotally, our members and ESG experts tell us that ESG data is now largely administered inside companies using basic tools like Excel. However, as the demands on ESG reporting increase, companies will increasingly adopt technology such as AI to add rigour to their social metrics in real time. Nasdaq's ESG Reporting Platform uses software to match companies' inputs with frameworks including GRI and SASB. Deloitte's Social Impact Measurement Model uses machine learning to track and forecast social impact. Truvalue Labs uses AI to mine over 100,000 data sources to identify positive and negative ESG behaviour, independent of what companies themselves report. In September 2020, the company announced a collaboration with Citi to analyze AI-driven ESG data at scale. S-Factor analyses 1,200 metrics to determine individual companies' social impact in the world. Blockchain technology, while not yet widely used, may add rigour to ESG reporting and help companies and auditors build a more complete set of social metrics along supply chains. The World Economic Forum launched a blockchain-based supply-chain traceability platform that presents the flow of goods and suppliers' social indicators.[91]

"A large amount of ESG data is collated and verified manually. We expect technology will play a key role. The ESG rating agencies are working to leverage technology, for example machine learning and data analytics, to create predictive ESG ratings, which go beyond the universe they traditionally cover. This will speed up the analysis of large pools of companies."

— Lucie Mouzin, Director of Sustainable Finance, Standard Chartered

A NEW ROLE FOR CPAs?

For some Ontario CPAs, the very question of ESG reporting is a distraction from their day job. For others, it's an interesting topic looming on the horizon, which may yet zoom into view or float away. But for a growing number of CPAs, ESG and social metric reporting represents an opportunity to contribute meaningfully to a growing trend of companies doing good.

At its core, the question of whether companies—and the CPAs who serve them—should be responsible for monitoring and managing their social impact is one of values. Will social views continue to shift to such an extent that this becomes the norm? Will continuing social upheavals mean that business needs to plan for and mitigate social risks, in the way it is now starting to do with climate risk?

CPA Ontario believes that CPAs, armed with the information and tools to make sense of the changes taking place, should embrace the warrior accountant mission. Our profession has a valuable role to play adding rigour, accuracy and consistency to social measurement and reporting, just as we do to financial reporting.

It may still be too early to tell what the lasting impact of the covid-19 pandemic, and its effect on how governments and communities view the role of the company, will be. Will a vaccine-led recovery consign a year of soul-searching to the dustbin? Or will 2021 be like 1945: a pivotal year that future generations will look back on as a turning point that shaped the decades ahead? If so, "warrior accountants" may yet be in the vanguard of change.

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