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The Audit Committee Frontier—addressing climate change

A Deloitte Global Boardroom report issued November 2021

Audit committees are unprepared for climate change, Deloitte Global survey finds

The announcement of a new International Sustainability Standards Board (ISSB) is a major milestone in global efforts to set businesses on the path to net-zero. Audit committees have a critical role to play in the new reporting landscape. But how prepared are they to go green?

Research conducted by Deloitte Global with audit committee members during September 2021 reveals that 42 percent believed that their organizations' climate responses are too slow and lack strength. But, nearly 50 percent said they did not have the information, capabilities, and mandate to fulfill their climate related responsibilities.

These responses are sobering and indicate that much work remains to be done in many of today's boardrooms in order to come to grips with the climate emergency and its increasingly catastrophic consequences.

A clear strategy is needed

For the majority of audit committee members in the survey, the top internal obstacle is the lack of a clear and agreed carbon reduction strategy, an action plan with milestones, and a way to hold management accountable for it (65%). Nearly half singled out poor data and management information quality as challenges for audit committees in overseeing climate change (46%).

Understanding how the physical effects of climate change and transition risks affect business operations and resilience is another challenge. Especially so when just under half of the audit committee members in the Deloitte Global survey do not consider themselves "climate literate". 40 percent said they must rely on company management or outside parties when considering climate impacts.

Despite environmental destruction and its dire consequences being one of the most urgent societal issues of our time, and despite growing pressure from investors for audit committees to more explicitly consider climate impacts, only six percent of respondents said that they discuss the topic at every meeting of the board's audit committee. Most audit committee members, globally, never or rarely had climate change on their agenda (58%).

In some ways, while disappointing, the results are also not surprising; most directors and audit committee members are learning alongside the mainstream population. Developing and monitoring new climate change measures is a new practice for most directors. Greater investment in learning is required.

Audit committee members can also point to no shortage of external challenges. Key concerns here related to the lack of common global reporting standards (60%) and difficulties to keep up with the pace of change in reporting regulations and practice (46%). Fortunately, this is changing fast with the announcement at the recent COP26 meeting in Glasgow of the new International Sustainability Standards Board under the IFRS Foundation.

However, bringing the uncertainty and complexity of climate change into the core of conventional management and governance processes is challenging. Informative climate reporting requires a complex transformation of reporting systems, data collection, and new skills within the finance function. Also, 46 percent of respondents to the Deloitte Global survey identify that solutions require coalitions and alliances beyond their own organization to achieve real progress, and these are difficult to achieve.

Those reporting or planning to report on Scope 3 emissions, which the organization is indirectly responsible for, indicated some serious challenges, including the ambiguity of measurement standards (78%) and lack of understanding of the perceived value of this information (52%).

Considering, however, that Scope 3 emissions are likely to be the most material part of a company's carbon footprint, companies need to get more comfortable with preparing and exchanging information to facilitate greenhouse gas reporting in the value chain.

Boards need to do more

There is much more that today's boardrooms could do to ensure clarity in how companies report climate commitments and measure climate progress. Coming to grips with climate change means undertaking a comprehensive climate assessment and reflecting the outcomes in the financial statements. This involves organizations assessing how the changing climate affects their operations, supply chain, customers and the wider ecosystem on which they depend to create enterprise value.

Still, the vast majority of respondents to the Deloitte Global survey (70%) said that they have not completed a comprehensive climate change assessment. Most of them assume the issue had no material impact on the organization. Just 18 percent of respondents said that their financial statements fully reflected the outcomes of a climate impact assessment. This alone indicates a clear need to accelerate activity.

"While audit committees are beginning to address how assumptions about the future should be reflected in financial statements and risk assessments, there are steps that can be taken now to improve the decision-making process and put boards and their organizations on a successful track to respond to the climate crisis," says Jean-Marc Mickeler, Deloitte Global Audit & Assurance Business Leader.

Findings from the Deloitte Global survey suggests that 70 percent of companies already look to the CEO as taking overall responsibility for climate strategy, just as the CEO is overall responsible for company strategy.

"The crux of the matter is that climate must be integrated with company strategy," notes Veronica Poole, Vice Chair of Deloitte UK and Deloitte Global IFRS and Corporate Reporting leader. "From this integration commitments can be made, which, in turn, reorient the whole business."

Practical advice

In the Deloitte Global survey, audit committee members had good advice for other audit committee members: Improving climate education came out on top (87%) followed closely by ensuring good management information as part of regular reporting to the board (79%), and having the all-important internal alignment around the company's climate strategy (78%).

"Through greater education and engagement, audit committees can help their organizations take more decisive climate action," says Sharon Thorne, Deloitte Global Board Chair. "This means ensuring their organizations are assessing their own environmental risk profiles, establishing mitigation plans to reduce their carbon footprints, ushering in global ESG standards, and accurately reporting on their progress."

There really isn't a choice. The transition to a low-carbon economy has begun and we all have a part to play.

Link to the report

https://118.del-extra.com/pdf/audit-committee-frontier---addressing-climate-change.pdf

About the Audit Committee Frontier

The world of the Audit Committee is changing fast, and critical topics move at pace. When on the agenda, these new topics require investment in learning, acquiring experience, and developing judgment both on the part of company management and around the audit committee table.

This series about the Audit Committee Frontier, from the Deloitte Global Boardroom Program aims to address the critical issues on the frontier—a place unfamiliar and challenging. Each report, beginning with the present one about climate change, will address a topic on the audit committee agenda that requires development and greater attention. These reports are intended to help audit committee members with insightful commentary, from both Deloitte subject matter experts and those who deal with the issue in their daily lives—whether company executives, investors, regulators, or audit committee chairs. Each report will also include the results of a survey of audit committee members and chairs, taking the pulse of committees globally.

The word "frontier" for this series is chosen advisedly: Each of the issues in the series sits squarely in a landscape that is, in a sense, difficult and unmapped. There will be obstacles in tackling them, difficulties to overcome, and decisions to take with imperfect information. Travelers in this environment require something different: a thoughtful guide and a level of nuanced thinking that will help them navigate the way through.

About Deloitte's Global Boardroom Program

The Deloitte Global Boardroom Program brings together the knowledge and experience of Deloitte member firms around the world to address critical topics of universal interest to company boards and the C-suite. Supplementing geography programs, its mission is to promote dialogue among Deloitte practitioners, corporations and their boards and management, investors, the accounting profession, academia, and government. In addition to the publication of thought-pieces on critical topics, the Deloitte Global Boardroom Program hosts a series of must-see webinar discussions with eminent panellists to enable boards and management of global companies to challenge perceived wisdom. For more information about the program contact globalboardroomprogram@deloitte.com. Find us online.

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