

# BOARDS AND AUDIT COMMITTEES: CONSIDERATIONS FOR THE REMAINDER OF 2022

March 2022

# Your presenters

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# Regulatory Update

Reassessing areas of focus in light of changing priorities

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“Change is the only constant in life. One’s ability to adapt to those changes will determine their success in life.”

- Benjamin Franklin



Adapt and focus

## SEC's most notable recent focus: Enforcement

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“Enforcement is one of the fundamental pillars in achieving the SEC’s mission...We will continue to pursue misconduct wherever we find it.”



**SEC Chair**  
**Gary Gensler**  
Nov. 4, 2021

## SEC focus areas

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- Enforcement
  - Special Purpose Acquisition Companies (SPACs)
  - Cyber – directed at ransomware victims
  - Crypto
  - Private funds
  - Accounting fraud
  - Insider trading
  - Record keeping
- Auditor independence
- ESG disclosure rule-making

## Intentional and ongoing reassessment of areas of focus

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“To maintain the strength of our U.S. financial reporting system, each stakeholder should constantly reassess its areas of focus in light of changing priorities, evolving investor needs, and updates to standards, rules, and regulations. This process must be intentional and ongoing, such that it results in continuous improvement to maintain the flow of high-quality financial information to investors.”



**SEC Acting Chief Accountant**

**Paul Munter**

Dec. 6, 2021

## High-quality financial reporting: Financial statement preparers

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- Making well-reasoned and supported judgments
- Considering the usefulness and transparency of information
- Continually assessing financial reporting risks and evaluating whether the Internal control over financial reporting (ICFR) environment is effective
- Disclosing material ICFR changes in the quarter they occur
- Identifying and communicating material weaknesses in ICFR before they become evident in the form of a restatement
  - Involving the audit committee when there are “close calls”
- Judiciously evaluating both quantitative and qualitative factors in determining whether an error is material



# High-quality financial reporting: Independence

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- Auditors

- Carefully monitor the scope of services being provided by the audit firm, including network firms
  - Includes evaluating the impact of business relationships and non-audit services on both existing and prospective audit relationships

- Audit committees

- Consider the sufficiency of the auditor's and the issuer's monitoring processes, including those that address corporate changes or other events that could affect auditor independence
- Proactively identify, and discuss with the auditor, potential transactions with third parties

## High-quality financial reporting: Audit committees

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- Focus on core responsibility
  - Oversight of financial reporting, including ICFR
  - Engagement of the independent auditor
  - Oversight of the external audit process
- Assess whether scope of responsibilities is
  - Appropriate
  - Achievable
  - Aligned with committee member experience

## SEC proposed rules regarding cybersecurity-related disclosures

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- Current reporting about material cybersecurity incidents on Form 8-K within four business days after the registrant determines that it has experienced a material cybersecurity incident
- Periodic reporting on Form 10-Q and Form 10-K to provide updated disclosures about previously reported incidents
- Annual reporting in Form 10-K to provide disclosure about cybersecurity policies, procedures and governance, and management's role therein
- Annual reporting or proxy disclosure about the board of directors' cybersecurity expertise

# Audit innovation

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- Innovation – Doing things differently
  - Keeping pace with the changing business environment
- Consider whether the introduction of “audit innovation” should cause the audit committee to ask more questions
  - Are the results of innovative testing evaluated by an auditor with the appropriate level of experience?
  - How does audit innovation keep the auditor’s focus on the high-risk matters?
  - How are auditors trained regarding the innovative technology and the consequences of that?
  - Is the innovative tool universally applied to all audits, regardless of the size of the entity?

## 2021 Audit committee transparency barometer

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- Gauges how public company audit committees approach the public communication of their external auditor oversight activities
  - Includes examples of disclosures
- Biggest uptick (five to seven percentage points) in disclosure year-over-year was related to cybersecurity
  - Is audit committee responsible for cybersecurity risk oversight?
  - Does the board of directors have a cybersecurity expert?
  - On what committee does the cybersecurity expert serve?
- As investor interest in cybersecurity vulnerabilities increases, this upward disclosure trend is likely to continue

## Environmental, social, governance (ESG) rulemaking

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- June 3, 2021, CAQ roundtable discussed March 2021 SEC request, Public Input Welcomed on Climate Change Disclosures
  - 20 participants (board members, public company management, institutional investors, public company auditors)
    - 87 percent - supportive of ESG disclosure system built from existing standards
    - Broad support of need for an independent standard setter for ESG reporting
    - 62 percent - SEC ESG disclosure requirements should be based on investor demand
    - Should ESG disclosures be subject to assurance from public company auditors?
      - 45 percent – yes
      - 46 percent – yes, over time

## SEC comments on companies' climate-change disclosures

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- In September of 2021, the SEC released a sample letter, which illustrates comments the SEC may issue to companies regarding their climate-change-related disclosure
- Per 2010 SEC Climate Change Guidance, SEC disclosure rules may require disclosure related to climate change, including
  - The impact of pending or existing climate-change-related legislation regulations and international accords
  - The indirect consequences of regulation or business trends
  - The physical impacts of climate change

## SEC proposes required climate-related disclosures for registrants

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- If finalized, would require disclosure of:
  - Certain climate-related information in registration statements and annual reports on Form 10-K, together with disclosure in Form 10-Q of material changes to such information
  - Certain climate-related metrics in a note to the registrant's audited financial statements
- Proposed after a 3-1 vote by the SEC Commissioners, with Commissioner Hester M. Peirce dissenting
- The 510-page proposal is available for comment until the later of May 20, 2022 or 30 days after it is published in *The Federal Register*



## Climate-related metrics to be disclosed in the audited financial statements

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- Disclosure of the following for all fiscal years included in the consolidated financial statements in the filing:
  - Impact on financial statement line items related to severe weather events and other natural conditions and transition activities if impact exceeds 1% of the related line item
  - Expenditures expensed and capitalized to
    - Mitigate the risks of severe weather events and other natural conditions
    - Reduce GHG emissions or otherwise mitigate exposure to transition risks
  - How severe weather events and other natural conditions and transition activities affected estimates and assumptions the registrant used to produce the consolidated financial statements

## Proposed Regulation S-K Part 1500

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- Governance – board and management oversight
- Material impact on strategy, business model and outlook over the short-, medium- or long-term
- Process for identifying, assessing and managing climate-related risks
- GHG emissions metrics
- Attestations of Scope 1 and Scope 2 emissions disclosure
- Targets and goals, and related progress toward those



# ESG Round Up

ESG reporting and attestation engagements

# ESG: From the viewpoint of our clients

## CONFUSION



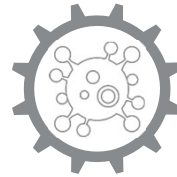
- What is ESG?
- Why now?
- Does ESG adoption come at the cost of better business results? Is it one or the other, or both?
- How do ESG behaviors influence business results?
- What's expected of an organization like us (given our size, industry, stakeholder group, etc.)?
- Is it a risk or strategy exercise? Or both?

## COMPARABILITY



- Need for reporting standardization.
- What matters to one industry may not matter to another industry.
- Materiality.
- Measurement methodology.

## CURRENT EVENTS



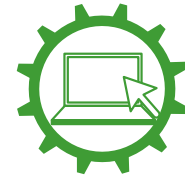
- Societal trends and the pandemic
- U.S. and Canadian government encourage organizations to set ESG strategy.

## TRUST



- Stakeholders want verified information to make informed decisions.
- Flight to quality amidst greenwashing.

## DATA & TECHNOLOGY



- Inconsistencies across the data sets.
- Data latency.
- Technology is powerful to correlate risk and return.
- Data abundance vs. data scarcity.
- Type and quality of data.
- Technology as a data enabler.

# Regulatory round-up: Priorities coming into focus

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1

Data aggregators and ratings agencies—ensure accuracy, substantiate the data and create uniformity

2

FASB intersection of ESG matters with financial accounting standards—going concern, risks and uncertainties, impairment of goodwill, loss contingencies, and fair value measurement.

3

Reporting convergence projects with the AICPA, CAQ, ASB, and Chamber of Commerce

4

SEC's climate change disclosures and the Division of Examination's review of ESG investing and greenwashing

5

Biden infrastructure plan focuses on green technologies and green jobs

# RSM's ESG special report

9 out of 10 companies support social, community or philanthropic causes over the past two years

Educational support	37%
Support for community organizations	36%
Community health and wellness	35%
Environmental issues	35%
Children/youth issues	31%
Energy issues	29%
Entrepreneurship and small business	26%
Racial justice	26%
Food quality and access	25%
Gender equity	25%

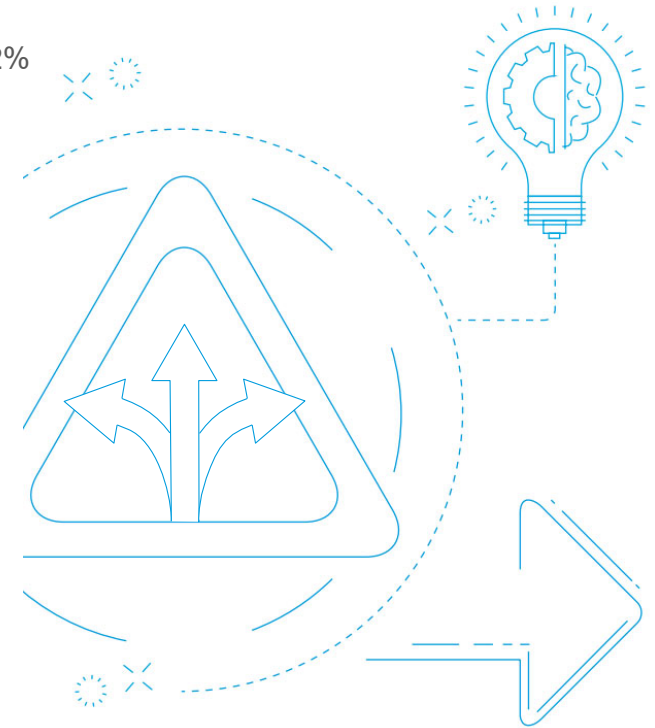
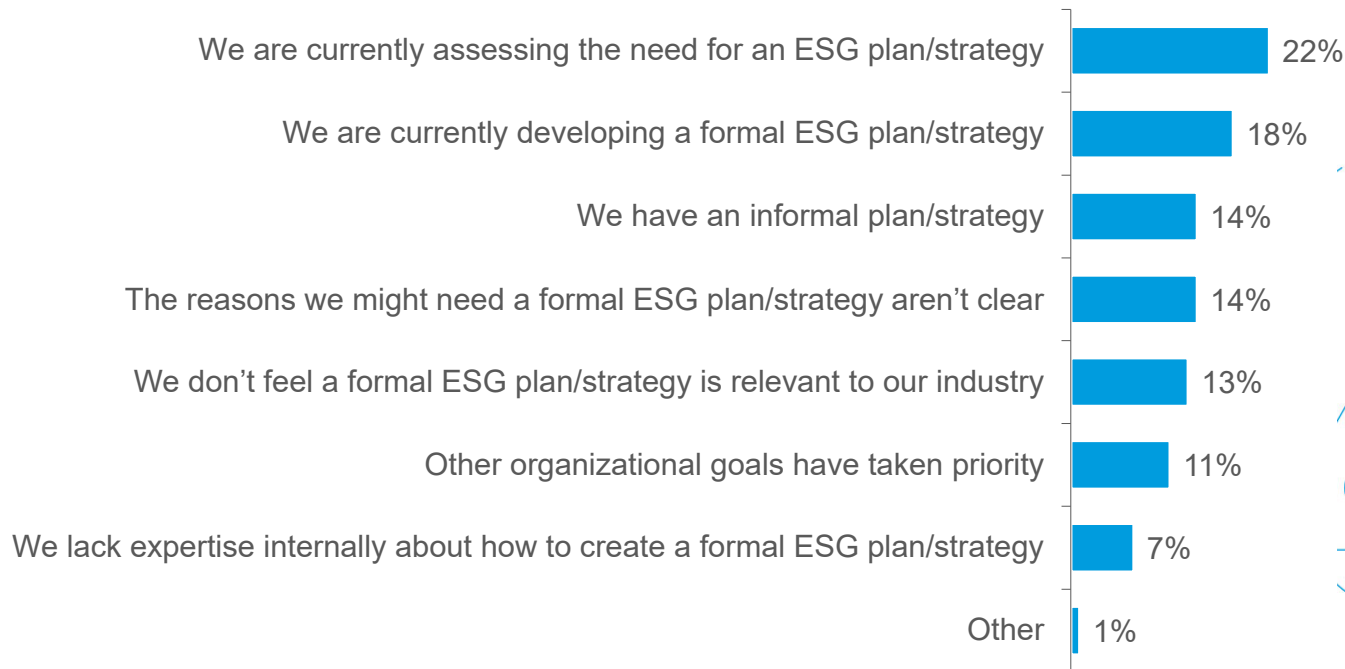


## RSM's ESG special report

From Q4 2019 to Q3 2021 the number of companies that are familiar with ESG has risen dramatically from 39 percent to 69 percent.

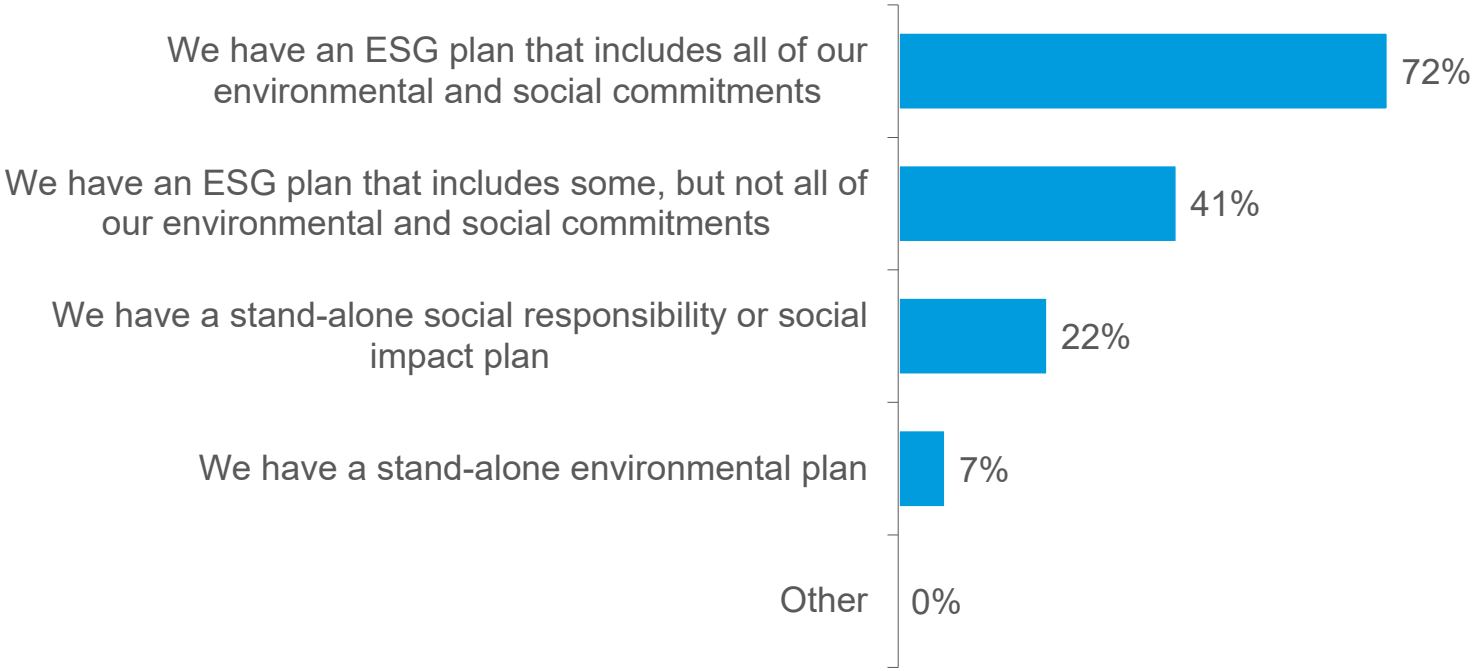
	Q4'19	Q3'21
<b>Very familiar/somewhat familiar</b>	<b>39%</b>	<b>69%</b>
<i>Very familiar</i>	14%	30%
<i>Somewhat familiar</i>	25%	39%
<b>Somewhat familiar/not at all familiar</b>	<b>61%</b>	<b>32%</b>
<i>Somewhat unfamiliar</i>	19%	15%
<i>Not at all familiar</i>	41%	17%

# Companies that do not have a formal ESG plan in place



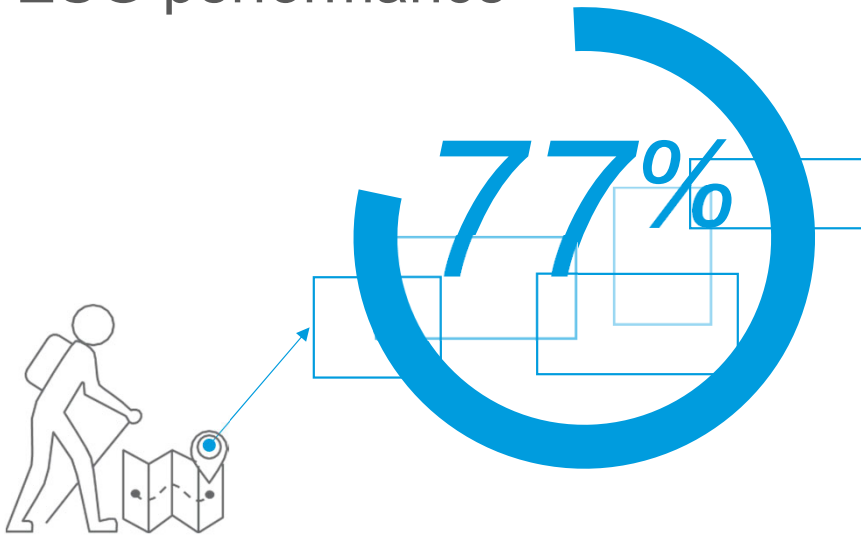


# Companies that have a formal ESG plan in place



## RSM's ESG special report

Percentage of organizations providing external reporting on ESG performance



Of those that report, the most common financial reporting frameworks include:

- SDGs (52 percent)
- CDSB (45 percent)
- PRI (41 percent)
- SASB (40 percent)
- WEF (38 percent)

# RSM's ESG special report

Companies are increasingly using ESG to evaluate their own performance and the performance of others

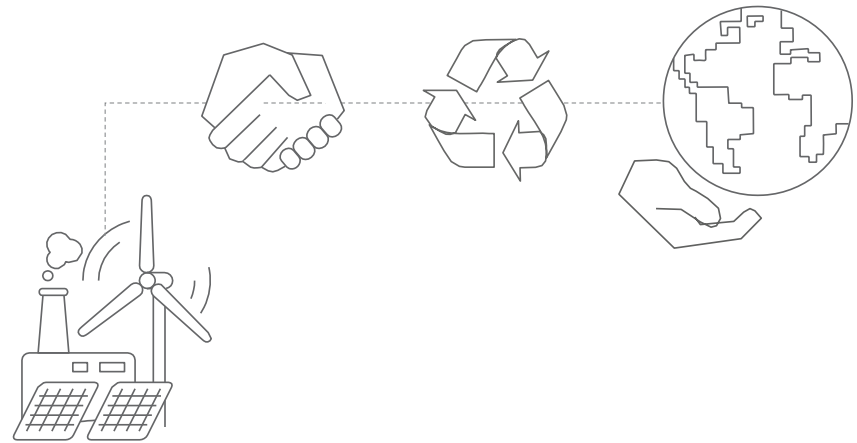


*vs. 79% two years prior*



*vs. 74% two years prior*

**2/3** of all companies have dedicated a senior executive in setting ESG strategy

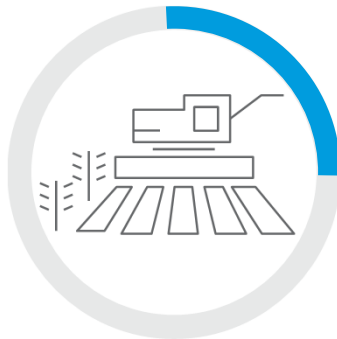


# The most cited ESG priorities



32%

Environmental issues



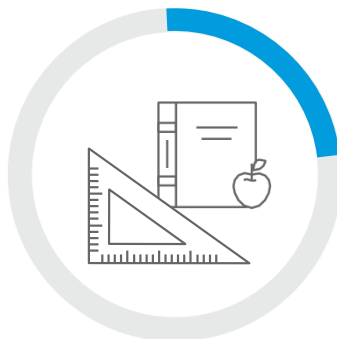
25%

Fair trade and (or) sourcing



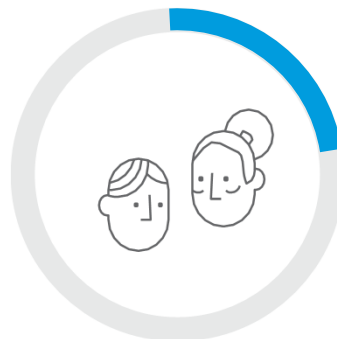
24%

Community health and wellness



23%

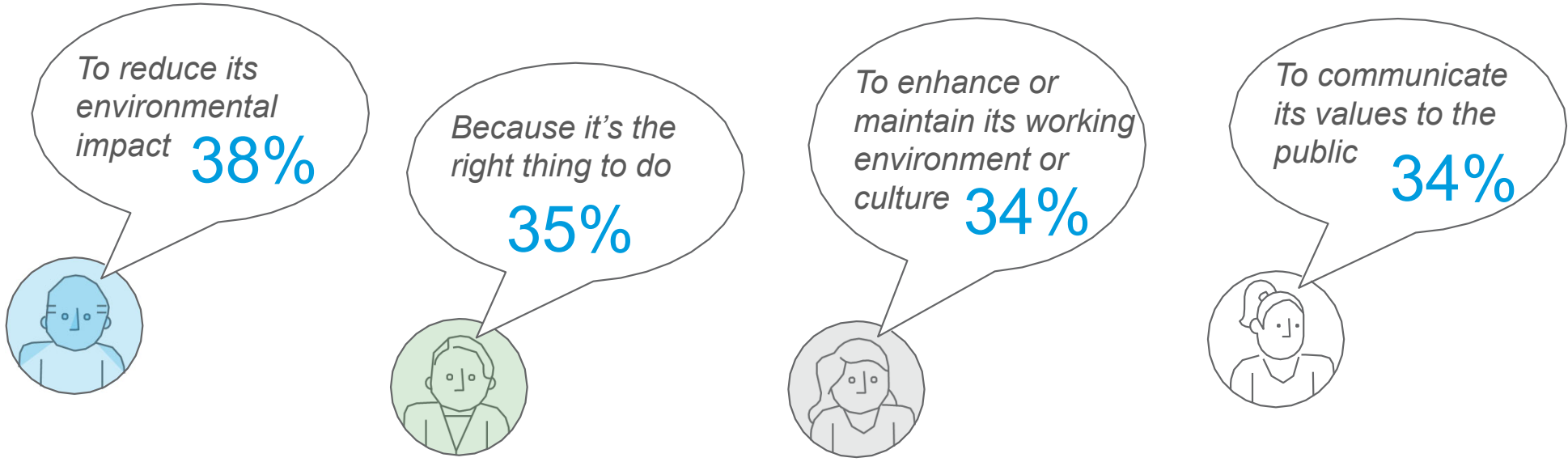
Educational support



22%

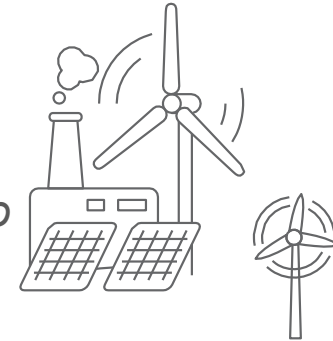
Gender equality

# Why is an organization embracing ESG?



# RSM's ESG special report

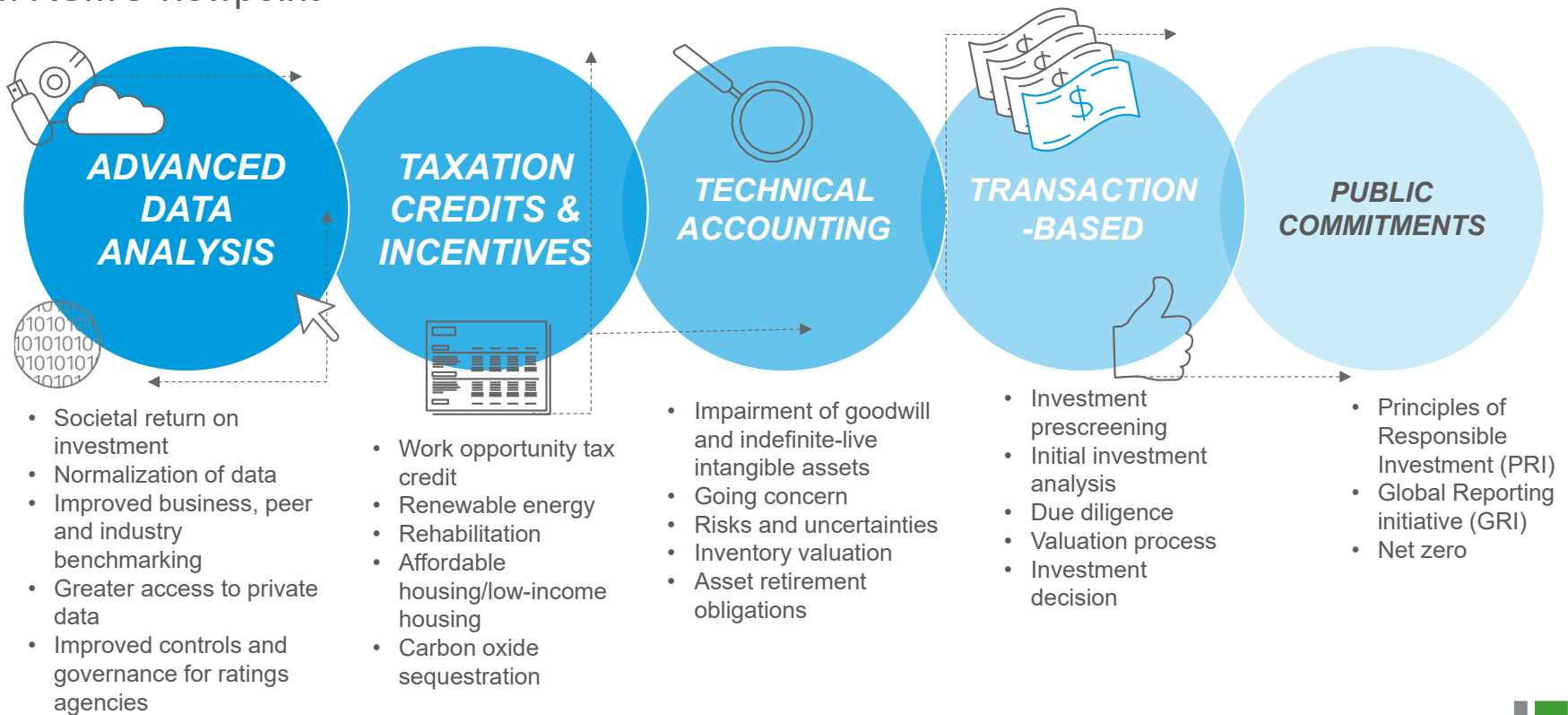
**68%** Companies are increasingly working to reduce their **carbon footprints**, especially amongst the \$50 million to \$1 billion category



Respondents mention there is **so much more** climate data but not enough time to cover

# Where is ESG headed?

From RSM's viewpoint



# ESG issues that are material to select companies

Below is a subset of the most prevalent ESG issues, drawn from frameworks and standards – such as SASB, GRI and MSCI – for a select infrastructure industry.

<b>Environment</b>	 GHG Emissions & Renewable Energy	 Energy Management	 Climate Change Vulnerability (Risk to Individuals/Assets)	 Water Stewardship
<b>Social</b>	 Workplace Health & Safety	 Energy Affordability & Structural Integrity	 Labor Practices	 Diversity & Inclusion
<b>Governance</b>	 Emergency Management	 Network Resiliency	 ESG Governance	 Business Ethics

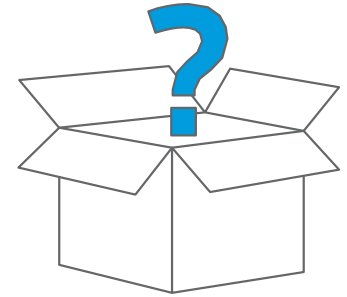


# Center for audit quality

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## Questions for consideration:

- Is there a need for a **global** set of internationally recognized **sustainability reporting standards**?
- What suggestions does each firm have on **improving the process**?
  - Global support
  - Achieving consistency & reducing complexity
  - Funding
  - Technical expertise
- Should the counsel initial adopt **climate-related disclosures**?
- Should there be a **focused definition** of climate-related risks or considered broader environmental factors?
- How is **materiality** defined?
- Should sustainability information subject to **external assurance**?



# ESG reporting and attestation engagements

	Assertion-Based Examination [AT-C 205]	<b>*COMING SOON*</b> Direct Examination [AT-C 206]	Review [AT-C 210]
Level of assurance	Reasonable	Reasonable	Limited
Report	Opinion	Opinion	Conclusion
Measurement and (or) evaluation	Client	RSM	Client
Responsibility for the underlying subject matter	Client	Client	Client
Written assertion required	Yes	No	Yes
Procedures performed	Audit-level	Audit-level	Inquiries and analytical procedures



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