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The Audit Committee Frontier

Addressing climate change

A Singapore perspective

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Climate change and the audit committee

The climate crisis is one of the most urgent societal issues of our time. As temperatures rise, we face a cascade of dire consequences – from increasingly catastrophic weather events to disrupted ecosystems and extreme socio-economic burden. For the sake of the generations to come, addressing this crisis must be a top priority on the corporate agenda.

Yet, research conducted by Deloitte Global with audit committee members across the Americas, Asia-Pacific (APAC), and Europe, Middle East, and Africa (EMEA) in September 2021 has revealed that organisations' climate responses continue to be too slow and lack strength.

These are sobering results, 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.

With every region and country at varying levels of progress in their fight against climate change, however, there are likely to be many nuances across individual markets. In this publication, we present our perspective for Singapore – one which we have developed based on the survey findings for the broader APAC region, as well as our own local research and marketplace observations.

Climate preparedness and literacy

Overall, the survey found audit committees in the APAC region to be the least prepared for climate change when compared to their global counterparts (see Figure 1). Specifically, 69% of APAC audit committee members either do not discuss it at all or have not developed a fix cadence to discuss climate change as a specific topic on the audit committee agenda – the highest proportion across all regions.

Figure 1: Climate preparedness and literacy is the lowest amongst APAC audit committees

Percentage of APAC respondents who say that their audit committee does not discuss climate change on a regular basis

Percentage of APAC respondents who say that some or all of their audit committee members are climate literate

Percentage of APAC respondents who say that their organisation's climate response is not as swift as they would like

Percentage of APAC respondents who do not believe that their audit committee is well-equipped to fulfil its regulatory responsibilities in relation to climate change

Similarly, climate literacy also appears to be the lowest in APAC, with only less than half (41%) of respondents saying that some or all audit committee members are climate literate. This, in turn, could be a contributory factor to some degree of frustration experienced by audit committee members: 44% of respondents in APAC say that their organisation's climate response is not as swift and robust as they would like.

When asked about whether the audit committee is well-equipped to fulfil its regulatory responsibilities in relation to climate change, more than half (51%) of APAC respondents said that they do not believe they possess the necessary capabilities. This is not a surprise: in Singapore and across the broader APAC region, climate literacy in the boardroom remains patchy – with significant reliance on management or outside parties.

These results point to the need to increase the pace of change, and equip audit committees with the necessary information, capabilities, and mandate that they need to fulfil their responsibilities. But the good news is that some encouraging signs of progress can already be observed, not least with the recent launch of Climate Governance Singapore – the Singapore chapter of the Climate Governance Initiative.

Unveiled by Minister for Sustainability and the Environment Grace Fu in October 2021, Climate Governance Singapore aims to bring more discussions on climate change into boardrooms, and increase board members' awareness and literacy on the risk and opportunities associated with climate change. Broadly, the initiative will provide Singapore's directors with access to the latest science on climate change and the tangible actions that they can take to tackle climate challenges at the board level (see "About Climate Governance Singapore" for more information).

About Climate Governance Singapore

Through Climate Governance Singapore, board members will gain access to workshops, conferences, and a curated library, where they can leverage the expertise of renowned experts in risk management; strategic, financial, and human capital planning; remuneration; as well as legal and governance across Singapore and throughout the Climate Governance Initiative's global network.

The Singapore Institute of Directors will collaborate with Climate Governance Singapore in engaging with the Director community, while the Singapore Management University (SMU) will act as the knowledge partner to curate and manage a content library of useful research and pedagogic materials, curate and deliver a suite of training programmes, as well as organise regular events and public programs to improve the awareness and preparedness of the stakeholder community to better address the challenges of climate change.

Deloitte Singapore is proud to be a founding strategic partner of Climate Governance Singapore, with representations on both the advisory board and steering committee.

Climate-related responsibilities

When it comes to climate-related responsibilities, there appears to be somewhat of a dichotomy in the audit committees' or board members' recognition of their roles. Specifically, for corporate reporting – areas where audit committees and board members have very broad remits – survey respondents did not appear to sufficiently recognise that their core responsibilities in relation to these reporting matters extend to climate-related impacts (see Figure 2).

Figure 2: APAC audit committees do not sufficiently recognise their core responsibilities in relation to reporting matters extend to climate-related impacts

Percentage of APAC respondents who say that their audit committee has oversight for corporate reporting (front half of the annual report, integrity of narrative reporting on climate risks and opportunities)	Percentage of APAC respondents who say that their audit committee has oversight for corporate reporting (impact of addressing climate risks and opportunities in financial statements, including in relation to judgements and estimates in valuations and impairments)	Percentage of APAC respondents who say that their audit committee has oversight for external audit (approach taken by external auditor to identify and respond to climate-related financial statement risks)	Percentage of APAC respondents who say that their audit committee has oversight for assurance (effectiveness, independence, and objectivity of assurance obtained over climate-related information and disclosure)

> Increasingly, audit committees will be viewed as responsible for the clarity with which organisations report their climate commitments and measure progress. As part of its own regular review of skills and knowledge, audit committees should therefore consider including an assessment of its own climate literacy and competence, and consider how its responsibilities in relation to risk and internal control, as well as internal and external assurance, should evolve to reflect climate impacts."

Seah Gek Choo, Centre for Corporate Governance Leader, Deloitte Southeast Asia

Indeed, only 56% of APAC respondents recognised their responsibility for climate reporting in the front half of the annual report, including the integrity of both narrative reporting on climate risks and opportunities, and a similar 56% recognised their responsibility for addressing climate risks in the financial statements, including in relation to judgements and estimates in valuations and impairments.

But our observations suggest that the picture is significantly different when it comes to climate-related considerations in the context of investment decisions. In a recent survey conducted by Deloitte Southeast Asia and Nanyang Technological University (NTU) with audit committee members, board members, and CFOs in the first of 2021, we asked Singapore-based respondents how regularly their organisation considers the various ESG factors – environmental (including use of renewable energies, responsible waste management, and carbon footprint reduction), social (including diversity and inclusion policies, labour standards and human rights, and local community relations), and governance (including anti-corruption and bribery policies, ethics and conduct, and board-level responsibility) – when making investment decisions.

What we found was that all survey respondents frequently or occasionally considered governance factors in their investment decisions. This was followed by environmental and social factors, both of which were either frequently or occasionally considered by 89% of survey respondents – suggesting a very strong focus on all types of ESG considerations, including climate change, for investment decisions.

However, in line with the findings from the global survey which found attention in APAC on external audit (51%) and assurance (43%) to be lacking, our respondents also only ranked ESG considerations third – behind more sophisticated data analytics and strengthened risk management and controls – when it came to the factors contributing to an enhanced external audit process.

Taken together, these results suggests that audit committees' and board members' attention to climate change issues tend to be more skewed towards those relating to investment decisions, rather than reporting requirements. This, in turn, suggests the need for them to develop a greater awareness of how climate-related considerations contribute to the integrity of corporate reporting – not just sound investment decisions – and the roles that they must play in this process (see "Four areas of responsibility for audit committees").

Four areas of responsibility for audit committees

The traditional deep focus of audit committees on the scrutiny of judgements and estimates in financial statements needs to evolve to take into account potentially significant impacts that climate change can have on asset valuations, and ensure completeness of liabilities reflected in financial statements. In this context, audit committees consider thinking about climate change along four different areas of responsibility (see Figure 3):

Corporate reporting

With its focus on the integrity of corporate reporting, the audit committee will need to be able to judge for itself that all material climate-related risks, opportunities, and strategic decisions have been clearly incorporated in recognition, measurement, and disclosure – which will involve an assessment of whether management's forward-looking assumptions and forecasts in respect of the climate-related risks and opportunities are robust and appropriately reflect the organisation's climate commitments and strategies.

Risk and internal control

The audit committee will need to ensure that the organisation identifies and monitors current and emerging material climate-related risks physical and transition risks – to inform business decisions. Measurement and reporting on progress towards established targets are essential for accountability and addressing any concerns about resilience. This, in turn, requires an appropriate climate governance framework, with clear parameters and appropriate adaptation of the internal controls framework to enable climate vulnerabilities to be uncovered and for timely, relevant data to inform the strategic response.

Internal assurance

The audit committee will need to have confidence in the quality of the management information used in the organisation's climate analysis — both for decision-making and in corporate reporting. Audit committees should hear from executives how managers in the business are being upskilled to deal with climate-related risks and opportunities as part of the core business. They will also need to understand how the Chief Internal Auditor plans to upskill team members to provide appropriate challenge to management, and build confidence in climate-related management information through internal assurance.

External audit

The audit committee should evaluate how climate-related matters have been incorporated into the work of the external auditor, along with any planned use of specialists and whether the external auditor has been provided with the information needed to identify and respond to climate-related risks to financial statements, and assess adequacy and quality of the disclosure.

It is also worth considering whether climate-related KPIs and disclosures that are outside the scope of the audit are critical to understanding business performance and resilience and should be subject to reasonable or limited scope assurance.

Figure 3: Four areas of responsibility for audit committees

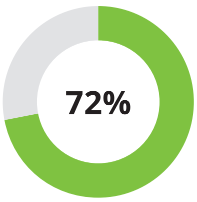
Corporate reporting	Risk and internal control	Internal assurance	External audit
• Quality of required disclosures, including material risks, opportunities, and strategic decisions • Asset and liability valuations • Clarity around governance structures, management's role, and where decision-making responsibility sits	• Identifying and evaluating existing principal risk and emerging risks over the short, medium, and long term • Resilience of the business to potential climate-related threats (including use of scenario analysis) • Business-specific governance and internal controls	• Suitable focus on climate-related risks and processes underlying risk identification, assessment, and management • Availability of appropriate expertise • Level of assurance over climate-related management information • Level of assurance over climate-related KPIs and targets, especially as they impact executive remuneration	• Level of assurance over climate-related data and analysis • Impact of climate change on financial statements adequately reflected in audit plan • Impact of change on going concern risk fully understood, where relevant

Climate assessment and reporting

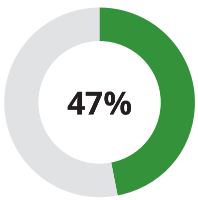
To enable organisations to come to grips with climate change, undertaking a comprehensive climate assessment – and reflecting the outcomes of the assessment in the financial statements – is a necessary step. Broadly, the assessment should cover the impact of climate-related events on the operations, supply chains, customers, and wider ecosystems on which organisations depend on to create enterprise value.

Across the APAC region, however, only about a quarter of respondents have completed this process: the majority (72%) have yet to finalise their climate assessments or reflect them in their financial statements (see Figure 4). This, in turn, suggests a lack of understanding of the financial statement impacts of climate-related events – and is likely highly correlated with the lack of awareness of how climate-related considerations contribute to the integrity of corporate reporting amongst audit committees and board members.

Figure 4: Majority of APAC audit committees say their organisations have not completed a comprehensive climate assessment, but a significant proportion are reporting on Scope 3 emissions



Percentage of APAC respondents who say that their organisations have not completed a comprehensive climate change assessment or reflected the judgements and estimates in financial statements

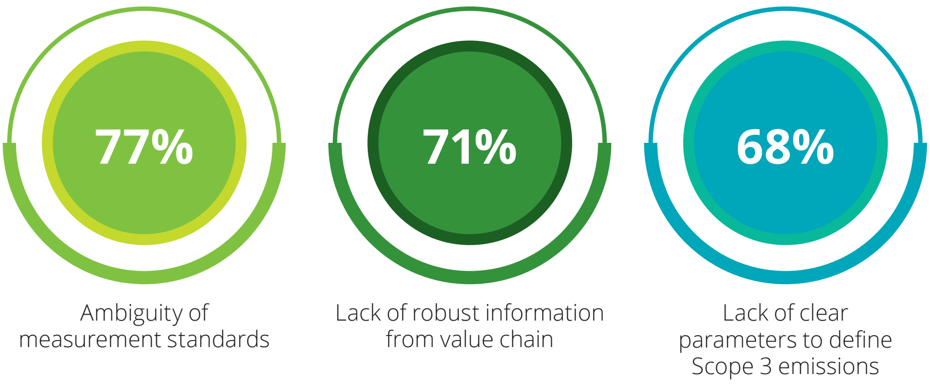


Percentage of APAC respondents who say that their organisations are reporting or planning to report on Scope 3 emissions as part of their TCFD disclosures

When asked if their organisations are reporting on Scope 3 GHG emissions as part of their TCFD disclosures, however, 47% of APAC respondents said that they are reporting or planning to do so. This figure is significantly higher than the global average of 36%, and suggests that audit committees in the APAC region are more relatively more concerned about the emissions which their organisations are indirectly responsible for, up and down the value chain.

Nevertheless, APAC respondents who are reporting or planning to report their Scope 3 emissions also cited a number of serious challenges, with the top three including ambiguity of measurement standards (77%), lack of robust information from value chain (71%), and lack of clear parameters to define Scope 3 emissions (68%) (see Figure 5).

Figure 5: Top three challenges cited by APAC audit committees for the reporting of Scope 3 emissions



These results illustrate the magnitude of the task ahead, as Scope 3 emissions are significantly more difficult to quantify than Scope 1 or 2 emissions. Yet, considering that Scope 3 emissions are also likely to be the most material part of an organisation's blueprint, audit committees need to get more comfortable with understanding and utilising granular information to facilitate GHG reporting in the value chain.

Although the lack of consistent and comparable information – including from period to period, company to company, and within sectors – continues to remain the primary roadblock for GHG reporting across the globe, there are promising signs that a growing convergence towards more consistent sustainability reporting standards is on the horizon.

For example, notable recent global developments include the announcement during the 2021 United Nations Climate Change Conference (COP26) for the International Sustainability Standards Board (ISSB) to be established under the IFRS Foundation, alongside the existing International Accounting Standards Board (IASB). With this move, a climate-related disclosure standard – one that builds upon some of the existing work done by leading sustainability standard-setters, such as the TCFD – could be published by as early as June 2022.

Closer to home in Singapore, the regulatory landscape is also rapidly developing. Following the Singapore Exchange (SGX)'s unveiling of its roadmap for issuers to provide climate-related disclosures based on the TCFD, all issuers will be required to provide climate reporting on a 'comply or explain' basis in their sustainability reports from financial year (FY) 2022. Climate reporting will subsequently be mandatory for issuers in the financial, agriculture, food and forest products, and energy industries from FY 2023; and the materials and buildings, and transportation industries from FY2024.

Other key changes effective 1 January 2022 also include requiring issuers to subject sustainability reporting processes to internal review; all directors to undergo a one-time training on sustainability; and sustainability reports to be issued together with annual reports unless issuers have conducted external assurance.

"Looking ahead, the traditional approach to financial reporting – that is, providing a historical view of financial information – will continue to come under greater scrutiny, with many stakeholders wanting to see it expand and include forward-looking elements such as climate change and sustainability.

Audit committees will need to ensure that their financial statements are able to inform as well as assure, and extend its scope to these areas of broader public interest. This requires not only technical knowledge of the latest ESG standards and their evolution, but also the capabilities for the interdisciplinary and integrated thinking that their role will require of them in relation to understanding the impact of ESG goals on financial disclosures."

Shariq Barmaky, Regional Managing Partner, Audit & Assurance, Deloitte Southeast Asia

Next steps for audit committees

When asked if they had advice for other audit committee members, APAC respondents cited the following: more education on climate topics (81%), higher quality management information (79%), and internal alignment on the organisation's climate strategy (77%) (see Figure 6).

Figure 6: Advice from APAC audit committees for other audit committee members

With audit committees viewed by shareholders and other stakeholders as "reporting arbiters", there appears to be a growing urgency for them to become more climate literate. Broadly, climate literacy entails not only developing a strong understanding of their organisation's operations and impact on our planet, but also in-depth knowledge of sustainability reporting requirements and emerging standards.

This entails no small investment of time from the director, and requires – as respondents have rightly pointed out – reliable information flows from management. But the crux of the matter is that climate considerations must be integrated with strategy, and cascaded down to business operations, control processes, metrics, and reporting.

Ultimately, however, our view is that the oversight responsibilities of audit committees may need to extend even further: directors must now also embrace the need to describe their business model and its resilience in the face of climate change, including existing and emerging climate-related risks. For some organisations, there may even be the need to change entire business models – or face extinction – and directors need to step up to consider how such a strategy and its milestones should be described to investors.

> With the move towards more regulated climate disclosures, audit committees will need to consider more rigorous governance and controls around their ESG accounting and reporting processes. These include, for instance, designing and implementing processes to track progress and accountability for target metrics, creating a roadmap that establishes and documents the climate strategy as part of the broader business strategy, and conducting a robust climate risk assessment to understand and mitigate overall risk."
>
> **Brian Ho, SEA Climate & Sustainability Assurance Leader**

Questions for audit committees to consider

Expertise of the audit committee

- Does the audit committee have climate competence?
- Has the audit committee received relevant training on industry context on climate change, accounting for climate in the financial statements (including forecasting), and disclosure in line with recognised standards?

Audit committee meetings and terms of reference

- Is climate a specific topic on the audit committee agenda? If so, is it given sufficiently frequent attention?
- Does the audit committee conduct appropriately detailed "deep dives" into climate, including in relation to the most critical areas and judgements?
- Has the audit committee's role regarding climate-related matters been recognised in its terms of reference, or charter?

Oversight of financial reporting

- Is the audit committee confident that it receives sufficiently robust management information and metrics (both financial and non-financial)?
- Does the audit committee consider the level of internal or external assurance on climate-related matters published by the company?
- Has the audit committee assessed management forecasting and scenario testing on climate-related risks in light of recognised scenario data, the industry circumstances, and the business model?
- Has the audit committee considered disclosure of the carbon price assumption behind financial judgments?
- Does the audit committee review all information outside the annual financial statements, for example, TCFD disclosures, to ensure it is both reliable and consistent with information used in preparing the financial statements?

Risk management and internal control

- Does the audit committee consider that the company's procedures for identifying emerging risks can be successful in identifying and assessing material climate-related risks, covering both physical and transition risks?
- Has the audit committee ensured that there is an appropriate climate governance framework, with clear parameters and appropriate adaptation of the internal controls framework, so that controls around business decisions support the company's climate objectives?
- Has the audit or risk committee confirmed that the business is undertaking a proper inventory of its assets or operations to assess climate vulnerabilities and that the business is addressing any resilience issues identified?

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