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SEC Issues Final Climate Disclosure Rules

PRACTICAL CONSIDERATIONS FOR BOARDS AND MANAGEMENT TEAMS

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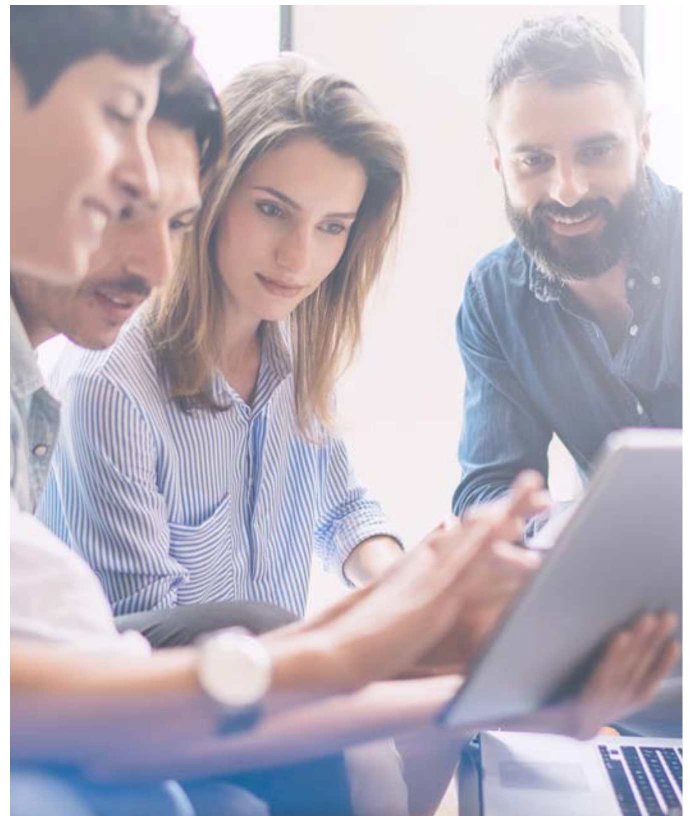
OVERVIEW

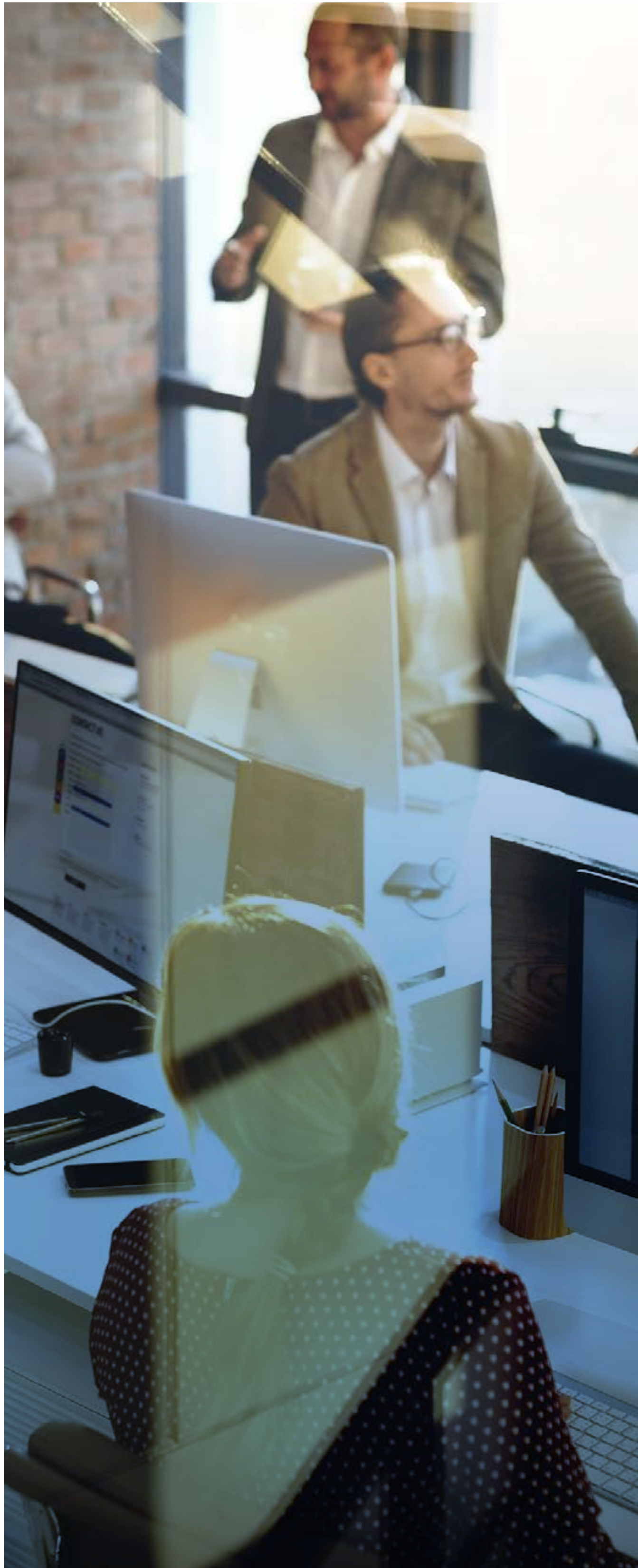
On March 6, 2024, the SEC issued its rule on The Enhancement and Standardization of Climate-Related Disclosures for Investors. Now that the rules have been finalized, Boards and management teams must assess how the new rules will affect their organizations and determine the best path forward to navigate through the challenges and opportunities created by the new requirements.

The final rules and the adopting release are lengthy – over 880 pages – and registrants will need to perform extensive analysis to obtain an understanding of the scope of the new requirements and the potential ramifications for their organizations' governance, management, operating and and financial reporting processes. Many entities have already invested significant time and resources into implementing ESG and sustainability reporting and preparing for the final rules while others are further down the learning curve. The level of effort required to adopt the new rules will depend on where your company is on this continuum.

This publication highlights some top-level observations about the new requirements that Boards and management teams should consider when they develop implementation plans to ensure compliance with the new rules. It also provides a reminder that the SEC's new requirements need to be analyzed in conjunction with rules that have been issued in other jurisdictions.



The final SEC rules require all registrants to provide certain disclosures. Highlights of these requirements and practical considerations that Boards and management teams should contemplate include the following:



Identify a knowledgeable cross-functional team to analyze and implement the rules

One challenge posed by the new SEC rules is that they require integration of environmental reporting concepts into traditional financial reporting, which may be outside the current comfort zone of many corporate finance teams. To create and maintain a robust and repeatable financial and sustainability reporting process that satisfies the SEC's requirements, management should form an implementation team that possesses expertise in both traditional financial reporting (e.g., financial statement preparation and disclosure) and in sustainability-specialized areas. The team should be cross-functional and involve professionals from groups such as IT, HR, investor relations, internal audit and legal.

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Determine which regulations apply to your company in the jurisdictions in which it operates

Although it is understandable that the primary concern of most management teams right now is trying to understand the requirements of the final SEC rules, companies and their advisors still must focus on identifying all sustainability regulations that apply to the company. Doing so will help ensure that the design and implementation of the company's financial and sustainability reporting process is capable of satisfying the reporting requirements in each jurisdiction in which the company operates, especially if the requirements in those jurisdictions do not align.

The current sustainability reporting environment is a patchwork of regulations that vary by jurisdiction, and some of these jurisdictions, such as the state of California, currently require disclosures that are more extensive than those required by the final SEC rules. Also, regulatory requirements are continuing to evolve (for example, climate legislation is currently being proposed in New York and Illinois). Therefore, it may be challenging to identify the regulations that apply to your company, so proactive monitoring of the regulatory environment is critical.

Companies with an international presence also must be mindful of international sustainability regulation and reporting requirements that may apply to their foreign operations, such as the Corporate Sustainability Reporting Directive (CSRD). Complying with such regulation will necessitate gaining familiarity with other global sustainability reporting standards, such as the European Sustainability Reporting Standards (ESRSs) or standards issued by the International Sustainability Standards Board (ISSB).

Certain stakeholders also may encourage companies to provide supplemental voluntary reporting that adheres to one of frameworks commonly used for ESG reporting, such as the framework developed by the Task Force on Climate-Related Disclosure (TCFD).

Therefore, although the final SEC rules may warrant your immediate attention, it still is important to be mindful of how those rules interact with reporting requirements in other jurisdictions in which your company operates.

Understand the scope of your current sustainability reporting

Before beginning a detailed analysis of the final SEC rules, companies should take inventory of any sustainability reports and disclosures currently provided by the company. Such disclosure could appear in regulatory filings, corporate social responsibility (CSR) reports, press releases, on the company's website or in other external reporting. Taking this inventory will help clarify the extent of your company's current sustainability reporting, the individuals within the organization responsible for such reporting and whether the company has publicly announced sustainability targets or goals that may trigger additional disclosure under the final SEC rules.

Assess which filings will trigger disclosure under the final SEC rules

The breadth of the disclosures that your company must provide under the final SEC rules will depend on the size and characteristics of your company. The SEC's final rules amend Regulation S-K by adding Subpart 1500, *Climate-Related Disclosure*, which requires registrants to provide climate-related disclosures in certain filings. The final rules also add Article 14, *Disclosure of Severe Weather Events and Other Information to Regulation S-X*, which requires registrants to provide certain disclosure in audited financial statements included in filings that require the Regulation S-K climate disclosures. Comparative disclosures are required for those years for which audited financial statements are included in the filing (to the extent such information was previously provided). Affected filings include those on:

- Forms 10-K and 20-F
- Form 10
- Form S-1 and F-1
- Forms S-4 and F-4 (however such information is not required for the financial statements of acquirees, unless such acquirees already provide that disclosure)
- Form S-11
- Forms S-3 and F-3 (requires incorporation by reference)

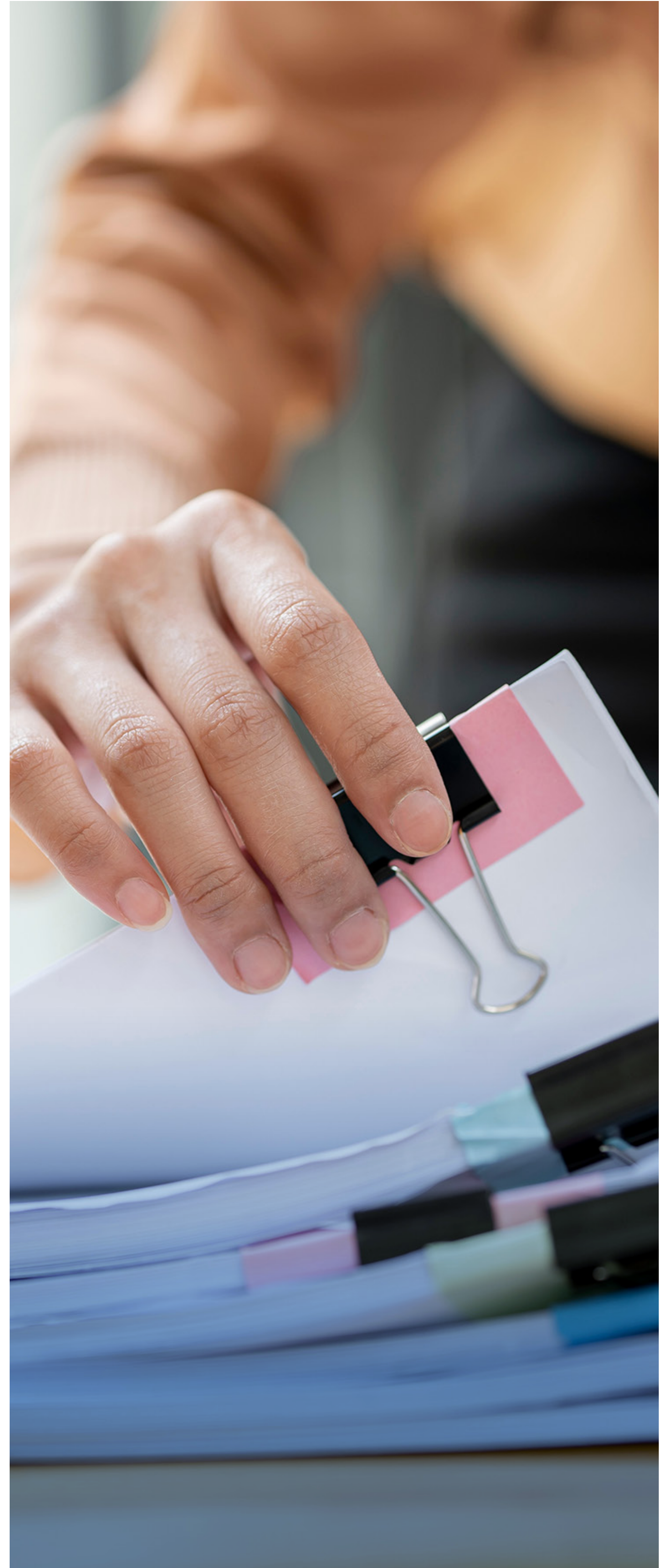
Interim reporting of climate disclosure is not required; however, a large accelerated or accelerated filer may elect to provide its annual GHG emission disclosures in its filing on Form 10-Q for the second quarter in the fiscal year immediately following the fiscal year to which those GHG emission disclosures relate.

Ensure Disclosure Consistency

When the SEC staff conducts filing reviews, it also may review other information publicly reported by the registrant such as press releases, corporate web site postings, or publicly posted CSR reports and assess whether the disclosures provided in the company's SEC filings are consistent with the company's other public reporting. Therefore, companies should establish controls to ensure that consistency in public messaging is maintained.

Regulation S-X Amendments

The Regulation S-X amendments require companies to disclose certain climate–related information about expenditures, losses incurred and costs that were capitalized (excluding any recoveries) as a result of severe weather events and other natural conditions in the footnotes to their audited financial statements, subject to the following thresholds:



Metric	Reporting Threshold	De Minimis Exclusion	Additional Disclosure
Aggregate amount of expenditures expensed as incurred and losses (“expenses”), excluding recoveries, incurred during the fiscal year as a result of severe weather events and other natural conditions.	Disclose if the aggregate amount of expenses equals or exceeds 1% of the absolute value of income or loss before income tax expense or benefit for the relevant fiscal year	Disclosure not required if the aggregate amount of expenses is less than $100,000 for the relevant fiscal year	Must identify where the expenses are presented in the income statement
Aggregate amount of capitalized costs and charges, excluding recoveries, incurred during the fiscal year as a result of severe weather events and other natural conditions	Disclose if the aggregate amount of the absolute value of capitalized costs and charges equals or exceeds 1% of the absolute value of stockholders’ equity or deficit at the end of the relevant fiscal year	Disclosure not required if the aggregate amount of the absolute value of capitalized costs and charges is less than $500,000 for the relevant fiscal year	Must identify where the capitalized costs and charges are presented in the balance sheet.
Carbon offsets or renewable energy credits (RECs), if used as a material component of a registrant’s plans to achieve its disclosed climate-related targets or goal	Disclose the aggregate amount of: • Carbon offsets and RECs expensed, • Capitalized carbon offsets and RECs recognized, and • Losses incurred on the capitalized carbon offsets and RECs, during the fiscal year	None – Disclosure requirement is subject to a materiality assessment	Disclose the beginning and ending balances of the capitalized carbon offsets and RECs for the fiscal year. Also, separately identify where the expenditures expensed, capitalized costs, and losses are presented in the income statement and the balance sheet
Must describe how each metric was determined, including “significant inputs and assumptions used, significant judgments made, other information that is important to understand the financial statement effect and, if applicable, policy decisions made by the registrant to calculate the specified disclosures”. Also, must disclose accounting policy for carbon offsets and RECs when disclosure of such amounts is required. Furthermore, registrants must separately state the aggregate amount of any recoveries recognized during the fiscal year related to costs capitalized or expensed for severe weather events and other natural conditions and disclose where such recoveries are presented in the income statement and balance sheet.			

The final rules include an attribution principle that states that "a capitalized cost, expenditure expensed, charge, loss, or recovery results from a severe weather event or other natural condition when the event or condition is a significant contributing factor in incurring the capitalized cost, expenditure expensed, charge, loss, or recovery." If this condition is satisfied, the company must include the entire amount of such cost, expenditure, charge, loss, or recovery in the disclosures.

Therefore, management teams must (1) consider whether the company's systems and processes are capable of identifying costs that are related to severe weather events or other natural conditions and any related recoveries, and (2) establish an appropriate process for applying the attribution principle. As a result, there may be changes to people, processes, controls, and systems that support these disclosures. Considering these disclosures will appear in audited financial statements, companies will need to design and evaluate the effectiveness of any internal controls that support the completeness and accuracy of the disclosures. Each company might also consider evaluating whether its existing control environment is sufficient to identify, measure, capture, and report the required information should a severe weather event or other natural condition (which, while not inclusive, includes events such as hurricanes, tornadoes, flooding, drought, earthquake, wildfires, extreme temperatures, or sea level rise) be identified. Similarly, companies will need to perform an ongoing assessment to determine whether they are subject to attestation requirements for internal controls over financial reporting (ICFR) or are likely to become subject to those requirements in the future.

The Board and management also will need to determine if the Company's strategy for addressing climate-related risk should include specific climate-related targets and goals, and whether the company should use carbon offsets or RECs as a tool for achieving those goals. If the Company decides to pursue this strategy, management should ensure that the company's systems and processes are able to capture the additional information about offsets and RECs that the company must provide in the incremental disclosure that would be required under the rules.

Regulation S-K Amendments

The climate-related disclosures required by Regulation S-K will not be subject to audit (although the disclosures about GHG emissions provided by large accelerated and accelerated filers may be subject to phased-in attestation requirements); however, such disclosures must be addressed by the company's existing disclosure controls and procedures (DCP) program, which may also require enhancement as a result of the new requirements. For example, a company may need to assess whether its existing DCP program is sufficient to consider environmental elements and/or other non-financial data. Other aspects of the new climate-related disclosures required by Regulation S-K that may warrant consideration include the following:

Climate-related opportunities – Regulation S-K, as amended, will require a registrant to provide certain disclosures about its climate-related risks. A company also may provide voluntary disclosure about material climate-related opportunities that the Company may pursue. Management teams should assess whether their company and stakeholders would benefit from the company gathering and disclosing information about climate-related opportunities in the company's public filings.

Governance - The final rules require companies to describe the nature of Board and management oversight over a company' climate-related risks. They also require disclosure of the relevant expertise of individuals or committees that are responsible for assessing and managing climate-related risks. Therefore, the Board and management may want to establish or refine existing oversight processes. Furthermore, companies should consider opportunities for enhancing the skillsets and expertise of those involved with managing climate-related risks.

Materiality Considerations – the Regulation S-K disclosures focus on climate-related risks that have materially affected or are reasonably likely to have a material impact on the registrant "including on its strategy, results of operations, or financial condition." The amended rules also require qualitative and quantitative disclosure about certain material climate-related expenditures. The final SEC rules do not, however, redefine the notion of materiality applied under other SEC laws and regulations. Registrants should continue to consider a matter material "if there is a substantial likelihood that a reasonable investor would consider it important when determining whether to buy or sell securities or how to vote or such a reasonable investor would view omission of the disclosure as having significantly altered the total mix of information made available." However, the new rules will require management teams to apply the existing materiality definition in a new manner to assessments of climate-related risks; therefore, registrants may need to develop new policies or processes for assessing materiality in this context.

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Characterization of Climate-Related Risks – The final SEC rules will require disclosure of certain characteristics of a registrant's climate-related risks. For example, certain disclosures will require descriptions of (1) whether the climate-related risks are likely to occur within the next 12 months or beyond that timeframe (2) whether physical climate-related risks are acute (i.e., event driven) or chronic (i.e., related to longer term weather patterns) (3) the geographic location and nature of the properties, processes, or operations subject to the physical risk and (4) the nature of transition risks that arise from the Company's mitigation of, or adaptation to, climate-related risks (i.e., whether such risks are regulatory, technological, market or other types of risk). Companies will need to assess whether their systems and processes are capable of gathering this information in the timeframes necessary to fulfill their reporting obligations.

Assess benefits and incremental disclosures required for risk mitigation strategies – When a company's Board and management team identify and analyze potential material climate risk exposures, they may elect to implement various strategies to manage or mitigate such risks. Management teams also may conclude that the company may benefit from announcing goals or targets related to sustainability efforts. When weighing alternative approaches to pursue, management teams should consider potential disclosure ramifications of different strategies. Under the final rules, a company must provide additional disclosure regarding the following (subject to materiality considerations):

- Adoption of a transition plan to manage a material transition risk
- Use of scenario analysis to assess the effect of climate-related risks on the company's business, results of operations or financial condition
- Use of an internal carbon price
- Establishing a climate-related target or goal
- Use of carbon offsets or RECs to achieve climate-related targets or goals

Greenhouse Gas Emission Disclosures – The SEC rules require registrants that are large accelerated or accelerated filers to disclose Scope 1 and Scope 2 GHG emissions for their most recently completed fiscal year, if such emissions are material. Registrants also must describe how they calculate such emissions, including the methods and significant inputs and assumptions used. The requirement to provide the GHG emission disclosures will be phased-in, as will the requirement to obtain an attestation report covering these disclosures. Therefore, a management team should (1) determine whether its company must provide the GHG emission disclosures on the basis of whether the company is currently a large accelerated or accelerated filer or expects to become one in the future (2) plan accordingly to obtain the required attestation reports.

Effective Dates

The SEC rules will become effective 60 days after they are published in the Federal Register. The effective dates for different registrant types and the phase-in periods for the GHG emission disclosures are as follows:

<table>
<tr><th>Registrant Type</th><th>Financial Statements and Climate Risk Disclosure</th><th>Certain Regulation S-K Disclosures[2]</th><th>GHG Emissions Disclosures</th><th>Limited Assurance on GHG Emissions</th><th>Reasonable Assurance on GHG Emissions</th><th>Electronic Tagging Inline XBRL</th></tr>
<tr><td>Large Accelerated Filers</td><td>FYB[1] 2025</td><td>FYB 2026</td><td>FYB 2026</td><td>FYB 2029</td><td>FYB 2033</td><td>FYB 2026</td></tr>
<tr><td>Accelerated Filers</td><td>FYB 2026</td><td>FYB 2027</td><td>FYB 2028</td><td>FYB 2031</td><td>Not Applicable</td><td>FYB 2026</td></tr>
<tr><td>Smaller Reporting Companies</td><td rowspan="3">FYB 2027</td><td rowspan="3">FYB 2028</td><td rowspan="3">Not Applicable</td><td rowspan="3">Not Applicable</td><td rowspan="3">Not Applicable</td><td rowspan="3">FYB 2027</td></tr>
<tr><td>Emerging Growth Companies</td></tr>
<tr><td>Non-Accelerated Filers</td></tr>
</table>

[1]*FYB - any fiscal year beginning in the calendar year listed*

[2]*Quantitative and qualitative disclosures about material expenditures and material impacts to financial estimates and assumptions required by Item 1502(d)(2), Item 1502(e)(2), and Item 1504(c)(2)*

Interactive Data Requirement

Companies will need to tag all the disclosures required by the new rules using XBRL; therefore, management teams should consider this requirement in their implementation plans.

Next Steps

Implementing a new rule as sweeping as the final SEC rules can be daunting, but management teams can streamline their companies' implementation efforts with appropriate planning and prioritization of decision-making. Before diving too deeply into the details of the rules, it may be helpful to identify the types of information and data that a company must gather to comply with the new requirements and assess whether the company's current systems, processes and controls are capable of gathering this information in the timeframes required to meet reporting deadlines while still ensuring the completeness, transparency and accuracy of the required disclosures.

To discuss the SEC climate disclosures, contact:

ANGELA DEPOY | PARTNER
ADEPOY@CFGI.COM

DIANA CORDEIRO | PARTNER
DCORDEIRO@CFGI.COM

MARK BOLTON | MANAGING DIRECTOR
MBOLTON@CFGI.COM

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