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Time to Act: SEC Issues Final Climate-Related Disclosure Rules

March 7
2024

On March 6, 2024, the U.S. Securities and Exchange Commission (SEC) approved its long-awaited — and, for many, controversial — new rule, The Enhancement and Standardization of Climate-Related Disclosures for Investors. The final version of this much-debated and discussed regulation in the U.S. will require SEC-listed companies to report on greenhouse gas (GHG) emissions and climate goals, as well as on climate-related risks and efforts to manage those risks. The rule features a phased adoption period whereby the compliance date is dictated by the registrant's filer status (pursuant to existing filer status criteria and rules). The earliest filers are required to provide disclosures for the 2025 calendar year or fiscal year beginning in 2025.

The SEC climate disclosure requirement has been controversial since it was first proposed. The Commission modified its initial proposal following an extensive comment period, which included 24,000 public comments, the most in the SEC's history. In this Flash Report, we break down the new rule released yesterday and what companies need to do to prepare themselves to comply.

Why Did the SEC Issue This Ruling?

The SEC has been considering this matter for several years. During his March 2, 2021, confirmation hearing before the Senate Banking Committee, current SEC chair (then nominee) Gary Gensler expressed his support for additional climate change-related disclosures, stating, "… there are tens of trillions of dollars of invested assets that are looking for more information about climate risk." (And, in fact, a substantial number of public and private companies have been making related disclosures in response to market and stakeholder interest, even without this new rule.) He also asserted that issuers would benefit from additional climate change and risk disclosures. The SEC's climate-disclosure rule comes after climate disclosure regulations have already been adopted in Europe, as well as in the U.S. in the State of California.

What Is in the Final Rule?

Regarding potential material climate-related financial statement risks:

The following information should be disclosed in notes to the financial statements:

- Climate-related risks that have had or are reasonably likely to have a material impact on the registrant's business strategy, results of operations or financial condition, including actual and potential material impacts of any identified climate-related risks on the registrant's business model and outlook;

- Information about a registrant's climate-related targets or goals, if any, that have materially affected or are reasonably likely to materially affect the registrant's business, results of operations or financial condition, including material expenditures and material impacts on financial estimates and assumptions as a direct result of the target or goal or the actions taken to make progress toward meeting such target or goal; and

- If the estimates and assumptions a registrant uses to produce the financial statements are materially impacted by risks and uncertainties associated with severe weather events and other natural conditions or any disclosed climate-related targets or transition plans, a qualitative description of the impact on such estimates and assumptions.

Regarding climate disclosure process activities and governance:

The following information should be disclosed pursuant to the risk management disclosures required by new Regulation S-K Item 1503:

- Processes the registrant has in place for identifying, assessing and managing material climate-related risks and, if the registrant is managing those risks, whether and how any such processes are integrated into the registrant's overall risk management system or processes;

- If, as part of its strategy, a registrant has undertaken activities to mitigate or adapt to a material climate-related risk, a quantitative and qualitative description of material expenditures incurred and material impacts on financial estimates and assumptions that directly result from such mitigation or adaptation activities; and

- Oversight by the board of directors of climate-related risks and any role by management in assessing and managing the registrant's material climate-related risks.

Regarding quantifiable financial statement impacts:

The following information should be disclosed in a note to the financial statements:

- Capitalized costs, expenditures expensed, charges taken, and losses incurred due to severe weather events and other natural conditions, such as hurricanes, tornadoes, flooding, drought, wildfires, extreme temperatures and sea level rise, should be disclosed in a note to the financial statements, subject to applicable one percent and de minimis disclosure thresholds; and
- Capitalized costs, expenditures expensed and losses recognized related to carbon offsets and renewable energy credits or certificates if used as a material component of a registrant's plans to achieve its disclosed climate-related targets or goals.

Regarding other financial statement-related items:

- For large accelerated filers and accelerated filers that are not otherwise exempt, information about material direct emissions (Scope 1) and/or indirect emissions from purchased energy (Scope 2) in the annual report filed under Form 10-K; and
- For large accelerated filers and accelerated filers, an assurance report at the limited assurance level and, ultimately for large accelerated filers, at the reasonable assurance level.

Reporting Timelines and Assurance Requirements

The finalized rule includes a phase-in period and certain accommodations based on the registrant's filer status and materiality considerations. The table below summarizes the compliance dates and assurance requirements by type of registrant:

Compliance Dates ***Dates are for fiscal year beginning in:***				
Registrant Type	**Disclosure and Financial Statement Effects Audit**	**GHG Emissions/Assurance**		
	All Reg. S-K and S-X disclosures	Scope 1 & 2 GHG emissions	Limited assurance	Reasonable assurance
Large accelerated filers	2025	2026	2029	2033
Accelerated filers	2026	2028	2031	N/A
Non-accelerated filer, smaller reporting company or emerging growth company	2027	N/A	N/A	N/A

These additional disclosure requirements have internal control implications. The financial statement impact disclosures would be subject to Sarbanes-Oxley (SOX) Section 404, *Internal Control Over Financial Reporting*, due to their inclusion in the financial statements. Because many of these disclosures fall outside of the traditional financial reporting model, it should be noted that, in 2023, COSO provided supplemental guidance on applying its internal control framework to sustainability reporting. Furthermore, all disclosures would be subject to SOX Section 302, *Disclosure Controls and Procedures*.

What is NOT in the Final Rule

The SEC made several meaningful modifications to the initial proposed rule exposed in 2022. These changes were likely made not only as a reaction to the comments received on the proposal, but also to position the rule to survive expected pushback.

The major differences between the SEC's initial proposal and the final rule are:

- Scope 1 and 2 emissions disclosures are only required if deemed material by the registrant.
- Scope 3 emissions disclosures were removed entirely from the final rule. The original rule would have required a phased-in reporting requirement for emissions associated with a registrant's value chain — the supply chain, distribution channels and related logistics — as well as the end-users of its products. This was the most controversial aspect of the 2022 proposed rule, in the comment process and in the resulting debate over the proposal.
- The proposed bright-line threshold of 1% of a consolidated financial statement line item to disclose the financial impacts from severe weather events, other natural conditions, transition activities and climate-related events has also been removed entirely from the final rule, leaving a subjective evaluation of materiality to be used to determine the need for disclosure.

What Companies Should Be Doing Now

Companies should conduct gap and materiality analyses by assessing the core components of their existing sustainability programs and related data-gathering, validation and reporting. They should map these programs to the SEC requirements and design strategies to achieve compliance by addressing any gaps. Organizations that have operations in Europe and the state of California may already be compliant with parts of the SEC's final rule by virtue of filing, or preparing to file, reports in compliance with the EU's Corporate Sustainability Reporting Directive (CSRD) and California's new climate disclosure laws.

In performing gap and materiality analyses, the following steps are relevant to multiple climate reporting requirements:

1. **Review existing sustainability programs.** Evaluate the core components of any sustainability program already in place. In particular, review existing sustainability program data and supporting artifacts to identify what is already available. Review the organization's current financial reporting infrastructure and the reports it produces. Reports currently being issued pursuant to stakeholder interests and demands may already address some of the required disclosures or could be extended to do so.

2. **Assess the underlying support for materiality assessments.** While Scope 1 and 2 emission disclosures are only required if deemed material by the registrant, relevant and accurate GHG data is required to assess materiality effectively and on an ongoing basis. To ensure the requisite data is available, companies should identify the support they need to comply with the new disclosures and compare those needs to the data, information and documents already present in the organization. They should evaluate the current GHG data available, the GHG targets the organization may have already defined, and the current processes and controls to provide a context for considering the available technologies that would make data-gathering and validation easier. Finally, review and document existing reporting and data sources. These activities will facilitate the identification of gaps and articulate the organization's remediation needs and the business case for obtaining support for remediation efforts from senior decision-makers.

3. **Roadmap and remediation.** Use the identified gaps to develop remediation plans. If there are many gaps, consider prioritizing them based on the urgency, timetable and effort required to remediate each gap. Group the gaps logically into separate initiatives, assign owners for each and establish accountability for results. Develop plans, budgets and timelines for these initiatives, and enact a readiness program that incorporates all activity. Align the program scope, priorities and schedule for tracking against the respective SEC disclosure compliance dates.

While the above approach has been encapsulated into three steps, each step admittedly may require significant effort for most organizations. Conducting and documenting a gap analysis as the first step will help executives keep the board, other internal stakeholders and the external auditors apprised of climate disclosure reporting goals and needs. More importantly, it will help management obtain their support for the resources needed to get the organization into compliance. This process should begin as soon as practicable.

Protiviti Commentary

To bolster the rule's standing in the event of litigation, the SEC has leaned heavily on the concept of materiality to inform its disclosure requirements. And while certain information may or may not be required to be disclosed, based on whether or not it is determined to be material, assessing for materiality is not optional. Companies will need to evaluate materiality using their traditional definitions of assessing whether or not the information is important to a reasonable investor when making an investment decision. To that end, even if a company deems certain potential disclosure requirements to be immaterial, it must go through the formal exercise of assessing materiality and preserving (in anticipation of potentially providing) evidence to demonstrate its decision regarding its conclusion that disclosure is not necessary.

Legal challenges to the SEC ruling are all but guaranteed from multiple vectors, including major business groups, the U.S. Chamber of Commerce, both chambers of Congress, state attorneys general and others, including climate advocates unhappy that the rule does not go far enough to address their concerns. Potential legal battles aside, the SEC ruling sends yet another signal to American companies, in addition to the ones they have already received as the wave of sustainability disclosure requirements sweeps across the globe, that it is time to act.

Most SEC registrants and large private companies domiciled in the U.S. have a global presence and may already be subject to broad-reaching regulations such as the CSRD or even the California laws. And for those not yet under a regulatory regime, sustainability reporting already is required on some level because their stakeholders demand that information. For those companies, the SEC's rule is simply a formalization of what they may already be doing. The reports they are issuing currently can function as a starting point for the SEC disclosures.

How Protiviti Can Help

Sustainability is a continuous journey, presenting new risks and opportunities. There are no blueprints or out-of-the-box solutions, and each company needs an individualized and holistic approach to environmental, social and governance (ESG) reporting and operations to manage its high level of complexity and position the organization for continued, long-term success.

At Protiviti, we leverage our reporting and regulatory expertise and our strategic partnerships to help clients define and build a seamless sustainability reporting process. We assist companies with defining and aligning sustainability metrics to strategy and regulatory expectations, support the reporting process with innovative data and analytics solutions, and facilitate audit and assurance readiness so they can face a sustainable future with confidence.

About Protiviti

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