Sustainability and ESG Reporting 2.0

The Next Frontier

May 2022

The CFO Suite®

The regulations around sustainability and ESG ("environmental, social, and governance") reporting continue to evolve, having changed in the last year, and there are now even more changes on the horizon for 2022 and beyond. In addition, public companies are now having to discuss and address the effects of climate change and the risks they carry.

Currently, there are several ESG reporting standards and frameworks that organizations are using to report ESG information. With the goal to bring more consistency to ESG reporting, six of the seven most used are being consolidated with the International Sustainability Standards Board (ISSB) or have committed to coordinate their standard-setting activities with the ISSB. On March 31, 2022, the ISSB released exposure drafts of its new standards, which include industry-specific standards.

In addition, the US Securities and Exchange Commission ("SEC") is seeking more details from companies regarding their specific climate risks. On March 21, 2022, the SEC proposed new rules that would require most public companies to disclose their greenhouse gas ("GHG") emissions and details of how their business is affected by climate change. The SEC proposed rules align with the climate portion of the ISSB's proposed standards. These proposed rules would bring increased consistency in GHG emissions disclosures if these rules are finalized.

Given these initial developments, there are actions companies can take today. While we will discuss this further in this document, we would begin by encouraging Large Accelerated Filers to thoroughly evaluate their readiness for assurance over ESG controls and disclosures and further review the necessity to develop and implement sustainability and ESG reporting around disclosures required for fiscal year 2023.

How The CFO Suite Can Help You!

- ✓ Conduct an assessment including a gap analysis
- ✓ Identification of reporting deficiencies and a benchmark review
- ✓ Support your organization develop and implement sustainability and ESG reporting
- ✓ Assist in readiness for assurance over your sustainability and ESG controls and disclosures
- ✓ Identify deficiencies in your organization and prioritize them by risk and ease to rectify
- ✓ Evaluate and optimize financial processes and develop policies to ensure control and compliance

While not <u>yet</u> mandatory for all companies, more directives are being initiated globally for publicly traded and larger companies; the trend is that non-financial disclosures are becoming increasingly valued.

Overview

The SEC currently requires public companies to disclose certain ESG information, such as a description of human capital resources and any measures or objectives on which management focuses, if material to an understanding of the business. However, there is general agreement that the level of information that companies are compelled to disclose under the existing regulatory framework is significantly lower than in several other developed markets.

In March 2022, the SEC proposed new rules to enhance and standardize disclosures that registrants make about climate-related risks, their climate-related targets and goals, their GHG emissions and how the board of directors and management oversee climate-related risks. The proposal would also require registrants to quantify the effects of certain climate-related events and transition activities in their audited financial statements.

The proposed rules would provide investors with consistent, comparable, and decision-useful information and would provide registrants with a consistent and clear framework for reporting. The proposal stated that climate disclosures are "fundamental" to investors' understanding of a registrant's business and prospects. Therefore, disclosures need to be provided in a new "Climate-Related Disclosures" section of registration statements and annual reports, though they could be incorporated by reference from other parts of the reports (e.g., risk factors). Registrants would be required to disclose information about climate related risks that have or are reasonably likely to have material impacts to their business or financial statements.

Accelerated and large accelerated filers would also be required to obtain assurance over their Scope 1 and Scope 2 emissions data. In a new note to the audited financial statements, registrants would have to quantify and describe the effects of climate-related events and transition activities on individual line items and disclose the impact of climate-related events and transition activities on estimates and assumptions used in preparing the financial statements.

The proposal would affect all registrants, including smaller reporting companies and foreign private issuers. The proposal would appear to apply to companies, including emerging growth companies, that are entering the US capital markets for the first time by conducting initial public offerings or as acquisition targets of public companies in a Form S-4. Importantly, it does not provide relief for recently acquired companies, which means registrants would need to include those operations in their disclosures upon consolidation.

Proposed Rules Changes

The proposed rule changes would require a registrant to disclose information about:

(1) the registrant's governance of climate-related risks and relevant risk management processes;

(2) how any climate-related risks identified by the registrant have had or are likely to have a material impact on its business and consolidated financial statements, which may manifest over the short-, medium-, or long-term;

(3) how any identified climate-related risks have affected or are likely to affect the registrant's strategy, business model, and outlook; and

(4) the impact of climate-related events (severe weather events and other natural conditions) and transition activities on the line items of a registrant's consolidated financial statements, as well as on the financial estimates and assumptions used in the financial statements.

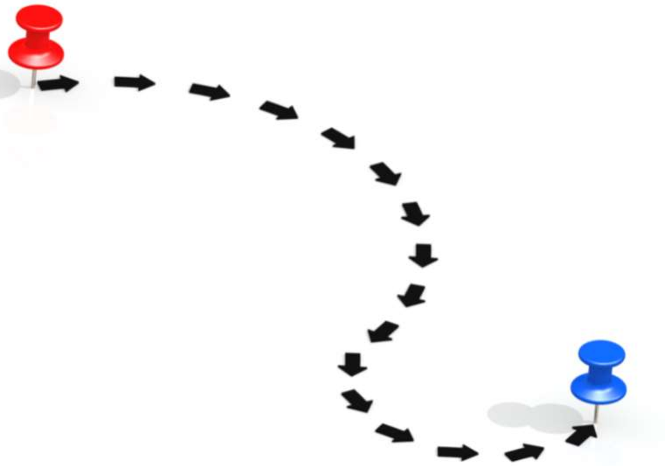
Financial Statement Disclosures

Registrants would be required to disclose in a note to the audited financial statements the following climate-related impacts:

- The positive and negative financial impacts of severe weather events and other natural conditions and transition activities on each financial statement line item, unless the aggregate impact on an absolute value basis is less than 1% of the total for the line item

- The aggregate amount of climate-related costs incurred that are both expensed and capitalized, unless the aggregate is less than 1% of expenditures or capitalized costs incurred

- Whether and how climate-related events and transition activities impacted the estimates and assumptions they used in preparing the financial statements



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Non-Financial Statement Disclosures

Climate-related risks

The proposal would require registrants to disclose climate-related risks reasonably likely to have a material impact on their business or consolidated financial statements over the short, medium, and long term. With these terms not defined in the proposal, registrants would be required to disclose how they define them.

Governance and risk management

Disclosure as to whether any board members have climate-related expertise would be required including a description of that expertise. They would also be required to identify board members or committees responsible for the oversight of climate-related risks, whether and how the board considers climate-related risks, how it is informed about climate-related risks and the frequency of those discussions. Furthermore, disclosures would include whether and how the board of directors set climate-related targets or goals and how the board oversees progress toward those targets or goals.

Targets and goals

Those that set climate-related targets or goals (e.g., goals to reduce GHG emissions) would be required to disclose the activities and emissions included in the target, how they intend to meet the target or goal, whether they are making progress toward meeting the target or goal, any interim targets they have set and details about any carbon offsets or renewable energy credits (RECs) that are part of the plan to achieve the target or goal.

GHG emission metrics

Companies would be required to disclose direct GHG emissions from operations they own and control (Scope 1) and indirect emissions from purchased electricity and other forms of energy their operations consume (Scope 2). Other than smaller reporting companies, they would also be required to disclose indirect emissions from upstream and downstream activities in their value chain (Scope 3), if material, or if they have set a GHG emissions reduction target or goal that includes Scope 3 emissions.

Assurance Requirements

Initially Scope 1 and Scope 2 emissions would be subject to limited assurance and later reasonable assurance by an independent provider for accelerated and large accelerated filers. Assurance providers would need to be independent and have significant experience in measuring, analyzing, reporting, or attesting to GHG emissions.

Disclosures as to whether the assurance provider has a license from a licensing or accreditation body, whether the engagement is subject to an oversight inspection program and whether the provider is subject to record-keeping requirements for the engagement would be required. The proposal doesn't specify the attestation standards that would need to be used but establishes criteria for the standards that would be acceptable.

Registrants that voluntarily obtain assurance on their required emissions disclosures would also be required to make certain disclosures, including identifying the provider and any oversight program to which it is subject, describing the standards used with the results of the engagement, and describing any relationships (including professional services) that might impair independence.

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Transition Period

Companies with December 31 fiscal year ends would be required to comply on the following schedule, assuming the rules are adopted by the end of this year:

Registrant Type	**Compliance Date**		
	All disclosures, except for Scope 3	**Scope 3 GHG emission disclosures**	**Assurance on Scope 1 and Scope 2 emission disclosures**
Large accelerated filer	Fiscal year **2023** (filed in 2024)	Fiscal year **2024** (filed in 2025)	Limited assurance – **2024** Reasonable assurance – **2026**
Accelerated filer	Fiscal year **2024** (filed in 2025)	Fiscal year **2025** (filed in 2026)	Limited assurance – **2025** Reasonable assurance – **2027**
Non-accelerated filer	Fiscal year **2024** (filed in 2025)	Fiscal year **2025** (filed in 2026)	Exempt
Small reporting company	Fiscal year **2025** (filed in 2026)	Exempt	Exempt

The use and importance of voluntary or mandatory sustainability reporting is increasing and is here to stay. While not yet mandatory for all companies, more directives are being initiated globally for publicly traded and larger companies; the trend is that non-financial disclosures are becoming increasingly valued.

Here's how The CFO Suite can help:

- Conduct an assessment including a gap analysis
- Identification of reporting deficiencies and a benchmark review
- Support your organization develop and implement sustainability and ESG reporting
- Assist in readiness for assurance over your sustainability and ESG controls and disclosures
- Identify deficiencies in your organization and prioritize them by risk and ease to rectify
- Evaluate and optimize financial processes and develop policies to ensure control and compliance

If you're interested in learning more about Sustainability Reporting and how The CFO Suite can help you, reach out to:

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