

SEC's Proposed Rules for Climate-Related Disclosures

Forensic & Litigation Consulting

On March 21, 2022, the Securities and Exchange Commission (SEC) [proposed amendments to Regulations S-K and S-X](#) that, if finalized, would require domestic registrants and foreign private issuers to disclose certain qualitative and quantitative information regarding exposure to climate-related risks. The proposed rule would require greater and specific disclosure than what has been provided under the SEC's 2010 interpretive guidance that reminded registrants of their obligation to consider material risks arising from climate change, including in Management's Discussion & Analysis.

The proposed rule requires disclosure in registration statements and annual periodic filings of:

- Governance structures and risk management processes for climate-related risks.
- Physical and transition risks from climate change.
- Material climate-related impacts on the registrant's business and consolidated financial statements.
- Material climate-related impacts on the registrant's business model, strategy and outlook.
- Scope 1 direct and Scope 2 indirect greenhouse gas emissions, regardless of materiality.
- Scope 3 emissions, if material, or if the registrant has set a target or goal that includes Scope 3 emissions.
- Climate-related targets and goals, if any.

The proposed rule also requires disclosure in a footnote to the audited financial statements of:

- The impact on financial statement line items of climate-related events and climate-related transition activities if they exceed, on an absolute basis, 1% of the financial statement line-item.

- Capitalized and expensed expenditures during the reporting period if the same line-item threshold is met.
- Whether estimates and assumptions used in preparing the consolidated financial statements were impacted by risks and uncertainties associated with climate-related events or transition-related activities and, if so, a qualitative description of how the events or activities affected the development of the estimates and assumptions.

The above disclosures would be subject to audit and within the scope of the registrant's internal controls over financial reporting (ICFR).

The proposed rule would require a registrant to obtain attestation of its Scope 1 and Scope 2 quantitative disclosures and outlines minimum requirements for such attestation. The attestation requirements would be phased in over a three-year period.

Registrants required to provide information on Scope 3 emissions would have an additional year to provide those disclosures. Smaller Reporting Companies would be exempt from the Scope 3 emissions disclosures.

If the proposed rules are finalized and effective in, for example, December 2022, registrants could begin providing required disclosures on the following schedule:

	Fiscal Year Ended December 31	Form 10-K or Form 20-F Filed
Large accelerated filers	2023	2024
Accelerated and non-accelerated filers	2025	2025
Smaller reporting companies	2025	2026

Background Commentary

Even before the proposed rules were announced, the [SEC's Division of Corporation Finance issued comment letters](#) (including, in some cases, second and third letters) to registrants regarding differences between disclosures in the registrant's Form 10-K filings and disclosures in its Corporate and Social Responsibility reports. Further, in 2021 the SEC created the ESG Task Force within the Division of Enforcement. The task force will focus on identifying and investigating ESG-related misconduct, including identifying material gaps or misstatements about disclosures under existing rules and bringing enforcement actions for "greenwashing," or exaggerated claims about commitment to and progress toward ESG-related goals.

Overseas Sustainability Models

In addition to the SEC's activities on climate-related disclosures, US companies with overseas operations should be considering developments outside of the US. For example, Europe continues to make progress on its Corporate Sustainability Reporting Directive (CSRD), which will apply to subsidiaries of companies domiciled outside of Europe if those subsidiaries meet certain criteria related to total assets, revenues, and number of employees.

According to FTI's January 2022 [Resilience Barometer](#) survey of more than 3,300 large G20 companies, 46% of the largest companies (turnover exceeding \$1 billion) state that they are under extreme pressure to improve their approach to ESG and sustainability.

How Companies Can Prepare

The global movement toward regulating information that companies may be required to disclose about their climate-related risks is rapidly evolving and therefore, companies should be preparing now by:

- Identifying appropriate governance structures and risk management processes for climate-related disclosures to the extent existing governance structures and risk management processes are not suited to climate-related matters.
- Developing processes and controls for identifying climate-related events and transition plans, and the impact those events and transition plans have on information reported in financial statements. While those processes and controls would be needed to provide the required financial statement disclosures if the proposed rule is finalized, they would also be important to a registrant's ability to make required MD&A disclosures under the 2010 interpretive guidance.
- Developing processes to identify the source of Scope 1 direct, Scope 2 indirect and, if applicable, Scope 3 emissions within its upstream and downstream value chain.
- Developing processes and controls to compute a company's Scope 1, Scope 2 and, if applicable, Scope 3 emissions in compliance with the standards incorporated into the proposed rule.
- Companies should look to the COSO framework in developing controls that will comply with the requirements of the Sarbanes-Oxley Act.
- Data-driven processes to ensure accurate and complete disclosures will be a crucial element of complying with the required disclosures. Companies should be developing data access, collection and aggregation processes and controls.
- Developing disclosure controls to ensure that events or activities that give rise to qualitative disclosures under the proposed rule are properly identified.

Investigations and Litigation Risk

Further, while no one wants to think about investigations or litigation, it is a factor that companies should consider in preparing for the required disclosures should the SEC finalize the proposed rule. The involvement of legal counsel and specialist advisors as a company develops its proposed disclosures could help avoid unpleasant surprises.

Nearly half (49%) of Chief Risk Officers and 40% of Chief Legal Officers surveyed in FTI's January 2022 [Resilience Barometer](#) stated that they are already being investigated, or expect to be investigated, by regulators or governments over their company's ESG and sustainability practices in the next 12 months.

— HOW FTI CAN HELP

FTI Consulting has expertise in climate-related risk identification and mitigation, supply chain carbon footprint analysis and related reduction strategies, calculating Scope 1, 2 and 3 emissions, data management and analysis, internal controls and SOX compliance, SEC reporting requirements, audit and attestation requirements, investigations, and litigation who can assist companies with each of the areas identified above.

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CASE STUDY

ESG Reporting

SITUATION

A leading oilfield transportation provider with a commitment to sustainability sought assistance developing a list of over 35 KPIs to manage its ESG program and eventually provide disclosures for certain of those KPIs. The company also sought assistance in defining a repeatable process for ESG reporting and to identify and map its internal control environment to ensure completeness and accuracy of key ESG data.

OUR ROLE

FTI Consulting assembled a team of leading ESG experts to help the company determine KPIs to be reported as part of its ESG program. The team assessed the client's current ESG data gathering processes and procedures throughout the company's global operations, identified gaps and suggested process improvements.

FTI's cross-disciplinary team supported the client by:

- obtaining comprehensive understanding of client's existing data collection process, policies, procedures, and internal control environment; and,
- developing a detailed report with key findings to management and suggesting next steps to operationalize our recommendations and implement a repeatable process.

OUR IMPACT

FTI's work assisted the client in adopting and implementing specific KPIs to measure and benchmark its ESG performance. Our work enabled the company to implement a series of effective program enhancements to develop a repeatable process and ensure that the company provides complete and accurate information to internal and external stakeholders.

KPI CATEGORIES ANALYZED FOR THIS CLIENT

Environmental

- Emissions and Air Quality
- Energy Uses
- Fuel Efficiency
- Spill Management
- Waste Minimization
- Biodiversity

Social

- Health and Safety
- Labor Practices
- Workforce Engagement

Governance

- Diverse Director Percentage
- Independent Director Percentage
- Total Amount of Monetary Losses as a Result of Legal Proceedings Associated with Anticompetitive Behavior Regulations

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