Mandatory climate reporting

Now what?

May 1, 2024

With you today

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Partner, Audit services

As a lead advisor within RSM's ESG advisory practice, Anthony guides companies and boards of directors through ESG strategy development, data collection, and reporting and communications.

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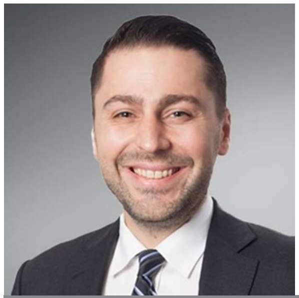
Scott is the national SEC services leader for RSM US. In this role he is responsible for methodology related to SEC assurance standards, tools, training and thought leadership supporting SEC assurance engagements at RSM. Scott is RSM's representative on several external Center for Audit Quality committees, including the SEC Regulations Committee, Small Firm Task Force, and Audit Reporting Task Force.



Alex Kotsopoulos
Partner, ESG advisory practice

Alex Kotsopoulos leads RSM's ESG advisory practice for RSM Canada LLP, helping public and private companies integrate sustainability factors into their strategy and operations to drive improvements in financial performance and societal outcomes.

Agenda

Course objectives

01 Explain the core requirements and status of SEC's new climate regulations

02 Describe practical compliance strategies to stay ahead of the curve

03 Articulate the potential challenges and opportunities associated with climate and/or sustainability reporting

04 Further identify the business implications pertaining to California's climate laws and the European Union's Corporate Sustainability Reporting Directive

No longer optional: An overview

The **U.S.** Securities and Exchange Commission on March 6, 2024, adopted a final rule that will require climate-related disclosures in registrants' annual reports and registration statements.

The **State of California** passed 3 new laws requiring certain companies with business activities in their state to provide disclosures about their greenhouse gas emissions, climate-related financial risks, voluntary carbon offsets, and certain climate-related emission claims.

The **European Union** (EU) commission adopted the European Sustainability Reporting Standards (ESRS) in 2023 as part of the EU's Corporate Sustainability Reporting Directive (CSRD). The ESRS requires a wide range of disclosures across each of environmental, social and governance categories.

SEC climate-related disclosure: Final rule

In an open meeting on Wednesday, March 6, 2024, the Securities and Exchange Commission ("SEC") approved in a 3-2 vote a **final rule on climate disclosures** that will "**require registrants to provide certain climate-related information** in their registration statements and annual reports".

The final rule will **be effective 60 days after its publication** in the federal register. Key areas include:

- Incremental financial statement disclosures
- New disclosures of greenhouse gas (GHG) emissions / Climate targets and goals
- Impact of climate risks on the company's strategy, business model, and outlook, risk management processes for climate-related risks
- Governance and oversight of material climate-related risks

The requirements are subject to certain materiality thresholds, registrant applicability, and an adoption phase-in timetable.

Financial statement requirements

Disclosures subject to audit and internal control over financial reporting

Impact of severe weather events or natural conditions

- Aggregate or gross (before recoveries) expenses or losses due to severe weather events or natural conditions if amount is greater than 1 percent of the absolute value of income (loss) before income taxes
- Capitalized costs and charges recognized due to severe weather events or natural conditions if the amount is greater than 1 percent of the absolute value of stockholders' equity (deficit)
- Separate disclosure of recoveries including which financial statement line item is impacted

Attribution principle and de minimis thresholds

- Attribute and disclose full amount of the cost, expense, loss or recovery to the event or condition when it is a significant contributing factor in incurring such cost, expense, loss, or recovery
- Disclosures not required if amounts are less than a de minimis threshold of $100,000 for income statement items or $500,000 for balance sheet amounts

Carbon offsets and renewable energy credits (RECs)

If a material component of the registrant's climate-related targets or goals, disclose the aggregate amounts of:

- Carbon offsets and RECs expensed
- Carbon offsets and RECs capitalized
- Losses incurred during the year on capitalized carbon offsets and RECs

Include line item (location) on income statement and/or balance sheet where amounts are reported

Include both beginning and ending balances of capitalized carbon offsets and RECs

These disclosures are not subject to the previously mentioned 1 percent materiality threshold

GHG emissions metrics, targets & goals

GHG emissions metrics

The final rule requires Scope 1 (direct GHG emissions from operations owned or controlled by the registrant) and Scope 2 (indirect GHG emissions from the generation of purchased or acquired electricity, steam, heat, or cooling that is consumed by operations owned or controlled by the registrant) emissions to be separately disclosed, on a gross basis, before consideration of any offsets.

Registrants must also disclose the relevant protocol or standard utilized to report the GHG emissions, including the methodology and significant inputs and assumptions used in the calculation.

Targets & goals

Registrants are required to disclose:

- Description of the activities to be performed and how the targets and goals will be met
- Scope and timing of the related activities, and where applicable, the baseline being measured against
- Impact of carbon offsets or RECs if they are expected to be a material part of the plan for achieving these climate related targets or goals
- Annual updates on the progress toward the targets or goals

Other disclosure requirements

Governance

- Description of the board's oversight and monitoring of climate-related risks as well as management's role in managing material climate-related risks
- Disclosures are not required if the registrant does not monitor climate-related risks

Climate risks

- Communicate climate-related risks that may have a material impact on the business strategy, financial condition, or operating results of the registrant
- Specify if the risk is a physical risk or a transition risk and short-term versus long-term impact

Risk management

- Registrant's process for identifying, assessing, and managing climate-related risks and if integrated into the overall risk management process of the registrant
- Actual or potential impact of climate-related risks on the registrant's strategy, business model, or outlook/forecasts

Material expenditures and impact on assumptions

- Quantitative and qualitative information about material expenditures and the impact on assumptions that result from the mitigation of climate-related risks, transition plans, and actions towards the registrant's targets and goals

Compliance dates and phase-in periods

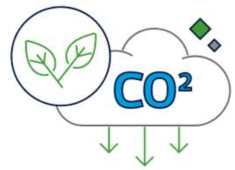
The following table summarizes the final rule and includes a phased-in compliance schedule based on a registrant's filing status and the type of information or reporting.

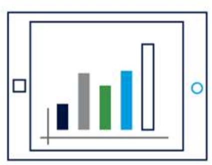
Compliance dates					
Type of registrant	**Financial statement disclosures and other disclosures except material expenditures and impacts and GHG emission**	**Disclosures about material expenditures and impacts**	**Scope 1 and Scope 2 GHG emissions**	**Attestation on Scope 1 and Scope 2 GHG emission disclosures**	**XBRL**
Large accelerated filers	FYB 2025	FYB 2026	FYB 2026	Limited assurance: FYB 2029 Reasonable assurance: FYB 2033	FYB 2026
Accelerated filers (other than SRCs and ECGs)	FYB 2026	FYB 2027	FYB 2028	Limited assurance: FYB 2031 Reasonable assurance: N/A	FYB 2026
SRCs, EGCs and non-accelerated filers	FYB 2027	FYB 2028	N/A	N/A	FYB 2027

California climate disclosure laws: Overview

The State of California has passed 3 new laws intended to address growing concerns about climate change and its impacts and to promote transparency and integrity in voluntary carbon markets (VCMs).

These laws represent a significant step in developing standard emissions reporting requirements in the United States and have wide-spread implications for many companies doing business in the state.





CA SB 253

Requires companies meeting certain revenue thresholds and that do business in California to disclose their scope 1, 2, and 3 Greenhouse Gas (GHG) emissions data for the prior fiscal year.

CA SB 261

Requires companies meeting certain revenue thresholds and that do business in the state of California to prepare and publish a publicly available report on a company's website that discloses climate-related financial risks.

CA AB 1305

Requires companies meeting certain revenue thresholds and that do business in California, regardless of size, to publicly disclose specified information related to carbon offset projects and claims related to being "carbon neutral".

California climate legislation: Reporting obligations

Regulation	Applicability	Reporting requirements	Adoption timing	Cost of non-compliance	
CA SB 253	➢ Public / private companies ➢ Doing business in CA ➢ Annual revenue > $1 billion	✓ Scope 1 and 2 emissions data by 2026 on 2025. ✓ Limited assurance from an independent third-party. ✓ Report Scope 3 emissions data in 2027.	In 2026, entities will submit their first annual public report on 2025 data.		Up to $500,000 per year.
CA SB 261	➢ Public / private companies ➢ Doing business in CA ➢ Annual revenue > $500 million*	✓ Disclosure of identified climate-related financial risk(s) and measures taken to reduce and adapt to physical and transition risks. ✓ Pay an annual fee to CARB (California Air Resources Board) upon filing their disclosures. Amount is TBD.	Earliest disclosure of climate-related information to be completed in 2026.	• Operational disruptions • Reputational damage • Financial losses • Compromised client relationships	Up to $50,000 per year.
CA AB 1305	➢ Public / private companies ➢ Doing business in CA (all sizes) ➢ Implying or making claims that products are carbon neutral, do not emit additional CO2 or GHGs ➢ Have made reductions in amount of GHG emitted	Specific disclosures according to types of claims made regarding Voluntary Carbon Offsets annually: ✓ Companies that make climate-related claims, the reporting must include disclosures of the accuracy of claims as well as third-party verification information. ✓ Companies that make climate-related claims, the reporting must include disclosures of the accuracy of claims as well as third-party verification information. ✓ No explicit assurance report requirements.	January 1, 2024; however, there is no specificity as to when disclosures are first required.		Up to $2,500 per violation/per day. Not to exceed $500,000.

*caveat that companies subject to the California Department of Insurance regulation, or conducting insurance business in other states, are exempt from SB261

EU’s corporate sustainability reporting directive

Applicability

Scope:

- EU and non-EU companies with a subsidiary that meet two of the following three criteria:
  - Total assets > 25 million euros
  - Total turnover > 50 million euros
  - Average of > 250 employees
- Any listed companies and non-EU companies that have net turnover greater than 150 million euros and have a branch or subsidiary in the EU
- Certain other thresholds and exemptions are as defined

Timetable:

- Phased adoption timelines ranging from those currently in scope of the existing Non Financial Reporting Directive reporting on FYE’s beginning on January 1, 2024 through global consolidated level reporting by non-EU headquartered companies reporting on FYE’s beginning on January 1, 2028

Requirements

European Sustainability Reporting Standards:

- Cross cutting standards (2) – general requirements and general disclosures
- Environmental standards (5) – climate change, pollution, water and marine resources, biodiversity and ecosystems, resource use and circular economy
- Social standards (4) – own workforce, workers in the value chain, affected communities, consumers and end users
- Governance standard (1) – business conduct

Other matters

- “Double materiality” – financial / impact
- Third-party assurance required over all reported sustainability information (limited, then reasonable)
- Other standards to come – sector specific, non-EU dedicated standards, simplified standards
- EU member states have until July 2024 to transpose the requirements of the CSRD into national law (can add local requirements)

High level comparison of jurisdictional regulations

	SEC rule	CA laws (SB 253 and 261)	EU (CSRD/ESRS)
Applicability	SEC registrants	US companies (including US subsidiaries) doing business in CA subject to certain revenue thresholds	Subject to certain criteria, companies domiciled (or listed) in EU including subsidiaries of non-EU parent
GHG emissions disclosure	Scopes 1 and 2, if an applicable filer type and if material	Scopes 1, 2 and 3 required	Scopes 1, 2 and 3, subject to materiality
Incremental financial statement disclosures required?	Yes	No	No
Scenario ananlysis required?	No	Yes	Yes
Climate-related risks disclosure required?	Yes; opportunity disclosures optional	Yes, along with opportunities	Yes, along with impacts and opportunities
Assurance requirements over GHG emissions disclosures	Yes. Limited assurance. Moving to reasonable assurance for certain filers.	Yes. Limited assurance moving to reasonable assurance over Scopes 1 and 2. Possibility of limited assurance over Scope 3.	Yes. Limited assurance moving to reasonable assurance.
Ramifications for non-compliance	Consistent with non-compliance with existing securities laws and regulations	Monetary fines	Dependent on member state laws and regulations
Adoption timeline	Different parts phased in by filer type from 2025 to 2033	First reporting due in 2026 on 2025 data	Phased in dependent on thresholds and definitions from 2024 through 2028
Other considerations	litigation	litigation, agency interpretations and funding	EU member state transposition into local law

Case study

Common issues

Global ESG compliance

Gaps in how changes in global compliance and country-specific compliance for ESG issues is **monitored and communicated** throughout the enterprise.

Ownership & accountability

Although personnel manage existing risk categories and owners **oversee major business risks**, there is a **lack of formal ownership and accountability** over sustainability risks and opportunities.

Factors such as **a lack of delineated roles and responsibilities**, and differing business unit priorities, may contribute to the lack of formal ownership and accountability.

Expertise

Certain business units lack the necessary **baseline sustainability knowledge** to identify, assess, prioritize, and manage sustainability risks and opportunities.

It will be critical for all **risk owners and data owners** to have a baseline level of sustainability understanding to:

1. Tag existing risks and opportunities as sustainability-related
2. Identify new and emerging risks and opportunities
3. Report complete and accurate data to track progress

Case study

Common issues

Processes, controls, & documentation

Gaps in the processes, controls, and documentation, whether formal or informal, necessary to **execute incoming reporting and data-led decision making.**

The Company has a **robust foundation in risk management** that can be enhanced through the **integration of sustainability-related risk drivers, criteria, and ownership**.

Many of the risks that are currently identified, assessed, and managed are sustainability-related, but have **not been formally tagged** as such.

Scope 3 emissions

Gaps in Scope 3 GHG emission reporting and considerations that may **impact complete and accurate reporting**, as well as GHG target achievements.

Technology enabled ESG

The Company is not effectively using technology for climate disclosures. Technology can enable **efficiencies and controls** to inform decision making as well as **complete and accurate** disclosures.

Case study

Common priorities

Hire an ESG controller (or equivalent) to coordinate ESG / financial reporting & compliance
An experienced resource to bridge the gap between all functions related to ESG reporting and provide oversight.

Formally integrate ESG into enterprise risk management
To formally manage climate and ESG risks, incorporating mitigation activities into enterprise strategy.

Enhance sustainability team roles & responsibilities
To ensure subject matter expert review over climate disclosures and enable strategic prioritization of ESG

Develop processes to evaluate financial impacts of climate risks
To quantify the impact of climate-related risks and develop proactive mitigation plans.

Incorporate ESG into executive decision making and strategy through ESG leadership
To connect the various business units to define an enterprise-wide ESG strategy.

Voluntary, unregulated climate reporting is ending.
Regulation is here to stay.

Welcome to the Third Wave.

Climate reporting maturity landscape

Stages of the climate reporting regulatory journey

01

Pre-mature/Early stage

02

Efficient/Middle stage

03

Mature/Tenured

Third wave of sustainability reporting

01

Corporate social responsibility

- High level reporting of company's broad commitment to sustainability with focus on philanthropy
- Often detached from corporate strategy

02

Rise of ESG and fiduciary awakening

- Growth of ESG reporting frameworks (e.g., TCFD, GRI)
- More structured reporting based on materiality
- Significant growth in sustainable finance/investing

03 ★

Government/Regulatory mandate

- Government and regulators increasingly mandating sustainability disclosures
- Ensure comparability and address criticisms of greenwashing

Case study

Fortune 500 global technology equipment manufacturing company – Climate gap assessment

RSM was engaged by an international technology company focused on technology to provide a climate disclosure gap assessment to prepare for eventual compliance with the SEC's proposed climate disclosure regulations, as well as any international climate regulations that may be implemented in the near term.

RSM reviewed the current state of climate disclosures and related processes pertaining to governance, risk management, target setting, GHG emissions calculation, and data systems to assess their current level of alignment to relevant regulations.

Based on the current state review, RSM discovered several key governance and risk management gaps that could materialize into financial, reputational, and legal risk.

RSM is currently working with the Company's leadership to develop initiatives that will address the identified gaps. This will support both their compliance efforts, as well as enable them to enhance their overall ESG metric tracking and decision making to address growing stakeholder expectations and ESG regulation requirements.

Calculation	Alignment	Attestation	Reporting
• Greenhouse Gas (GHG) inventory development • Use of recognized calculation methodologies	• Alignment to TCFD framework • Scenario analysis	• Internal controls around quantitative GHG data for financial statements • Consistency, completeness, and accuracy	• Technology systems for efficient reporting • Data and discussion in relevant reports (financial and non-financial)

Case study

Financial institution – Climate risk modelling

RSM is currently engaged by a global financial institution to provide climate transition risk modelling services with the goal of improving both the Company's climate risk management within their existing portfolio of investments, as well as improve their responsible investment procedures.

The Company is required by regulators to better account for climate related risk including transition risk. Therefore, RSM is helping the company to develop an approach to account for climate related risks within their risk management and portfolio management practices.

RSM is leveraging our in-house modelling software, DIVA, to dynamically project the financial and operational impacts of these climate-based movements in credit risk spreads, incorporating the Company's specific investment portfolio and management strategies.

By pairing RSM's proprietary Environmental Risk Score (**"E-Score"**) – which measures how a company is managing climate policy risk – and GHG intensity by industry – leveraging reputable data sources – RSM is in the process of calculating the risk premiums across the Company's investment portfolio.

The big picture: ESG advisory services

Becoming the trusted ESG advisor to middle-market firms throughout their entire ESG journey

RSM's ESG team specializes in advising private sector and public sector companies on ESG readiness, strategy development, and the incorporation of ESG metrics into corporate decision-making and strategy to **improve both long-term organizational performance and societal outcomes**.

Industry leading qualifications & credentials:

- Licensed in Principles of Responsible Investment
- Licensed in Fundamentals of Sustainability Accounting
- Seated on several board and committees (AICPA, Center for Audit Quality and Chamber of Commerce ESG initiatives)
- Greenhouse Gas Protocol Certified
- Task Force on Financial Disclosures (TCFD) Certified
- Global Reporting Initiative (GRI) Certified

Our team's areas of expertise:

- ESG materiality & stakeholder mapping
- Societal return on investment analysis
- Industry research & comparator benchmarking
- Technology assessments & data analysis
- Sustainable strategy development
- Circular strategy planning & analysis

How RSM supports their clients

Real-life examples of how RSM services their clients through mandatory climate reporting requirements

To build upon the client's foundation and to incorporate the third wave of sustainability reporting, RSM will provide recommendations, such as, to undergo our Regulatory Gap Readiness Assessment. Our aim is to guide our clients through regulatory requirements and industry best practices, recognizing existing efforts and establishing robust future reporting processes.

1 **Phase 1 – Kick-off and alignment**

- Kick-off to align objectives and establish a method for evaluating the current gaps, current ESG status and the TCFD framework, which will address the requirements of the SEC and other climate regulations in which impact the client (California, CSRD)
- Form an initial understanding for the current state of ESG through review of ESG documentation, policies, processes, reports, assessments, etc.
- Schedule workshops if needed with relevant stakeholder groups

2 **Phase 2 – Current state assessment**

- Conduct a benchmark analysis of up to five key comparators, evaluating how they are addressing mandatory climate regulations through public disclosure
- Facilitate workshops with management, key stakeholders and business unit owners to develop a deeper understanding of current state
- Issue follow up secondary data requests based on workshop findings
- Review additional current-state documentation to form current state baseline

3 **Phase 3 – Gap assessment and report out**

- Report on gaps through a gap assessment report which details the gaps in client's current state to incorporate mandatory reporting and compliance with the SEC and other climate regulatory requirements (California, CSRD). The Gap Assessment report will consist of: **Executive Summary, Comparator Benchmarking, Current State Assessment, Gap Listing, Readiness Level Setting and Future Considerations that will include prioritization of recommended initiatives.**

Thank you

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