Oversight of climate disclosures

SEC stay shouldn't mean stop

Despite the sense of relief that some companies initially felt with the SEC's stay of its climate disclosure rules,[1] the pause is unlikely to temper the forces demanding climate disclosures by other means. Whether the SEC rules are upheld, struck down in whole or part, amended, or abandoned, pressure from investors, stakeholders, and other regulators continues to drive the momentum toward detailed climate disclosure requirements.

Companies face a proliferation of new and complex climate disclosure mandates—including the SEC rules, state laws (with California leading the way), international laws and standards, or some combination of these. As a result, companies will have to comply with multiple inconsistent laws and will need to determine how best to structure their compliance and disclosure programs. (See **Pressure points on climate disclosures today**.)

[1] The SEC voluntarily stayed implementation of the final rules in April 2024 pending the completion of judicial review of the lawsuits challenging the rules, which were consolidated in the US Court of Appeals for the Eighth Circuit. The SEC will publish a document in the *Federal Register* at the conclusion of the stay addressing a new effective date for the final rules. See Elizaeth Ising and Ronald Mueller, Eighth Circuit Establishes Briefing Schedule for SEC Climate Disclosure Rules Litigation, Gibson Dunn Securities Regulation and Corporate Governance Monitor, May 24, 2024.

Pressure points on climate disclosures today

SEC staff. In its **order** staying its final climate rules, the SEC stated that the stay "does not stay any other Commission rules or guidance," including the 2010 Commission Guidance Regarding Disclosure Related to Climate Change (the Guidance), which provides guidance to public companies regarding the SEC's existing disclosure requirements as they apply to climate change matters. In recent years, SEC staff has issued comment letters based on the Guidance, often focusing on apparent discrepancies between a company's sustainability reports and its periodic reports filed with the SEC. In 2021, the SEC issued a **sample letter** to companies regarding climate change disclosures. Pending resolution of the litigation regarding the SEC's final climate rules, companies can expect the SEC staff to continue to issue comment letters seeking more-detailed disclosures from companies regarding the impact of climate change on their business and operations.

Business partners. If the company is a business partner, supplier, or customer of a third party that is required or elects to report Scope 3 greenhouse gas (GHG) emissions data, then the company's direct GHG emissions data must be included in the third party's Scope 3 emissions disclosures. As a result, the company should be prepared to provide accurate and timely GHG emissions data to the third party.

Investors and stakeholders. Given the increasing investor and stakeholder demands for information regarding the company's climate-related risks, opportunities, and activities, companies are increasingly providing climate-related information in sustainability or corporate social responsibility reports.[2] Accordingly, companies should be aware of the potential and increasing risks associated with such public disclosures (e.g., litigation risks, reputation risks, etc.), especially with the eventual shift from voluntary to regulatory disclosure. To address such risk exposures, management should be building robust disclosure controls and procedures around the company's public climate disclosures—such that they are subject to the same rigor as financial disclosures.

[2] Governance & Accountability Institute, Inc., "G&A Institute's New Research Shows Big Jump in Sustainability Reporting by Mid-Cap U.S. Public Companies in 2022," November 15, 2023.

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Given these near-term demands and growing consensus around common, comparable reporting standards—like the European Sustainability Reporting Standards or the sustainability reporting standards of the International Sustainability Standards Board (ISSB), which incorporate the Task Force on Climate-related Financial Disclosures' (TCFD) standards and Greenhouse Gas Protocol—we highlight key areas of focus for boards and audit committees as the SEC stay and broader regulatory landscape unfolds.

Adequacy of controls and procedures to support current climate disclosures

Boards/audit committees should task management with reassessing the adequacy of the company's internal controls and disclosure controls and procedures to support the company's current climate disclosures, including disclosures contained in SEC filings, as well as voluntary climate disclosures in sustainability reports, on websites, or elsewhere outside of SEC filings. Are the company's voluntary climate disclosures subject to review at a level of rigor similar to the financial statements?

Management should also be evaluating its policies and procedures for making climate risk materiality determinations, including the identification of climate risks that should be escalated and discussed with management's disclosure committee and legal team for final materiality determination, and documenting its materiality determinations. (See Considering Materiality, page 3.)

Lastly, does management have a clear process for ensuring that all climate disclosures are consistent and do not contain contradictory information—voluntary disclosures as well as disclosures in regulatory filings and elsewhere?

Management's preparations for new climate reporting frameworks/standards

The uncertainty associated with the litigation challenging the SEC's final climate rules—both the duration of the litigation as well as the outcome—obviously complicates management's preparations. While the SEC has indicated that at the end of the stay it will provide a new implementation period, it has not confirmed the duration of that period. Litigation involving the California climate laws poses similar uncertainty. However, the compliance timelines for the European Union (EU) and other international laws and standards are more settled. For additional information, also see **California imposes climate disclosures and assurance** and **SEC mandates climate reporting and assurance**.

Despite this uncertainty, companies should be assessing the potential implications of the SEC rules as well the California climate laws and international laws and standards on their business, determine which laws and standards apply and the level of interoperability, and prepare for compliance based on the company's unique facts and circumstances.[3] Preparation of the highly detailed disclosures, including SEC disclosures, is about more than disclosures—it will require reassessments of the company's climate-related risk management and board oversight processes, and other governance processes that are the subject of the disclosures. In the coming months, a priority for boards/audit committees will be to monitor management's preparations, particularly in the following areas:

- **Climate-related expertise and resources, at both at the management level and on the board or available to the board:** A key question for boards/audit committees is whether management has the necessary talent, resources, and expertise—internal and external—to gather, organize, calculate, assure, and report the necessary GHG emissions data, and to develop the necessary internal controls and disclosure controls and procedures to support the regulatory and voluntary climate disclosures. For many companies, this will require a cross-functional management team (Climate Team) from legal, finance, sustainability, risk, operations, information technology, human resources, and internal audit. At larger public companies, this team may be led by an ESG controller. Identifying and recruiting climate and GHG emissions expertise for a Climate Team—which may be in short supply—and implementing new systems to automate the data-gathering process will be essential.

[3] Subodh Mishra, "A Global Baseline? How to Navigate Interoperability Across Sustainability Reporting Rules," Harvard Law School Forum on Corporate Governance, March 28, 2024.

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A related question is whether the board has in place a governance structure and processes to provide effective oversight of management's preparations. Is there a need for board/individual director education? Should the board engage outside consultants with climate and GHG emissions expertise? Clarify the role of the full board and its standing committees in the oversight of management's preparations. The full board, the audit committee, the nom/gov committee, and other committees may each have oversight roles. For example, the audit committee would likely oversee the impact on financial statements, internal controls, compliance with the law, any required assurance, and the activities of management's disclosure committee, and the nom/gov or perhaps a sustainability committee might have primary responsibility for oversight of climate, including oversight of the company's approach to climate and the activities of management's Climate Team.

- **Management's plans to meet compliance deadlines:** While some larger public companies have taken steps to implement the standards/frameworks of the TCFD and the Greenhouse Gas Protocol—upon which the SEC's final rules and other standards are based—most other companies have not, and their climate disclosures are often included in risk factor disclosures or voluntary sustainability reports or websites, and not subjected to the same level of rigor as SEC disclosures. Companies should undertake a preliminary gap analysis to determine what additional disclosures are required by the SEC final rules and other applicable laws and standards/frameworks. With the gap analysis in hand, management's Climate Team, working with management's disclosure committee, should develop a detailed action plan and timeline to comply with the compliance phase-in requirements of the SEC's rules and other applicable laws and standards/frameworks.
- **Considering materiality:** The SEC rules require a number of disclosures subject to a determination of materiality—including many of the 10-K qualitative disclosures, Scope 1 and Scope 2 GHG emissions disclosures, as well as the company's transition plan, scenario analysis, and climate-related targets and goals. The SEC definition of materiality remains unchanged—i.e., information is material if there is a substantial likelihood that a reasonable investor would consider it important in deciding how to vote or in making an investment decision. Companies must take both qualitative and quantitative factors into account, including when determining whether Scope 1 and Scope 2 emissions are material. Management should update, as necessary, its policies and procedures for making final materiality determinations and educate members of the Climate Team as well as the board regarding these policies and procedures. At the same time, in preparation for the new 10-K disclosures, management should conduct a detailed materiality assessment of the company's material climate-related risks and their actual or potential material impact. For companies subject to EU regulatory standards, particularly the Corporate Sustainability Reporting Directive (CSRD), the double materiality assessment will be a priority, as companies will be required to disclose not only how climate and sustainability issues affect the company, but also how the company's operations affect the environment and society more generally.
- **Disclosure controls and procedures, and internal controls:** Clarification of the role and responsibilities of management's disclosure committee and the Climate Team for preparing for the SEC's climate disclosures, as well as other new laws and disclosure frameworks/standards, is critical. The disclosure committee's experience and its existing disclosure controls and procedures may be leveraged for gathering, verifying, and reporting GHG emissions data, and in the development and maintenance of additional internal controls and related disclosure controls and procedures. At the same time, management's Climate Team may also have responsibilities for gathering, verifying, and reporting GHG emissions data. The activities of the disclosure committee and Climate Team need to be closely coordinated.

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Expect complexity and scrutiny

Preparations for the SEC's climate rules, as well as the California laws, EU CSRD, and jurisdictional adoption of ISSB, will be a complex and expensive undertaking, involve difficult interpretational issues, and likely take months and perhaps years for some companies. Going forward, companies should closely monitor legal and regulatory developments, and consider the disclosures of their peers and others in their industry. Disclosure will be an iterative process (apart from any phase-in).

Finally, companies can expect the SEC staff to continue to issue comment letters to seek decision-useful, more-detailed disclosures from companies regarding the impact of climate change on their business and operations while the final SEC rules are being litigated. They can also expect demands from investors and other stakeholders for quality climate-related disclosures to continue to grow. A focus on climate-related disclosures should be a priority for management teams and boards even before the compliance phase-in of the final rules.

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