Josef Rashty, CPA, Ph.D. (candidate) has received his master's in accounting from Oklahoma State University and provides consulting services in Silicon Valley, Calif. He can be reached at j_rashty@yahoo.com.

SEC's Proposal for climate-change disclosures

By Josef Rashty, CPA, Ph.D. (candidate)

The performance of corporations on environmental, social and governance (ESG) issues has become an increasing concern for investors, consumers and management. The consensus is that companies with a strong track record in ESG practices are more stable and perform better in the end. However, defective ESG policies and executions pose environmental, legal and reputational risks that may eventually harm the performance of companies and their bottom lines.

In March 2022, the United States (U.S.) Securities and Exchange Commission (SEC) (in a 3-1 vote) issued Release Nos. 33-11042; 34-94478, The Enhancement and Standardization of Climate-Related Disclosures for Investors (hereinafter Release, the Release, Proposal or the Proposal). The Release proposes that public companies provide certain climate-related information in their registration statements and annual reports. The Proposal enhances and standardizes certain climate-related disclosures to address the demands of investors and consumers for more consistent and comparable information about climate-related risks. Comments for the SEC Proposal are due within 30 days of publication in the Federal Register, or May 20, 2022 (60 days after publication on the SEC's website, whichever is later). On May 9, 2002, the SEC announced that it extended the public comment period on the proposed rulemaking to enhance and standardize climate-related disclosures for investors until June 17, 2022.

The September/October 2021 issue of CPA*FOCUS* published "A Framework for Climate-Change Disclosures." This article discusses the background that led to the initiation of the SEC's public statement on climate-change disclosures. This article is the continuum of the previous article and expounds on the SEC's Proposal for climate-change disclosures in the footnotes to financial statements.

Greenhouse Gas (GHG) emission disclosures

GHG emissions include the following three categories: Scope 1 (emissions from sources owned or controlled by companies); Scope 2 (emissions from the generation of electricity and other energy sources that companies have purchased); and Scope 3 (emissions from sources that exist in the supply chain, but companies do not control them directly). The Release requires that registrants disclose their GHG emissions for Scopes 1 and 2 for the most recent fiscal year and the prior fiscal year(s) that they have included in their filings if they are reasonably available, but they do not need to disclose Scope 3 emissions if these emissions are not material and companies have not considered them as their goals and targets.

The Release requires that accelerated filers and large accelerated filers include an attestation report covering their Scopes 1 and 2 emission disclosures. However, it requires only limited assurance for the first fiscal year phase-in period, but for the second and the third fiscal years following the compliance with the GHG emissions disclosure requirement, accelerated filers and large accelerated filers should obtain an attestation report for their Scopes 1 and 2 emission disclosures.

Limited assurance implies that the audit firm expresses a conclusion that it is not aware of any material misstatement (similar to the assurance that auditors provide for an interim review for forms 10-Q), whereas in a full attestation, at a reasonable assurance level, the audit firm expresses an opinion that management presentations in all material aspects are free from any material misstatement (similar to assurance that they provide in an annual audit for forms 10-K).

In certain cases, the Proposal requires reporting of Scope 3 emissions, or those emanating along the supply chain and from product use, such as emissions from mining the materials used in manufacturing cars, which are the source of Scopes 1 and 2 emissions. The proposal provides an exemption from the Scope 3 emissions disclosure requirement for a registrant that meets the definition of a "smaller reporting company."

A smaller reporting company is an issuer that is not an investment firm, or a majority-owned subsidiary of a parent that is not a smaller reporting company and has a public float of less than $250 million or annual revenues of less than $100 million. If the threshold is total annual revenues, the company should have either: (i) no public float, or (ii) a public float of less than $700 million [CFR 229.10(f)(1), 230.405, and 17 CFR 240.12b-2] (see page 47 of the Proposal).[1]

Table 1 summarizes the Proposal's requirements if it becomes effective in December 2022 for a calendar year registrant.

Metric disclosure requirements

The Proposal, under Regulation S-K, requires that a registrant include certain metric disclosures in its most recent fiscal year and its prior years' filings. Furthermore, it requires that under Regulation S-X, the registrant discloses in a note to its financial statements disaggregated climate-related financial statement metrics, which it derives mainly from its existing financial statements line items.

The Proposal's metric disclosures fall into three broad categories: financial impact metrics, expenditure metrics and financial estimates and assumptions. Generally, if the aggregate impact of the events and activities is equal to or exceeds 1% of the total line item, to which it relates, disclosures would be required. The SEC favors the 1% threshold, arguing that a bright-line standard provides consistency in reporting. Registrants should evaluate the metrics that they adopt to ensure that they can measure and track the progress in achieving their GHG emissions goals.

Table 2 provides examples of such metric disclosures.

The SEC's proposed quantitative disclosures promote consistency and comparability among a registrant's filings over time and between different registrants' filings in the same period. The SEC does not provide a bright-line quantitative threshold for materiality determination. Thus, registrants use judgment to determine the materiality of their disclosures.

The SEC's proposed guidance concerns that companies should report their greenhouse-gas emissions promptly and accurately. The underlying belief is that the public may view it unfavorably if companies do not quantify and disclose their carbon footprint accurately and on time. There are fortune 500 technology companies and start-ups that have

▸▸

TABLE 1

Type of Registrants	Scope 1 and 2 GHG Disclosures	Scope 3 GHG Disclosures	Limited Assurance S Scope 1 and 2 GHG	Attestation on Scope 1 and 2 GHG
Large accelerated filer	2023 (filed in 2024)	2024 (filed in 2025)	2024 (filed in 2025)	2026 (filed in 2027)
Accelerated filer	2024 (filed in 2025)	2025 (filed in 2026)	2025 (filed in 2026)	2027 (filed in 2028)
Nonaccelerated filer	2024 (filed in 2025)	2025 (filed in 2026)	Exempt	Exempt
Small reporting company	2025 (filed in 2006)	Exempt	Exempt	Exempt

TABLE 2

Disclosure Metrics	Climate-Change Impact
Financial impact	Line items impacted due to severe weather events and other natural conditions (e.g., impairment charges)
Expenditure related	Line items expenditures related to mitigating the risk of severe weather conditions
Estimate	Cost estimates and assumptions related to climate-change events

developed software products that can capture and report an accurate picture of the carbon footprint of companies. A simple Google search furnishes the name of the companies that market software and technology products that can measure and manage carbon footprint.

Qualitative disclosure requirements

The Proposal requires that registrants disclose the material impact of climate-related risks and opportunities on their business and financial outlook. Furthermore, the Proposal requires that registrants disclose their plans and processes to detect and manage climate-related risks.

The SEC intends to provide GHG disclosures and reports available in Inline XBRL format to make them more accessible to the public.

Implications of the Proposal

The SEC proposal follows the recommendations of the Task Force for Climate-related Financial Disclosures (TCFD). TCFD has a framework consisting of guidance for governance (including board's oversight), strategy, risk management, metrics and targets. This framework is the basis of the SEC's Proposal on climate change and the efforts of international standard-setting bodies.

Companies most likely face higher compliance costs and disclosure challenges stemming from this Proposal. The registrants may need to hire experts to assist with the compliance efforts and tap an engineering and audit firm to attest to the accuracy of their estimates. The Proposal requires the companies to include independent assurance—typically from a consulting or audit firm—that their greenhouse emission disclosures from electricity, steam, heating or cooling are accurate.

However, challenges remain as Republicans and some industry groups have geared up to fight the Proposal. They argue that the Proposal increases the compliance costs and goes far beyond a strict interpretation of the SEC's mandate to protect investors. Democrats and the Biden administration, on the other hand, tout the Proposal as a promise of the administration to address the climate-change agenda.

Conclusion

The Proposal requires that companies provide estimates of their greenhouse emissions and risks to their businesses from climate change. The SEC's proposal seeks to remedy the issue of the incomparability of disclosures by compelling the companies to report greenhouse emissions consistently through quantitative and qualitative disclosures. The stringent requirements of the Proposal for publicly-traded companies mark steps toward creating unified policies for climate-change disclosures that ultimately benefit the public and investors.

Because public companies are responsible for 40% of GHG emissions, it was inevitable that either SEC or FASB initiate guidance for reporting and disclosure requirements of GHG emissions. The SEC proposal has a narrow scope and splits the greenhouse gas emissions from the rest of the ESG topics; however, the breadth of SEC's Proposal is startling and challenging. Even though the final rule on climate-change disclosures may be a year away, it is prudent that companies start preparing now by using the Proposal as a framework.

Resources

[1] https://www.sec.gov/rules/proposed/2022/33-11042.pdf

Loyal to LOCAL CPE

Self-Study CPE Details

Interest Area: Specialized Knowledge

Designed for: CPAs in public practice and in industry

Objective: Understand the SEC's Proposal for climate-change disclosures in the footnotes to financial statements.

Level: Intermediate

Prerequisite: None

MUST BE COMPLETED AND SUBMITTED BY APRIL 30, 2023 TO QUALIFY.

CPE Self-Study Section: Earn CPE credit for reading the article on pages 18-20.

Earn one hour of CPE credit by reading the preceding article and completing the self-study exam on the next page. Mail in the completed exam (by April 30, 2023) for grading. If you receive a score of 70% or higher, you will be issued a certificate for one hour of CPE credit. If your score is below 70%, you will be notified.

CPE EXAM: SEC's Proposal for climate-change disclosures *(Please mark your answers.)*

1. GHG emissions have ________ category/categories.

___ a. One
___ b. Two
___ c. Three
___ d. Four

2. For the second and the third fiscal years following the compliance with the GHG emissions disclosure requirement, accelerated filers and large accelerated filers should obtain an attestation report for their ______________ disclosures.

___ a. Scope 3 emission
___ b. Scope 2 emission
___ c. Scope 1 emission
___ d. Both b and c.

3. The Proposal's metric disclosures fall into three broad categories:

___ a. Financial impact metrics
___ b. Expenditure metrics
___ c. Financial estimates and assumptions
___ d. All the above.

4. Line items impacted due to severe weather events and other natural conditions (e.g., impairment charges) is an example of the following metrics:

___ a. Financial impact metrics
___ b. Expenditure metrics
___ c. Financial estimates and assumptions
___ d. All the above.

5. Identify the correct statement:

___ a. Companies most likely face lower compliance costs because of the Proposal.
___ b. Companies most likely face higher compliance costs because of the Proposal.
___ c. Companies' costs because of the Proposal is neutral.
___ d. None of the above.

Participant Evaluation

Please use the following scale to complete the below evaluation: 1=strongly disagree; 2=disagree; 3=neutral; 4=agree; 5=strongly agree

1) The stated learning objectives were adequately met.	❍ 1	❍ 2	❍ 3	❍ 4	❍ 5
2) The author conveyed a strong knowledge of the subject matter.	❍ 1	❍ 2	❍ 3	❍ 4	❍ 5
3) The article was timely and relevant.	❍ 1	❍ 2	❍ 3	❍ 4	❍ 5
4) The article and exam were well-suited to my background, education and experience.	❍ 1	❍ 2	❍ 3	❍ 4	❍ 5

My overall rating for the self-study program is: ❍ Poor ❍ Fair ❍ Average ❍ Very Good ❍ Excellent

It took me ______ hours and ______ minutes to read the article and complete the exam.

Name: ____ OSCPA Member No.: ___________________ Firm/Company: ______________________________________

Email address (where the CPE certificate will be sent): ____

Payment Information (choose one):

I am: ❍ **An OSCPA member ($25)** ❍ **A nonmember ($40)**

Payment Information (choose one): ❍ Enclosed is a check made payable to the Oklahoma Society of CPAs ❍ Personal credit card ❍ Corporate card

Card number ____ Exp. Date (required) _____________________________

Name as it appears on the card ____ Signature ____

After completing the exam above, please mail this page (photocopies accepted) along with your payment information to:

Oklahoma Society of CPAs / CPA*FOCUS* Self-Study / 1900 NW Expressway, Ste 910 / Oklahoma City, OK 73118-1898