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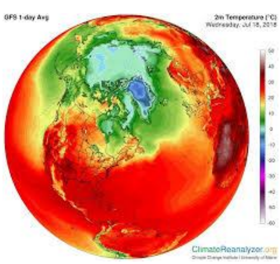
SEC Proposed Climate Disclosure Rule:

Challenges and Tips

At September 1, 2022, it has been almost six months since the SEC proposed a rule on disclosure of climate related risks. It has been nearly three months since the comment period closed. DHC was asked to offer challenges and suggestions at the Compliance Week ESG Conference in September 2022. Compare these to your own. See how they align with an SEC final rule.

CHALLENGES

- **The "1% Rule":** It is not clear what aspects of income, expenses, asset value, or liabilities could be subject to climate-related events or risks. Some might be obvious, such as (for an insurance company) increases in claims for flood damage. For most, though, the nexus between operational costs, asset value and other components of financial statements isn't yet clear. This is arguably the whole point of the proposed rule. Investors want to know how climate change could affect – and **have affected** - financial performance.



- **Company Processes and Controls:** These are not fully aligned with reporting frameworks, such as TCFD[1]. Many processes to gather data and information are informal (or non-existent). They are not yet developed as internal controls, such as the Internal Controls Framework used for financial reporting, posing challenges for CFOs, CEOs, General Counsel, or parties responsible for signing SEC filings.

- **Pace of Change:** The need for data, information, IT systems and controls is outpacing reliable platforms, and experienced resources. Vendors are racing to provide solutions as though one will fit all. It won't.

- **Attestation/ Assurance:** The SEC proposal would require attestation of GHG emissions inventories. If required by the financial auditor or another CPA firm, this would raise the bar considerably for documentation and preparation. This may also discard decades of experience by technical and other consultants.

- **Goals and Targets:** Some requirements are triggered only if a company reports goals and targets. If you don't, the first question from analysts will be "why not?" Goals and targets create expectations for future reporting periods. Companies will be challenged to prepare and implement action plans, backed by sufficient resources to achieve their goals.

[1] Task Force on Climate-Related Financial Disclosures; see www.fsb-tcfd.org

SUGGESTIONS

- **The 1% Rule:** Identify aspects of income, expenses, asset value, or liabilities that could be subject to climate-related events or risks. Assets with shortened useful lives may result in increased Asset Retirement Obligations. Include risks that arise from supply chain disruptions or other impacts. Also, from changes in distribution or marketing channels, or customer preferences.

- **Company processes and controls:** Perform gap assessment against leading frameworks, including TCFD. Where processes don’t exist, create them. Leverage the COSO Internal Controls Framework, and guidance on adopting it for sustainability reporting. Document the basis for qualitative and quantitative data and information, including uncertainties. Adopt features of controlled documents, for when they must be revised [and they will!].

- **Pace of Change:** You cannot keep up with the pace of change without resources. Invest in human resources, including training. Create or augment cross-functional teams. Use specialists with subject matter expertise, or to facilitate maturation of your programs. Invest in technology: external, internal – or both.

- **Attestation/ Assurance:** Prepare for assurance of GHG emissions inventories – at a minimum. Consider preparation for the entirely of the climate-related disclosures. Perform internal reviews, and leverage environmental and supply chain audit functions. Use Internal Audit to prepare for assurance by the financial auditor or other assurance provider.

- **Goals and Targets:** Setting lofty goals can get good press today; it can invite damaging press if there is no follow-through. Establish challenging, yet realistic goals. Develop SMART plans and ensure there are sufficient resources to achieve them. Prepare to report publicly on progress every year, and implement controls to facilitate the inevitable future audits.

About Douglas Hileman Consulting LLC

Douglas Hileman Consulting LLC (DHC) supports Clients in environmental, social and governance (ESG, or "Sustainability"), audits/ risk/ compliance, and non-financial reporting (aka "Sustainability reporting"). Mr. Hileman has been in the forefront of emerging issues for over forty years. He co-developed and presented a half-day workshop on ESG Reporting for Internal Auditors at a key conference in 2022. Recent focus areas include human rights (Uyghur Forced Labor Prevention Act), GHG emissions reporting, internal controls over sustainability reporting (ICFR), and ESG support to complex transactions and integration.

He has worked in operations and corporate compliance; environmental, health and safety compliance and auditing; Internal Audit; and external assurance for financial audits and conflict minerals submittals to the SEC. He was the senior technical specialist in environmental management and environmental auditing on the Volkswagen Monitor team, created for the company to fulfill obligations to the US Department of Justice. Mr. Hileman has reviewed frameworks for non-financial reporting (SASB, GRI, etc.), submitting comments on many proposed revisions. As an ESG specialist/ Sustainability specialist, he has supported Client audits, conducted audits, and redesigned Client EHS/ ESG audit programs (often after an EHS audit program Quality Assurance Review (QAR)). Primary Client contacts are in Legal, Compliance, Investigations, Sustainability, Executive (CEO, CFO), Risk and Internal Audit.

Mr. Hileman worked at a Big 4 accounting firm for six years, supporting financial audits, enterprise risk management, internal audit and the Sustainable Business Solutions practice. Mr. Hileman holds the credential in Fundamentals in Sustainability Accounting (administered by the Sustainability Accounting Standards Board). He is also a Certified Risk Management Assurance (CRMA) professional (granted by The Institute of Internal Auditors), and a Certified Professional EHS Auditor.

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