Climate Disclosure Mandates Demand A Big-Picture Approach

By **David Smith** (April 9, 2024)

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When it comes to corporate climate disclosures, there appears to be no middle ground. Either your company has been voluntarily accounting for and reporting its greenhouse gas emissions for years, or you haven't the slightest idea what the difference between Scope 2 and Scope 3 may be.

You've likely heard that California recently passed two laws mandating disclosures, but don't they only apply to entities larger than yours? And aren't the laws being litigated? What about the U.S. Securities and Exchange Commission's new mandates?

With all the chaos and uncertainty, many are rightly asking, "Should I even care at this point?" For better or for worse, the unequivocal answer is, "Absolutely!" And if you haven't started, you're late.

There has been extensive reporting on the SEC rule, the California laws and various European Union climate disclosure initiatives, and those details will not be reiterated here. However, litigation challenges, political attacks, implementation funding questions and prolonged implementation timelines have many adopting a wait-and-see approach.

This is not surprising, given the near universal recognition of the complexity, difficulty and expense involved in compliance. But even critics of the existing disclosure regimes are largely unified in the view that disclosure pressures and mandates are not going away, and that they will likely take years to prepare for.

So the time to start your carbon management regime is now.

Who's In and Who's Out

Those affected by adopted and forthcoming rules far exceed the entities identified on the face of each rule. Many large enterprises in all sectors are requiring those with whom they transact business or hire for services to commit to specified sustainability practices and metrics to which the underlying enterprise has committed itself.

If that entity does business with, leases facilities to or from, is in the supply chain of, or otherwise contracts with an entity that either is subject to a mandate or voluntarily chooses to make public climate disclosures, the reporting entity will eventually look to that apparently exempt entity to provide the information necessary for the disclosures.

So even if the entity itself does not directly disclose, it is increasingly likely that they do business with one that does. Competitive pressures from customer and employee bases are also increasingly driving voluntary disclosures relative to the entity's competitive business sector.

Other triggers that would require full internal accounting — even if not disclosed — include mergers and acquisitions and unique locally adopted mandates relative to energy efficiency of buildings, employee commute modalities, and evolving development and construction code restrictions.

Comprehensive Systems Management

Given the varied and evolving nature of climate disclosure mandates, the approach should not be targeted compliance with a given reporting regime. Rather, if not already in place, entities should be developing comprehensive systems assessment and management regimes.

Identification and tracking of physical facilities, supply chain components, manufacturing processes, employee travel and commute patterns, investment portfolios, consumer use and product disposal, energy consumption, water use, waste disposal, and geographic vulnerabilities to extreme weather events are just some of the enterprise variables that need to be identified, quantified and tracked on an ongoing basis.

There are great differences and variability among the various climate disclosure regimes. But the foundational drivers, for now, are quantification of greenhouse gas emissions and potential risks that climate dynamics pose to the enterprise.

The intent is to identify, assess and track the various sources of emissions and the universe of risk variables into a consistent reporting platform, such that whatever form a given disclosure mandate takes, the information is at hand and can be marshaled for compliance.

Data, Data and More Data

Underlying any climate disclosure regime is data. Companies have been voluntarily quantifying and reporting their greenhouse gas emissions for years.

CDP, formerly the Carbon Disclosure Project, was an early pioneer in persuading — some might say guilting — large corporate players to voluntarily quantify and publicly disclose emissions. It remains a leading source of emissions data and estimates.

Emissions accounting and reporting is a proven and demonstrable undertaking, and there is already a robust industry of professional firms doing both the counting and reporting. But entities are well advised not to fully outsource all climate-related considerations.

As noted above, experience has shown that a comprehensive systems management approach — as opposed to focused third-party accounting — is best. And that requires internal direction and oversight.

Software platforms, consultants and accounting firms are increasingly available and growing in sophistication to provide outside expertise and support. But a consistent hurdle in establishing a robust climate awareness regime is entities not knowing what they do not know.

The potentially reporting entity itself may not know what or how it should be reporting, and the third-party climate expert does not know the inner workings or dynamics of the reporting entity. Thus, the undertaking and collaboration must be strategic and iterative to vet and identify all dynamics that would be necessary for comprehensive consideration of what — if anything — must or should be disclosed.

For reporting entities, one of the most vexing dynamics is the lack of consistency between reporting authorities and regulatory jurisdictions. Applicable metrics, standards and materiality considerations, if applicable at all, vary widely.

While jurisdictions regularly pay lip service to the need for consistency and commonality across distinct reporting regimes, each has thus far mandated its own particulars — which may overlap somewhat with others, but are far from synchronous. This is an issue not only as to reporting formats, but also as to internal accounting and tracking standards.

Getting Started

The first step is determining the company's baseline status with regard to greenhouse gas emissions. This includes best efforts at quantifying Scope 1, Scope 2 and Scope 3 emissions.

A determination as to future reductions or a public net-zero pledge should not be made without this foundational information. Carbon accounting and reporting options are many.

There is a full industry of third-party consultants that have been quantifying emissions for over a decade. Others have fully integrated and manage quantification and reporting in-house with sophisticated software platforms and dedicated staff. Still others take a hybrid approach, utilizing both.

But that initial baseline assessment can take a year or more to determine verifiable numbers. And though there is an established industry of consultants and technologies, the effort is utterly unique to each business venture, its facilities, operations and ultimate objectives. There is no off-the-shelf solution.

The greatest uncertainty and volatility is with Scope 3 emissions. While the SEC dropped Scope 3 disclosures, California and the EU have not.

Many large corporations that have been voluntarily reporting emissions for years are becoming much more aggressive in mandating direct and verifiable emissions data from their suppliers and service providers. It is not uncommon for more than 90% of a given reporting entity's emissions to be Scope 3 — related to the procurement of upstream goods and services.

And such entities are increasingly mindful that a majority percentage of their Scope 3 emissions are their suppliers' Scope 2 emissions related to energy consumption. Thus, the more the reporting entity can force their supplier to adopt energy efficiency, renewable procurement or purchased offset credits, the better the Scope 3 reporting will be.

Many suppliers are being faced with a mandate to provide — and lessen — verified emissions data, or lose the business. Identification and quantification of this emissions data will then provide the pathway to determining risk exposure and responsive strategies, whether or not such identified risks are subject to public disclosure.

Physical acute and chronic risks, along with more systemic business transition risks, will span all segments of the enterprise: compliance cost and exposure with jurisdictional regulatory mandates, energy efficiency requirements, transportation and commute disruptions, facilities' exposure to extreme weather events, water consumption and conservation, and evolving consumer expectations and demands.

The execution of a climate and carbon assessment, management, and disclosure regime must be comprehensive and iterative. Industries, technologies and climate-related regulatory mandates are evolving as never before, and strategies and objectives must be

continually evaluated and adjusted accordingly.

Governance and Management Oversight

Climate considerations are injecting new and complex dynamics into entity governance and management decision making. This is especially true for — though not limited to — publicly traded companies.

Given the inherent multidisciplinary nature of climate management— including accounting, finance, operations, supply chain and facilities management — some sophistication at the board of directors level is desirable. Additionally, increasing consumer interest and workforce priorities bring pressure on an enterprise to define and disclose corporate positions on many progressive factors, including climate.

Though not presently mandated, in-house expertise on climate-related considerations will be of increasing value to reporting entities. As noted, external resources abound, but the key to strategic and compliant — though not unnecessarily elaborative — disclosures will depend on one or more internal resources that appreciate the nuances of the enterprise operations overlaid on the context of comprehensive climate regulation.

Some observers are already opining that given the foreseeable intersection of climate regulation with all aspects of the economy and corporate operations, regular staff training on climate compliance — not unlike antidiscrimination and harassment training — may become commonplace.

Voluntary Disclosures and Commitments

While adopted and enforceable climate disclosure mandates are relatively few at this point — and those that exist are subject to challenge — voluntary public disclosures and commitments expose the disclosing entity to potential enforcement action.

Federal enforcement agencies, state attorneys general and nongovernmental organization advocacy groups use "greenwashing" litigation as an additional means to advance climate disclosure principles and integrity.

It is not uncommon for a given entity's public commitment to achieve net-zero or carbon neutral status by a date certain to have originated exclusively from the company's public relations department. The problem is that once this disclosure or commitment is made public, the disclosing entity must be able to identify, uniquely to its own operations, how exactly it is on a trajectory to accomplish that target or goal by the specified deadline.

Failure to demonstrate a compliance plan can subject the entity to monetary penalties — and, often more consequentially, severe reputational damage.

Conclusion

Silence is often a legitimate strategic communications strategy, but only when the substance of what is not being disclosed is known and being withheld based on an informed risk assessment. A given entity cannot be certain whether it can or should make disclosures without doing at least preliminary analysis sufficient to know if it should disclose.

At a minimum, virtually any business enterprise should determine the strategy and resources necessary to assess the magnitude of its greenhouse gas emissions, and whether

climate considerations may pose a material risk in the sense of potential future disclosure.

Beyond that basic starting point, as more entities begin disclosing even their basic emissions data and risk assessment, it is likely that competitive pressures alone will drive those entities to publicly commit to net-zero or carbon neutrality pledges.

As the competition begins making such disclosures and commitments, your entity's choice of disclosure or strategic silence must be based on verifiable facts and data assessment.

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