The Institute of Internal Auditors

BULLETIN

Perspectives for internal auditors on today's most urgent issues

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SEC PROPOSES NEW CLIMATE DISCLOSURE RULES

Publicly-traded companies on U.S. exchanges could soon be required to report robust and complex climate-related data for investor consideration, including, "information about climate-related risks that are reasonably likely to have a material impact on their business, results of operations, or financial condition, and certain climate-related financial statement metrics in a note to their audited financial statements," according to much-anticipated rules proposals issued by the U.S. Securities and Exchange Commission (SEC) on March 21.

The proposed rules, if adopted, could have profound impacts on:

- How organizations view, measure, and mitigate climate-related risk.
- The level, sophistication and effectiveness of internal controls put in place to accurately capture, measure, analyze and report related data in both financial and nonfinancial terms.
- Internal audit's role in providing independent internal assurance on climate-related risk reporting in order to build confidence in the information disclosed externally.

The announcement comes as draft standards for general sustainability reporting and climate disclosures are expected to be released soon by the International Sustainability Standards Board (ISSB). The ISSB was created late last year by the IFRS Foundation and unveiled at the COP26 United Nations climate change conference. That announcement included publication of prototype requirements for climate-related disclosures and general disclosures of sustainability-related information. A draft of the ISSB standards could be published as soon as late March or early April.

"Our core bargain from the 1930s is that investors get to decide which risks to take, as long as public companies provide full and fair disclosure and are truthful in those disclosures," SEC Chair Gary Gensler, said in a news release. "Today, investors representing literally tens of trillions of dollars support climate-related disclosures because they recognize that climate risks can pose significant financial risks to companies, and investors need reliable information about climate risks to make informed investment decisions."

The SEC has been mulling over how to mandate climate change disclosure since it requested public input on the topic in 2021. In a speech in October, SEC Commissioner Allison Herren Lee emphasized that the SEC intended the process to be transparent and collaborative, pointing out that the agency had received thousands of letters in response to its initial request for input.

Commissioner Lee will be the featured speaker at The IIA's webinar, The Dawn of New ESG Requirements: Internal Audit Take Notice, Noon to 2 p.m. EDT, March 23.

Most public companies in the U.S. already generate some kind of climate change or sustainability reporting. However, such nonfinancial reporting has been voluntary and highly variable, with companies using a hodgepodge of standards, frameworks, and templates, rendering this information incomparable across peers, industries or sectors. In her October speech to UN Principles for Responsible Investment (UNPRI) and the London Stock Exchange Group, Lee argued that a mandatory system is necessary to ensure that climate change disclosure is "consistent, comparable, and reliable."

Indeed, the proposed rules would require publicly traded companies to include climate-related information in registrations statements and periodic reports including:

- Climate related risks and their actual or likely material impacts on an organization's business, strategy and outlook.
- The organization's governance of climate-related risks and relevant risk management processes.
- Certain climate-related financial statement metrics and related disclosures in a note to its audited financial statements.
- Information about climate-related targets and goals, and transition plan, if any.

The content of the proposed disclosures cover three general areas: an organization's assessment of climate-related risk and its response; the financial impacts of climate-related risks and climate-related events, such as a natural disaster; and the organization's carbon footprint, as measured in greenhouse gas (GHG) emissions. The complete 510-page proposal can be found here. An SEC fact-sheet on the proposal can be found here. The SEC has opened a comment period, which will remain open for 30-days after publication in the Federal Register or 60 days after its publication on sec.gov, whichever is longer.

Audit leaders at public companies should review the proposed SEC rules and be ready to discuss them with executive management, audit committees and boards, including breaking down the specifics and expectations of the rule, and possibly determining what feedback to provide to the SEC. Below are several questions for internal auditors to consider when advising their organizations on the SEC's proposed climate disclosure rule.

Questions to Assess Climate-related Data Reporting Preparedness

1. What are the climate-related impacts of my organization and the industry in which it operates?
2. What are the potential impacts of climate change on my organization?
3. What are the principal risks for an organization related to climate change?
4. Has my organization discussed/established a threshold to determine when climate-related events or risks are considered material?
5. How is climate considered in the risk appetite of the organization?
6. Is the climate risk appetite clear, and is it standalone or integrated within other risk appetite statements?
7. Where and how does the organization currently report climate-related data?

IIA RESOURCES

- Internal Audit's Role in ESG Reporting
- OnRisk 2021: A Guide to Understanding, Aligning and Optimizing Risk
- The ESG Risk Landscape Part 1: Understanding ESG Reporting Standards in 2022 and Beyond
- The ESG Risk Landscape Part 2: Implementation, Reporting, and Internal Audit's Role
- The ESG Risk Landscape Part 3: Evaluating ESG Risks

Internal auditor magazine

- The Responsible Organization
- Internal Audit: Are you ESG Ready?
- Beyond the Numbers

IIA Training

- Environmental, Social and Governance (ESG): the Growing Importance to Corporate Boards (PDF)

Other Resources

- TRWG Prototype Climate-related Disclosures Requirements (Climate Prototype)
- TRWG Prototype General Requirements for Disclosure of Sustainability-related Financial Information (General Requirements Prototype)
- Enterprise Risk Management: Applying enterprise risk management to environmental, social and governance-related risks (PDF)
- ESG Reporting and Attestation: A Roadmap for Audit Practitioners
- GRI Standards by language
- SASB Standards
- TCFD Implementation Guide - English

About The IIA

The Institute of Internal Auditors (IIA) is the internal audit profession's most widely recognized advocate, educator, and provider of standards, guidance, and certifications. Established in 1941, The IIA today serves more than 200,000 members from more than 170 countries and territories. The association's global headquarters is in Lake Mary, Fla., USA. For more information, visit www.globaliia.org.

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