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Ms. Vanessa Countryman
Secretary
Securities and Exchange Commission
100 F Street, NE
Washington, DC 20549-1090

17 June 2022

Re: Request for comment on the Enhancement and Standardization of Climate-Related Disclosures for Investors (Release Nos. 33-11042; 34-94478; File No. S7-10-22)

Ernst & Young LLP is pleased to provide comments to the Securities and Exchange Commission (SEC or Commission) on its proposal to enhance and standardize climate-related disclosures for investors.

We commend the Commission for its efforts to meet the growing needs of investors for decision-useful information about how climate change may impact their investments. We agree that investors need consistent, comparable and reliable information, and we support the SEC's efforts to leverage the framework developed by the Task Force on Climate-related Financial Disclosures (TCFD) and the Greenhouse Gas Protocol. Many investors are familiar with these frameworks, which are commonly used by companies that voluntarily provide climate-related disclosures in sustainability reports.

We support the SEC's proposal regarding disclosure of greenhouse gas (GHG) emissions and obtaining assurance over those disclosures from an independent third party. As we said in our 2021 comment letter[1] on the SEC's request for input on climate-related disclosures, investor confidence in the reliability and consistency of disclosures required by the SEC is critical to the capital markets. Assurance has long been a driving force behind the high confidence that investors have in the financial reporting of companies that participate in the US capital markets.

We also support the Commission's reliance on the US Supreme Court's definition of materiality as the threshold for disclosure in a number of areas of the proposal. We believe that threshold is well understood by registrants and investors, due to its decades-long use as a foundational aspect of the securities laws.

We also commend the SEC for taking a leadership role in the global regulatory landscape. As efforts to draft and adopt disclosure requirements progress in jurisdictions around the world,[2] we support the SEC's continued work as part of the Monitoring Board and the Technical Expert Group of the International Organization of Securities Commissions (IOSCO) to convey the US perspective and help minimize

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1 Ernst & Young LLP response to SEC's request for input on climate change and ESG disclosures.

2 For example, the European Union's proposed Corporate Sustainability Reporting Directive (CSRD).

differences. We also commend the SEC's engagement with the International Sustainability Standards Board (ISSB) as it develops a single set of baseline global environmental, social and governance (ESG) disclosure standards. We continue to believe that having a widely used single set of globally accepted ESG disclosure standards in place would benefit both the global capital markets and investors.

Given the importance of climate-related disclosures to the capital markets, we provide the following recommendations to help the Commission make sure that investors are provided with consistent, comparable and decision-useful information about climate risks.

Greenhouse gas emissions disclosures

Calculating emissions

We support the statements in the proposal that the GHG disclosures can be based on the widely used GHG Protocol. We note, however, that proposed Item 1504 of Regulation S-K would not require registrants to follow the GHG Protocol for calculating GHG emissions. We understand that one potential benefit of such an approach would be that it would allow for new frameworks to emerge. However, we are concerned that, without an explicit instruction to follow the GHG Protocol or other detailed guidance, unnecessary diversity in practice could result, and that diversity may adversely affect the usefulness of the information.

For example, registrants could use any alternative methods that emerge for calculating emissions in whole or in part as long as they adhered to the very general requirements contained in the proposed rules (i.e., definitions of the emission scopes and boundaries) and the methods qualify as suitable criteria under the applicable assurance standards.

We support the SEC's approach of incorporating into the proposed rules the significant provisions of the TCFD framework, and we believe the SEC could improve the quality and comparability of the emissions data disclosed by either incorporating the significant provisions of the GHG Protocol into the final rules or requiring the GHG Protocol's use. We note that the TCFD recommendations and the draft standards released recently by both the ISSB and the European Financial Reporting Advisory Group (EFRAG) include references to the GHG Protocol.[3]

If the SEC believes that its requirements must differ from the GHG Protocol, it can incorporate such differences into the final rules.[4] The SEC could then delegate authority to the SEC staff to address any future changes to the GHG Protocol that might render it inconsistent with the final rules.[5]

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[3] See the TCFD's **October 2021 recommendations,** the ISSB's March 2022 **Exposure Draft** IFRS S2 Climate-related Disclosures and EFRAG's **Exposure Draft** ESRS E1 Climate Change issued in connection with the proposed CSRD.

[4] See separate discussion of the SEC's proposed methodology for determining organizational and operational boundaries.

[5] The GHG Protocol has announced its **plans** to assess the need for additional guidance building on existing corporate standards

Boundaries

Consistent with our recommendation above regarding use of the GHG Protocol, we also recommend that the SEC consider changing the proposed organizational and operational boundaries that would determine which operations a registrant would need to include in its calculations of GHG emissions. The proposal would require registrants to report emissions for operations that are included in their consolidated financial statements. While this would align the proposed emissions disclosures with financial statement disclosures, it would require some registrants that voluntarily report emissions data under the GHG Protocol to change their boundaries.[6]

In addition, requiring reporting with different boundaries than the GHG Protocol could introduce uncertainty for investors if some companies had to revise their targets for reducing emissions due to the difference. We therefore recommend that the SEC carefully consider feedback from preparers regarding the cost and burden of using different boundaries than the GHG Protocol and from investors regarding whether they would benefit from it. We also note that the ISSB and EFRAG appear to have proposed more flexibility in their draft standards.[7] See the **Global standard setting** section below for more on potential global alignment with respect to climate disclosure standards.

If the SEC decides to move forward with the boundaries as proposed, we recommend that the SEC provide relief for reporting the emissions of recent acquisitions when emissions data is not immediately available. The proposed rules would appear to require a registrant to report the emissions of an acquired entity for the year in which it is acquired. We note that companies that voluntarily report emissions typically defer inclusion of newly acquired operations until the following year, as allowed under the GHG Protocol.[8] Similar relief could be considered for non-reporting target companies in transactions registered on Forms S-4 or F-4 if such information is not available or has not been previously provided to security holders.

Scope 2 GHG emissions

Proposed Item 1504 would allow companies to choose whether to disclose their Scope 2 GHG emissions using a location-based method, a market-based method, both methods separately, a combination, or another method entirely as long as it is identified. Under the GHG Protocol, a company reports its Scope 2 emissions using only a location-based method unless it determines the emissions using a market-based method, in which case it must report both (referred to as "dual reporting").[9] We recommend that the SEC consider incorporating this dual reporting into its requirements and limiting the additional proposed options to promote consistency and trend analysis and to align with current practice.

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6 For example, some registrants would need to start including emissions of investees accounted for under the equity method in their Scope 1 and Scope 2 emissions.

7 See **Exposure Draft** IFRS S2 Climate-related Disclosures, paragraphs 21(iii) and (iv) and EFRAG's **Exposure Draft** ESRS E1 Climate Change, Appendix A: Defined Terms.

8 See Chapter 5 of the **GHG Protocol**.

9 See Chapter 7 of the **GHG Protocol Scope 2 Guidance**.

Triggers for Scope 3 emissions disclosure

The disclosure of Scope 3 emissions would be required by proposed Item 1504(c)(1) when the emissions are deemed material using the US Supreme Court's definition. However, the proposal suggests that a registrant would need to calculate these emissions in order to assess materiality. As a result, a registrant would confront all of the challenges associated with calculating its Scope 3 emissions (that are well documented in the proposal) to determine whether those emissions must be reported. Given that these challenges could be especially acute for a registrant that has not previously calculated its Scope 3 emissions, we believe the Commission should consider providing an alternative to calculating Scope 3 emissions for purposes of a materiality assessment.

The SEC could instead allow a registrant to determine whether Scope 3 emissions disclosures are required based on any emissions data that it already has or can calculate without unreasonable cost and effort[10] and a qualitative analysis of its value chain. Broadly speaking, the intent of this approach would be similar to the optional qualitative impairment assessment for indefinite-lived intangible assets available under US GAAP.[11] We believe that this accommodation would strike an appropriate balance between the importance of Scope 3 emissions data and the significant cost and burden the proposal could impose on registrants if they had to calculate Scope 3 emissions to determine whether they are material.

Another area where we recommend the Commission consider modifications is with regard to the proposed requirement that Scope 3 emission data be disclosed if a registrant has set any goal or target that involves those emissions. For example, a target to be net zero[12] by 2030 would involve all of a registrant's emissions and would trigger an obligation under the proposed rules to disclose all relevant categories of Scope 3 emissions. However, a target to reduce just one category of emissions (e.g., business travel) would also appear to require disclosure of all relevant Scope 3 categories. We recommend that the SEC consider aligning the disclosure obligations with the triggering goals or targets. This could be accomplished by requiring a registrant to report only those Scope 3 emissions that are relevant to the target that has been set. In the examples described above, the net zero target would still trigger a requirement to disclose all of the registrant's Scope 3 emissions, but the business travel target would only require disclosure of emissions related to that travel.

Separately, we recommend that the SEC clarify in any final rule whether the SEC intends for the proposed rules to compel disclosure of nonpublic targets or goals. We note that the SEC has said the disclosure requirement would only apply to "publicly set" targets or goals,[13] but that isn't clear in Item 1506 of the proposed rules. In addition, we recommend that the SEC provide guidance on what it believes constitutes a target or goal. For example, it would be helpful if the SEC clarified what

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[10] For example, see the screening techniques described in the GHG Protocol's **Technical Guidance for Calculating Scope 3 Emissions**.

[11] See Accounting Standards Codification (ASC) Topic 350-30-35-18B.

[12] See **Science Based Targets' Corporate Net-Zero Standard**.

[13] See the **SEC press release and fact sheet** issued 21 March 2022, "For registrants that already conduct scenario analysis, have developed transition plans, or **publicly set** climate-related targets or goals, the proposed amendments would require certain disclosures to enable investors to understand those aspects of the registrants' climate risk management."

constitutes a "climate-related" target or goal and who would have to approve it (e.g., the board of directors, the chief executive, the chief sustainability officer) for it to be subject to the rules. Without clarity regarding which targets or goals are covered, we expect many registrants would struggle to implement this aspect of the proposal.

Estimation of emissions for the fourth quarter

We note that the SEC proposed an accommodation in Item 1504(e)(4)(i) intended to relieve the anticipated timing pressures related to reporting emissions data. Under this accommodation, a registrant would be permitted to include an estimate of its emissions for the fourth quarter that must be "promptly" updated if actual emissions prove to be materially different. It is unclear to us whether the proposal would subject these estimates to assurance and, if so, whether it would consider the update for actual emissions to be a form of restatement and whether the assurance provider must reissue its report. If the SEC proceeds with the proposed approach, we recommend clarifying those points.

An alternative approach would be to initially provide registrants with more time to provide the finalized, accurate emissions data and any required assurance report by allowing it to be filed as an amendment to the annual report on Form 10-K. Such an amendment could be included in Part III of the Form 10-K that is due 120 days after year end, making it part of the annual report. Under this approach, investors would not risk making decisions based on materially inaccurate emissions data that had been initially disclosed as an "estimate."

Assurance over GHG emissions data

Scope of GHG emissions data subject to required assurance

We support the proposed approach of excluding Scope 3 GHG emissions from assurance requirements for all filers because the cost of compliance for registrants would likely outweigh the benefits to investors. However, we believe the SEC should consider expanding the scope of the information subject to assurance to include the proposed intensity metrics for Scope 1 and Scope 2 emissions because the benefits to investors may outweigh the costs. We believe that these standardized efficiency metrics would be a critical tool for investors to use to compare registrants (e.g., within an industry), and the costs of obtaining assurance over them would be mitigated due to the proposed requirement to obtain assurance over the emissions data used to calculate these metrics.

Assurance provider qualifications and disclosures

We agree with the proposal to establish minimum qualifications for assurance providers in order to help meet investor expectations for reliability. We also support the proposed requirement that a registrant provide certain disclosures about its assurance provider in order to help investors assess the reliability of the attestation results. However, we recommend that the requirements be modified to explicitly require the assurance provider to have expertise in providing assurance, consistent with the Commission's intent as discussed in the proposing release. Item 1505(b)(1) would require that an assurance provider have experience in measuring, analyzing, reporting, **or** attesting. We believe investors would expect that the assurance provider is an expert in (1) providing assurance and (2) measuring, analyzing, or reporting on GHG emissions.

Scope 3 safe harbor

We agree with the Commission's assessment that the calculation and disclosure of Scope 3 emissions may present unique challenges, including potential difficulties in obtaining activity data from suppliers and other third parties in a registrant's value chain or verifying the accuracy of that information, and the fact that it may be necessary to rely heavily on estimates and assumptions to generate Scope 3 data. Therefore, we agree that a safe harbor is an appropriate way to balance the need for decision-useful emissions disclosures with concerns about liability for disclosures that contain such a high degree of judgment.

We also believe the final rules should clarify that the proposed Scope 3 safe harbor applies to GHG attestation providers and to statements made in an attestation report that is included in or attached to a document filed with the Commission.

We note that proposed Item 1504(f)(2) makes clear that paragraph (f) "applies to any statement regarding Scope 3 emissions that is disclosed pursuant to §§ 229.1500 through 229.1506 and made in a document filed with the Commission," which could be understood to include statements made pursuant to the attestation report requirements in proposed Item 1505(c). However, the inclusion of language referencing statements made "by or on behalf of a registrant" in proposed Item 1504(f)(1) could be interpreted to carve GHG emissions attestation providers out of the scope of the proposed safe harbor. This introduces a potential risk disparity between those making the disclosures (who would benefit from the safe harbor) and those providing limited or reasonable assurance regarding those disclosures (who would not benefit). That disparity could make it harder and/or more expensive for registrants to engage attestation providers, which could discourage them from voluntarily obtaining assurance over Scope 3 emissions.

Securities Act liability

We believe it would be appropriate to include in any final rule a provision similar to Securities Act Rule 436(c) that would state that a limited assurance report on GHG emissions by a GHG emissions attestation provider is not considered part of a registration statement or a report within the meaning of Securities Act Sections 7 and 11. In addition, we believe that this provision should cover attestation provided to accelerated or large accelerated filers who, at their option, obtain assurance over climate-related disclosures that the proposed rules would not require to be assured under proposed Item 1505(a), such as GHG intensity metrics or Scope 3 emissions disclosures. Similarly, we believe this provision should extend to other types of voluntary attestation obtained by a registrant, including (1) when an accelerated or large accelerated filer obtains reasonable assurance over its GHG emissions disclosures during the transition period, when only limited assurance would be required, or (2) when a non-accelerated filer obtains assurance, even though it would not be required by the proposed rules.

When addressing limited assurance for interim financial statement reviews performed by auditors, the adopting release for Securities Act Rule 436(c) indicates that the rule was intended by the Commission to address possible reluctance on the part of accountants to issue reports based on limited review procedures because of the auditor's potential Section 11 liability with respect to such information. As the Commission recognizes here, the calculation and disclosure of GHG emissions would be new for many registrants, as would the application of assurance standards to those disclosures. For these

reasons, and as GHG emissions attestation providers prepare to provide the required services, there may be a similar reluctance on the part of service providers to provide assurance earlier than the phase-in period and beyond the items of disclosure required to be assured by proposed Item 1505(a). At the same time, the proposing release recognizes that assurance over GHG emissions can improve the reliability of these disclosures and increase investor confidence in them and contemplates voluntary assurance earlier than, and beyond what is required by, the proposed rules.

We believe that a provision similar to Rule 436(c) for limited assurance reports or any assurance reports obtained voluntarily would strike the right balance between addressing the potential reluctance of qualified persons to serve as GHG emissions attestation providers because of the unique nature of Section 11 liability and maintaining other accountability mechanisms, including Section 10(b) of the Exchange Act.

Transition

We agree that limited assurance is the appropriate starting point because that is the level of assurance obtained today by many registrants that voluntarily report emissions data. We also support the proposed transition to reasonable assurance due to the importance of emissions data to investors as described in the proposal. We also note that it will take additional time for many registrants to develop the processes necessary to support obtaining reasonable assurance over emissions data, and for that reason, we also agree with the delayed implementation of this higher level of assurance.

Materiality

We agree with the SEC's reasoning that disclosures about climate-related risks and related metrics should be required if the information is material (as defined by the US Supreme Court) to investors in making investment or voting decisions. However, the proposed rules do not apply this concept consistently. For example:

- Item 1502(a) of Regulation S-K would require a registrant to describe any climate-related risks reasonably likely to have a material impact on the registrant. Paragraph (b) of Item 1502 would require a registrant to describe the actual and potential impacts of those risks on the registrant's strategy, business model, and outlook. Because paragraph (b) is not qualified by materiality, it appears that registrants would be required to disclose any actual and potential impacts of the risks, whether material or not. In addition, paragraph (b)(1)(vi) would require disclosure of any other "significant" impacts of the risks. It is not clear why significance would be used instead of materiality or why it applies to this particular item when paragraph (b) lacks a general disclosure threshold based on materiality.

- Item 1502(c) would require disclosure of how "any" resources are being used to mitigate the climate-related risks. In addition, disclosure about carbon offsets or renewable energy credits would be required "if applicable" rather than "if material" to a registrant's climate-related business strategy.

- Item 1502(d) would require a narrative discussion of whether and how climate-related risks have affected or are reasonably likely to affect the registrant's consolidated financial statements, whether material or not.

- Item 1502(e) would require detailed disclosures about a carbon price if a registrant uses one. This requirement would appear to apply, regardless of why a registrant uses a carbon price and whether describing it would be material to investors.

- Item 1502(f) would require a registrant to disclose the projected "principal" financial impacts on the registrant's business strategy of each scenario analyzed.

- Item 1504(c)(1) would require separate disclosure of any category of Scope 3 emissions that is "significant" to the registrant.

- Item 1506 would require comprehensive disclosure on an ongoing basis about "any" targets or goals related to the reduction of GHG emissions or "any" other climate-related target or goal.

We recommend that the SEC apply materiality uniformly throughout any final rules by including an overarching provision that makes it clear that the disclosures required by Items 1501 through 1506 need to be provided only if the information is material using the US Supreme Court's definition. (See also our discussion of the proposed 1% absolute value threshold for financial statement disclosures in the appendix.)

We also recommend that the SEC remove the requirement in proposed Item 1503(a)(1)(iv) that a registrant disclose how it determines the materiality of climate-related risks or explain in the adopting release why this requirement is necessary. We note that many existing SEC rules and regulations already use the term materiality without also requiring a registrant to explain how it was evaluated.

Financial statement disclosure requirements

We believe that substantive changes should be made to the proposed financial statement requirements in order for preparers and auditors to apply them in a consistent manner, which we believe is critical to investors. Examples of how the Commission could begin to address our concerns include:

- Clarifying the scope of the events and activities subject to disclosure

- Providing guidance to help registrants identify the relevant events and activities and quantify the financial statement impacts

- Changing the disclosure threshold from the proposed bright line of 1% to one based on materiality and extending the transition period[14]

In the appendix to this letter, we discuss some operational challenges the proposal would present for both preparers and independent auditors. They generally relate to whether registrants would be able to gather, evaluate and aggregate the required information and develop policies, processes, systems and controls to produce consistent and meaningful financial statement disclosures.

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[14] See also the **comment letter** submitted by the Council for Institutional Investors that recommends using materiality as the disclosure threshold and delaying the effective date of the proposed rules for one year.

To better understand what financial statement disclosures would be useful to investors, how a registrant should determine the amounts included in those disclosures and the audit implications, we believe the SEC should engage in additional robust and transparent discussions with investors, preparers and auditors (e.g., a series of public roundtables). The SEC could finalize the rest of the proposal and then repropose financial statement requirements based on those discussions.

Alternatively, the SEC could refer the topic of climate-related financial statement disclosures to the Financial Accounting Standards Board (FASB) for potential standard setting, consistent with the 2003 Policy Statement. The FASB could perform the additional stakeholder engagement through its existing robust and transparent process that investors and other stakeholders believe is a hallmark of the US capital markets. Once a project is completed, the FASB would also be able to use its existing processes to address any interpretive questions that may arise.

Global standard setting

We support the ISSB's efforts to develop a single set of baseline global standards for disclosure of ESG matters. We believe that having a widely used single set of globally accepted ESG disclosure standards in place could benefit both the global capital markets and investors. We note that the ISSB recently proposed standards for climate disclosure.[15]

We therefore recommend that the SEC include in any final rules an alternative reporting provision broadly similar to Exchange Act Rule 13q-1(c),[16] which allows issuers, governments, industry groups or associations, or trade associations to file an application for recognition of a disclosure regime as substantially similar to the SEC's disclosure requirements as set forth in Rule 0-13. Such a provision could be used for foreign private issuers that become subject to climate reporting in their home jurisdictions, some or all of which may adopt the ISSB's standards.

We also commend the SEC for participating in the ISSB's working group established to enhance compatibility between the ISSB's draft standards and the major regulatory efforts underway around the world.[17] Once the ISSB's standards are finalized, we recommend that the Commission consider directing its staff to prepare an analysis of the differences between the final rules and the ISSB's standards. If the ISSB's standards appear headed for global acceptance, we recommend that the Commission consider future rulemaking to incorporate them more broadly.[18]

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[15] March 2022 Exposure Draft — IFRS S2 Climate-related Disclosures

[16] See SEC Release No. 34-78167, Disclosure of Payments by Resource Extraction Issuers, where the SEC determined that issuers subject to the disclosure requirements of other jurisdictions could report in accordance with those requirements, subject to certain conditions.

[17] See ISSB announcement issued on 27 April 2022.

[18] For an example of a similar analysis prepared by the SEC staff, see SEC Staff Paper, A Comparison of U.S. GAAP and IFRS, issued in November 2011.

We once again commend the Commission for its efforts regarding climate change and its potential impact on investors' decision-making. We would be pleased to discuss our comments with the Commission or its staff at your convenience.

Yours sincerely,

Ernst + Young LLP

Appendix

We believe the Commission should reconsider the proposed financial statement disclosures because of the challenges we see in implementing and auditing them. As a next step, we believe additional discussions with investors and preparers would be helpful in understanding what financial statement disclosures would be useful to investors and how they would be used and what disaggregation threshold provides investors with the most comparable and decision-useful information. Additional guidance is also needed on how a registrant should determine the amounts included in those disclosures.

Clarifications on identifying and isolating the climate-related effects

Identifying and isolating the impacts of severe weather events and other natural conditions and transition activities — For the proposed disclosure requirements to be operable, we recommend that the Commission provide additional guidance on how to isolate and determine the financial impacts of severe weather events and other natural conditions and transition activities on individual financial statement line items (using any threshold, including a 1% absolute threshold) as proposed in Rules 14-02(c) and (d) of Regulation S-X. For example, proposed Rule 14-02(c)(1) notes that impacts can include "changes to revenue or costs from disruptions to business operations or supply chains." While we acknowledge that it would be relatively easy to estimate the impact in some situations (e.g., when the registrant has a supply contract with stated pricing and quantities that is suspended or terminated because of the severe weather event), quantifying the positive and negative impacts of severe weather events on revenue, expense, net income and other line items (including line items that are also impacted by other factors or that are only indirectly impacted) would be complex and subjective in many other situations. To comply with the proposed rule, management would need to develop and rely on its own entity-specific estimates and assumptions and would likely need to make changes to its information technology (IT) systems and processes to identify and track the information.

For example, the proposal would appear to require (see proposed Rules 14-02(c)(1) and (d)(1)) a registrant whose future uncommitted sales are negatively impacted by a severe weather event to estimate the "lost opportunity" impact on sales. The proposed rule would also require registrants to estimate the impacts on other line items that are directly and indirectly impacted, including income tax provisions, employee compensation expense, costs of goods sold, and the related cash flow line items.

We understand that the SEC may have intended for registrants to use the same information that is used to develop the primary financial statements (e.g., balance sheet, income statement).[19] The proposal notes the following:

> As discussed above, the proposed disclosures share many characteristics with other complex financial statement disclosures. The financial statement metrics present financial data that is derived from the registrant's consolidated balance sheets, income statements, and statements of cash flows, and would be presented in a similar way to existing financial statement disclosures. Requiring certain climate-related information to be included in a note to the financial statements, and therefore subject to audit and within the scope of ICFR, should enhance the reliability of the proposed financial statement metrics.

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[19] Refer to section 5 of the proposal page 151.

However, the proposed disclosure requirements in Rule 14-02 of Regulation S-X would require disclosure of information, much of it estimated or derived from other sources, that is not considered in the preparation of the financial statements and is not currently subject to internal control over financial reporting (ICFR), such as lost revenue opportunities. Registrants would therefore need to develop policies, processes, systems and internal controls to consistently report on this information, as discussed below.

Identifying and isolating impacts and expenditures related to transition activities — We believe registrants would find it challenging to apply the proposed disclosure requirements for direct and indirect financial impacts and expenditures related to transition activities (refer to proposed Rules 14-02(d) and (f) of Regulation S-X). For example, the proposal does not appear to provide guidance on how a registrant that purchases or leases electric vehicles would determine the portion of these expenditures that would be a climate-related transition activity rather than an ordinary course expenditure to maintain an efficient set of productive assets. Similarly, it's not clear how a registrant that implements new technologies or makes other improvements (e.g., renovations of purchased and leased buildings) to reduce its costs and make its operations more efficient would determine how much of these types of expenditures or cost savings should be considered climate-related transition activities. Without more guidance, many registrants may assume that all expenditures and cost savings are climate-related while others may come up with different estimates, further limiting comparability.

This diversity, and the lack of comparability it may cause, may result in disclosures that would not be useful for investors. Further, including the total costs of expenditures that even partially reduce "GHG emissions, increase energy efficiency, or improve other resource efficiency"[20] in the proposed disclosure could be misleading because the amounts could be very large, even when the expenditure only has a minimal impact on enhancing energy efficiency.

Qualitative disclosures — We observe that the proposal would require certain qualitative disclosures, including whether severe weather events and other natural conditions and transition activities have an impact on significant estimates and assumptions used to develop the financial statements and, if so, what that impact is. Without additional guidance, we believe this disclosure would be challenging for registrants to make because it would require them to develop estimates to isolate the relevant exposures.

Implementation and internal control over financial reporting considerations

As noted above, much of the information that would need to be disclosed about the financial impacts of severe weather events and other natural conditions and transition activities (e.g., lost revenue, positive and negative changes in expenditures and costs) is not currently contained in the books and records registrants use to prepare their financial statements. Registrants would need to modify their existing systems and processes to gather and aggregate the necessary data from other sources. Since the proposed disclosures would be included in the audited notes to the financial statements, the information would then be subject to ICFR.

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[20] See Proposed Rule 14-02(f) of Regulation S-X.

It also may be difficult for registrants to configure their systems to tag the financial data necessary for the proposed disclosures, even when that information is entered into the books and records used to prepare their financial statements. Once costs and expenditures are recorded in an IT system, some may be pooled by the system in various intermediate accounts and departments and ultimately allocated to the appropriate financial statement line items (e.g., selling, general, and administrative expense, inventory, cost of goods sold). This would make it difficult to know precisely which line item includes the climate-related expenditures or portions of expenditures. If a registrant is not able to do that, an independent auditor would not be able to perform sufficient procedures to audit the proposed disclosures and related internal controls (as applicable).

The proposal includes a requirement to include in these disclosures the climate-related amounts for noncontrolled investments (e.g., investments reported under the equity method of accounting) and newly acquired businesses and newly acquired assets. We would expect registrants likely will find it difficult to obtain the information for these investments and assets in a timely manner. We recommend that the Commission provide an exemption or some form of relief in those cases (e.g., similar to the relief from disclosure requirements and evaluating ICFR provided for certain noncontrolled investments, newly acquired businesses and asset acquisitions).

Threshold used for reporting disaggregated information

We note that, while the proposal uses the US Supreme Court's definition of materiality for determining when disclosure of climate-related risk would be required outside the financial statements, it sets a 1% absolute threshold for the financial statement line item disclosures and doesn't clearly explain why the Commission believes investors would be better served by this threshold. We acknowledge that the Commission has used lower thresholds in other rules, such as its requirement that excise taxes[21] of 1% or more of revenue be disclosed. But we note that, unlike the climate-related impacts, excise taxes are discrete event charges that are easily calculated and tracked in a registrant's accounting books and records. We also note that because the 1% threshold for proposed Rules 14-02(c) and (d) would be applied on an absolute value basis, the threshold for disclosure would in fact be lower than 1% (and significantly lower for certain financial statement line items, such as other income).[22]

If the Commission decides to move ahead with these requirements, we recommend that it consider revising proposed Rule 14-01 to indicate that all of the disclosures required by proposed Rule 14-02 need only be provided if they are material under the US Supreme Court's definition, which has been consistently used and relied upon for evaluating investor needs throughout financial reporting.[23]

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[21] See footnote 347 of the proposal.

[22] We also note that Rule 5-03(b)(1) of Regulation S-X identifies net income as one of the "line items" required to be presented in a statement of comprehensive income. Including this or other measures of income or loss (e.g., income before income tax expense) within the scope of the proposed rules would likely establish a threshold far below 1% of any individually impacted line item, such as revenue or cost of revenue.

[23] See also examples of materiality currently used in Regulation S-X, including 210.4-02 that states, "If the amount which would otherwise be required to be shown with respect to any item is not material, it need not be separately set forth" and 210.13-02 that states, "… provide the following disclosures to the extent material."

Removing the bright-line threshold for disclosure may allow registrants to focus on providing more robust decision-useful information pertaining to the most important climate-related events, including the registrant's ongoing climate transition-related initiatives.

Stating that the disclosures required by proposed Rule 14-02 need only be provided if material under the US Supreme Court's definition could mitigate certain of the operational challenges highlighted above. It could also mitigate likely inconsistencies in the financial statements between the proposed note and other notes to the financial statements. For example, the 1% threshold could require a registrant to disclose the amount and effect of an otherwise immaterial exit or disposal activity[24] (e.g., termination of an executory contract) upon a severe weather event, even though there would be no disclosure or description of the loss and related obligation elsewhere in the notes to the financial statements.

Cost benefit considerations

Regarding the Commission's estimate of the increase in costs of auditing the registrant's financial statement, we believe that auditing the proposed disclosure requirements may cost more than the SEC's estimate of adding "$15,000 to the overall costs associated with the audit of the registrant's financial statements." While we recognize that the SEC's estimate is an average, we are concerned that it may not appropriately reflect the time and expertise required to meet investors' expectations and an auditor's obligations under Public Company Accounting Oversight Board (PCAOB) standards for audited financial information. That is, an audit fee of $15,000 may not cover the new procedures that an independent auditor, applying the necessary objective scrutiny and professional skepticism that investors rely on, would perform.

We note that the Commission's cost analysis[25] is supported by data derived from the FASB's post implementation review of Statement 131, *Disclosures about Segments of an Enterprise and Related Information*, and the requirement to disaggregate revenue information in ASC 606, *Revenue from Contracts with Customers*. However, unlike those two examples, the proposed financial statement disclosure requirements would significantly expand the scope of information that would need to be gathered and what is ultimately reported in the financial statements. That is, neither of those standards were designed to provide information at a disaggregated level that is below the general materiality requirement applied to other areas of US GAAP or that was already being produced for internal reporting purposes. Therefore, we believe the implementation of the proposed disclosure requirements and the implementation of the segments and revenue standards are not sufficiently analogous to draw meaningful cost comparisons.

We appreciate that determining an estimate of additional audit costs that could be broadly applied across registrants is challenging. However, the Commission's current estimates of the incremental audit costs likely underestimates the necessary changes in scope and the level of effort necessary to appropriately design and execute audit procedures that comply with PCAOB standards. That said, it is difficult to generalize costs expected to be incurred by preparers, or even derive a reasonable range of increased costs, without additional clarity on the proposed financial statement disclosure

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[24] Refer to ASC 420, *Exit and disposal cost obligations*.

[25] Refer to footnote 1043 of the proposed rule.

requirements, as described above. We would be happy to meet with the Commission staff to discuss the challenges in more detail, including sharing our experiences with the adoption of other significant new financial reporting standards.

Transition

For purposes of its planned transition, the Commission has assumed that final rules would be adopted in December 2022 and that the proposed financial statement disclosures would be required to be included in the 2023 annual financial statements of large accelerated filers. This effective date would require a calendar-year large accelerated filer to have resources, policies, systems, processes and controls in place to start gathering and tracking the necessary information within a matter of weeks (i.e., 1 January 2023) so that it could make the necessary estimates and disclosures in its 2023 annual financial statements.

We therefore recommend that the Commission defer the proposed effective date of the financial statement disclosure requirements, specifically, for a minimum of two full years to allow a registrant to develop policies, processes and systems to identify and track the information on both a historical and prospective basis. However, the Commission should also consider the input from registrants on their available resources and the readiness and availability of systems needed to track the information to determine the appropriate transition period.