

Heads Up

In This Issue:

- Introduction
- Existing Legislation and Regulations
- Disclosures Related to Climate-Change Matters
- Current Rules and Regulations Requiring Disclosure of Climate-Change Issues
- Next Steps
- Deloitte Resources

Registrants should consider the impact of this interpretive guidance on their disclosures as they prepare their Forms 10-K.

A Climate for Change?

SEC Issues Interpretive Guidance on Disclosures Related to Climate Change

by Tiffany Prudhomme and Beth Ann Reese, Deloitte & Touche LLP

Introduction

On February 2, 2010, the SEC issued its anticipated [interpretive release](#) outlining the Commission's views on applying existing disclosure rules to climate-change matters. In addition to summarizing the disclosure rules and regulations, the release discusses considerations for registrants that are determining whether climate change and its related consequences have triggered a disclosure requirement. The SEC plans to use its ongoing disclosure review program to monitor the impact of the interpretive release on company filings. Registrants should consider the effect of this interpretive guidance on their disclosures as they prepare their Forms 10-K.

The interpretive guidance comes on the heels of state and local legislation and regulations that have been enacted within the last few years and that have resulted in increased scrutiny of greenhouse gas emissions as well as potential legislation at the federal level. Investor groups have also petitioned for more climate-change-related disclosures from public companies.

Existing Legislation and Regulations

Information about greenhouse gas emissions and climate-change-related matters is increasingly being made publicly available by companies in voluntary disclosure initiatives or other regulatory requirements, but to a lesser degree in SEC filings. The Environmental Protection Agency (EPA) enacted its mandatory greenhouse gas reporting rule, which requires, as of January 1, 2010, large, stationary emitters of greenhouse gases to report their emissions annually. On March 17, 2009, the National Association of Insurance Commissioners promulgated a uniform standard requiring that insurance companies disclose, to state regulators, financial risks due to climate change and actions taken to mitigate them. In light of the information publicly available under voluntary disclosure initiatives and other regulatory requirements, the SEC cautioned that "registrants should be aware that some of the information they may be reporting pursuant to these mechanisms also may be required to be disclosed in filings made with the [SEC] pursuant to existing disclosure requirements."

SEC Chairman Mary Shapiro noted the following in her statement before the January 27, 2010, Open Commission Meeting on Disclosure Related to Business or Legislative Events on the Issue of Climate Change:

It is neither surprising nor especially remarkable for us to conclude that *of course* a company must consider whether potential legislation — whether that legislation concerns climate change or new licensing requirements — is likely to occur. If so, then under our

traditional framework the company must then evaluate the impact it would have on the company's liquidity, capital resources, or results of operations, and disclose to shareholders when that potential impact will be material. Similarly, a company must disclose the significant risks that it faces, whether those risks are due to increased competition or severe weather. These principles of materiality form the bedrock of our disclosure framework.

Disclosures Related to Climate-Change Matters

The interpretive release addresses four topics related to climate-change matters that registrants should consider when assessing what information to provide in their filings under existing SEC disclosure requirements.

Impact of Legislation and Regulation

Developments in federal and state legislation and regulation on climate change may trigger disclosure obligations. Registrants should determine what specific risks they face as a result of climate-change legislation or regulation. A registrant's sensitivity to certain legislation or regulations may vary according to the nature of its business and industry. The interpretive release notes that a registrant should "avoid generic risk factor disclosure" that could apply to any registrant.

Management's Discussion and Analysis of Financial Condition and Results of Operations (MD&A) disclosures are required for any known uncertainty, such as pending legislation or regulation that a registrant determines is reasonably likely¹ to be enacted and is reasonably likely to have a material effect on the registrant and its financial condition or results of operations. The registrant should also consider disclosure of the "difficulties involved in assessing the timing and effect of the pending legislation or regulation," if material.

The interpretive release also indicates that a "registrant should not limit its evaluation of disclosure of a proposed law only to negative consequences." Changes to a registrant's business practices as a result of changes in the law may present new opportunities for certain registrants (e.g., "if a 'cap and trade' type system is put in place, registrants may be able to profit from the sale of allowances if their emissions levels end up being below their emissions allotment").

Other examples of possible consequences of pending legislation and regulation related to climate change cited in the interpretive release include:

- Costs to purchase, or profits from sales of, allowances or credits under a "cap and trade" system;
- Costs required to improve facilities and equipment to reduce emissions in order to comply with regulatory limits or to mitigate the financial consequences of a "cap and trade" regime; and
- Changes to profit or loss arising from increased or decreased demand for goods and services produced by the registrant arising directly from legislation or regulation, and indirectly from changes in costs of goods sold.

International Accords

Registrants should consider and disclose, when material, the business effect of international accords and treaties related to climate change, specifically those associated with governance of greenhouse gas emissions. The disclosure obligations related to U.S. climate-change regulations also apply to international accords.

Indirect Consequences of Regulation or Business Trends

Registrants should consider the need to disclose, as risk factors or in MD&A, the actual and potential indirect consequences of regulations or business trends related to climate change (e.g., reduced demand for greenhouse-gas-producing products, increased demand for energy from alternative sources). If the potential impacts are significant enough, disclosure may also be required in the registrant's business description. In

Developments in federal and state legislation and regulation on climate change may trigger disclosure obligations.

¹ "Reasonably likely" is a lower disclosure standard than "more likely than not." See SEC Release No. 33-8056.

addition, registrants need to determine whether the potential for reputational damage due to public perception of the potential adverse consequences to the entity's business would warrant the inclusion of a risk factor related to reputation.

Physical Impacts of Climate Change

Registrants should consider the actual and potential impacts of the physical effects of climate change on the business. When an entity is particularly vulnerable to severe weather or climate-related events, the registrant should disclose the material risks and related consequences of such weather or events. The interpretive release indicates the following possible consequences of severe weather:

- For registrants with operations concentrated on coastlines, property damage and disruptions to operations, including manufacturing operations or the transport of manufactured products;
- Indirect financial and operational impacts from disruptions to the operations of major customers or suppliers from severe weather, such as hurricanes or floods;
- Increased insurance claims and liabilities for insurance and reinsurance companies; [footnote omitted]
- Decreased agricultural production capacity in areas affected by drought or other weather-related changes; and
- Increased insurance premiums and deductibles, or a decrease in the availability of coverage, for registrants with plants or operations in areas subject to severe weather.

Current Rules and Regulations Requiring Disclosure of Climate-Change Issues

The interpretive release also highlights the SEC's existing rules that may require disclosure of material climate-change matters, such as the following Items of Regulation S-K:

- **Item 101, "Description of Business"** — Item 101 requires a registrant to describe its business and that of its subsidiaries. In addition, Item 101 expressly requires disclosures about certain costs of complying with environmental laws.
- **Item 103, "Legal Proceedings"** — Item 103 requires a registrant to briefly describe any material pending legal proceeding to which it or any of its subsidiaries is a party and to which its property is the subject of litigation. Instruction 5 in Item 103 includes some requirements that apply to disclosure of certain environmental litigation.
- **Item 303, "Management's Discussion and Analysis of Financial Condition and Results of Operations"** — Item 303 includes a broad range of disclosure items that address the registrant's liquidity, capital resources, and results of operations. Certain provisions of Item 303 specify the disclosures required for compliance, but in other instances the guidance includes principles that require management's judgment. For example, "registrants must identify and disclose known trends, events, demands, commitments and uncertainties that are reasonably likely to have a material effect on financial condition or operating performance" (footnote omitted). Item 303 does not specify what period a registrant must consider in assessing the impact of a known trend, event, or uncertainty that is reasonably likely to occur.

The interpretive release reiterates that the drafting of MD&A disclosures "should focus on material information," and while materiality may limit what a registrant discloses, it "should not limit the information that management considers in making its determinations." Instead, management should consider "all relevant information even if that information is not required to be disclosed." To capture all relevant sources of information, management should consider whether it has sufficient disclosure controls and procedures in place.

The interpretive release also highlights the SEC's existing rules that may require disclosure of material climate-change matters.

- **Item 503, “Prospectus Summary, Risk Factors, and Ratio of Earnings to Fixed Charges”** — Item 503(c) requires a registrant to provide, when appropriate, under the heading “Risk Factors,” a “discussion of the most significant factors that make [an investment in the registrant] speculative or risky.”

In addition to the disclosure requirements of Regulation S-K and Regulation S-X, Securities Act Rule 408 and Exchange Act Rule 12b-20 require a registrant to disclose “such further material information, if any, as may be necessary to make the required statements, in light of the circumstances under which they are made, not misleading.”

Next Steps

The SEC’s Investor Advisory Committee will consider climate-change disclosures in its role as an advisor to the SEC. Disclosures on climate change matters are also expected to be the subject of a public roundtable planned by the Commission for the spring of 2010. On the basis of insights gained from the Investor Advisory Committee and the roundtable, the SEC plans to determine whether additional guidance or rulemaking on climate-change disclosures is necessary.

Deloitte Resources

For Deloitte’s perspective on a range of climate-change and sustainability-related topics, please see the following whitepapers:

- [Carbon Accounting Challenges: Are You Ready?](#)
- [A Climate for Change? Understanding the Tax Implications of U.S. Greenhouse Gas Regulation.](#)
- [Confronting the Carbon Challenge: Business Implications of the Developing North American Carbon Markets.](#)
- [CFO Insights: Are Your Green Initiatives Tax Efficient?](#)
- [CFO Insights: Sustainability: Developing Key Performance Indicators: Measuring Sustainability Is the Bottom Line.](#)
- [Lifecycle Assessment: Where Is It on Your Sustainability Agenda?](#)
- [The Risk Intelligent Approach to Corporate Responsibility and Sustainability.](#)

Please contact [Eric Hespenheide](#) or [Kathryn Pavlovsky](#) in Deloitte’s Enterprise Sustainability group, or [Stephen Engler](#) or [Pat Concessi](#) in Deloitte’s Carbon Management Services practice, if you have questions about the information in this *Heads Up*.

The SEC’s Investor Advisory Committee will consider climate-change disclosures in its role as an advisor to the SEC.

Subscriptions

If you wish to receive *Heads Up* and other accounting publications issued by Deloitte's Accounting Standards and Communications Group, please [register](http://www.deloitte.com/us/subscriptions) at www.deloitte.com/us/subscriptions.

Dbriefs for Financial Executives

We invite you to participate in *Dbriefs*, Deloitte's webcast series that delivers practical strategies you need to stay on top of important issues. Gain access to valuable ideas and critical information from webcasts in the "Financial Executives" series on the following topics:

- Corporate governance.
- FAS 109.
- Private companies.
- Transactions and business events.
- Driving enterprise value.
- Financial reporting.
- Risk intelligence.

Dbriefs also provides a convenient and flexible way to earn CPE credit — right at your desk. [Join *Dbriefs*](#) to receive notifications about future webcasts at www.deloitte.com/us/dbriefs.

Registration is available for this upcoming 60-minute *Dbriefs* webcast:

- [Offense, Defense, Common Sense: Preparing for a New Age of White Collar Investigations and Litigation](#) (February 8).

Use the link above to register. The webcast begins at 2 p.m. (EST).

Technical Library: The Deloitte Accounting Research Tool

Deloitte makes available, on a subscription basis, access to its online library of accounting and financial disclosure literature. Called Technical Library: The Deloitte Accounting Research Tool, the library includes material from the FASB, the EITF, the AICPA, the PCAOB, the IASB, and the SEC, in addition to Deloitte's own accounting and SEC manuals and other interpretive accounting and SEC guidance.

Updated every business day, Technical Library has an intuitive design and navigation system that, together with its powerful search features, enable users to quickly locate information anytime, from any computer. In addition, Technical Library subscribers receive *Technically Speaking*, the weekly publication that highlights recent additions to the library.

For more information, including subscription details and an online demonstration, visit www.deloitte.com/us/techlibrary.

Heads Up is prepared by the National Office Accounting Standards and Communications Group of Deloitte as developments warrant. This publication contains general information only and Deloitte is not, by means of this publication, rendering accounting, business, financial, investment, legal, tax, or other professional advice or services. This publication is not a substitute for such professional advice or services, nor should it be used as a basis for any decision or action that may affect your business. Before making any decision or taking any action that may affect your business, you should consult a qualified professional advisor.

Deloitte shall not be responsible for any loss sustained by any person who relies on this publication.

As used in this document, "Deloitte" means Deloitte LLP and its subsidiaries. Please see www.deloitte.com/us/about for a detailed description of the legal structure of Deloitte LLP and its subsidiaries.

Copyright © 2010 Deloitte Development LLC. All rights reserved.