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Simplifying the California Climate Accountability Package for Businesses

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Key Topics

- Sustainability & ESG – Defined
- ESG Regulatory & Policy Landscape
- Greenhouse Gas Emissions Explained
- Next Steps: What you need to do!

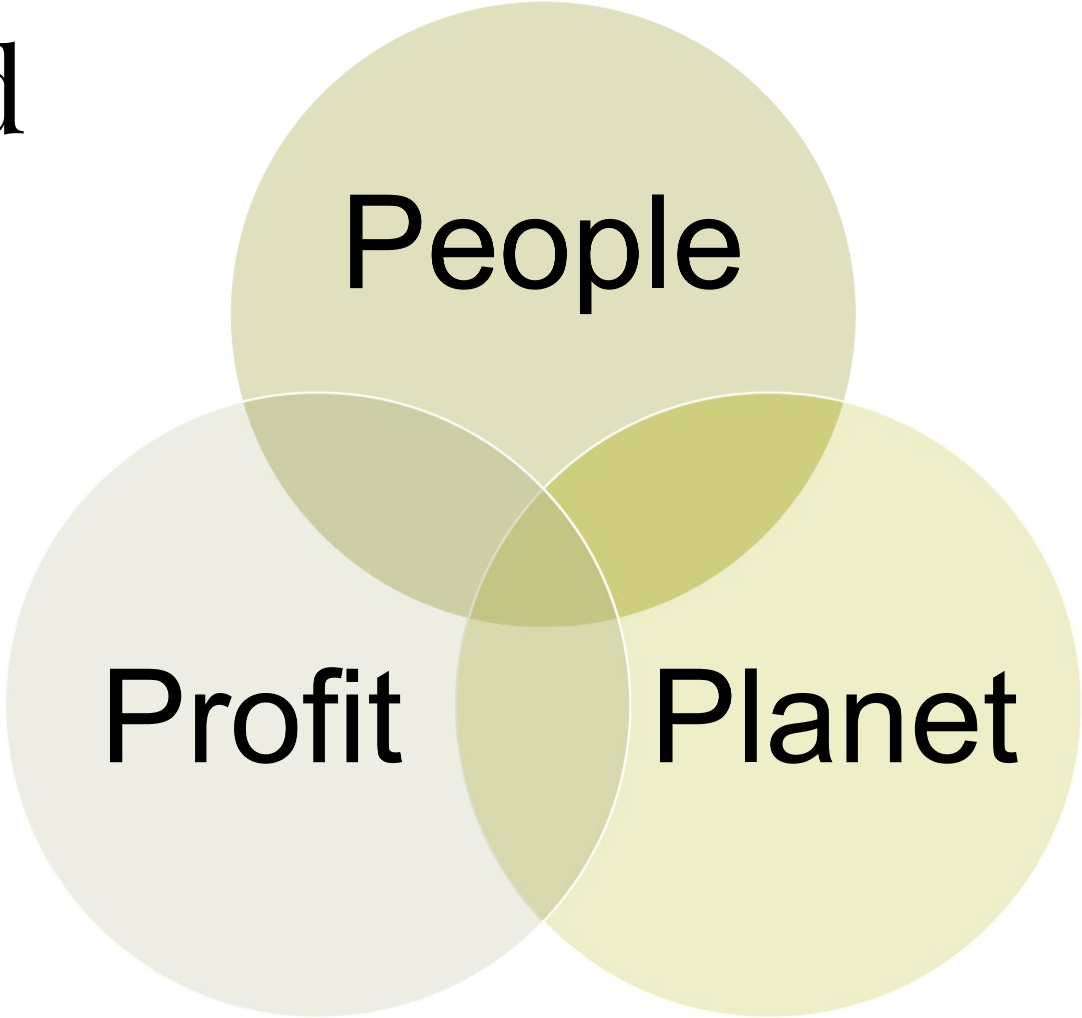
Introduction

Our journey today seeks to build awareness of Environmental, Social, Governance (ESG) issues and help you define the next steps needed to comply with the California Climate Accountability Package for Businesses.

Key Concepts

Sustainability Defined

In 1987, the United Nations Brundtland Commission defined sustainability as *"meeting the needs of the present without compromising the ability of future generations to meet their own needs."*



Key Issues

ESG Defined

Social

- ✓ Employee Health & Safety
- ✓ Diversity, Equity, Inclusion
- ✓ Data Security & Privacy

Human Capital

Natural Capital

Environmental

- ✓ Climate & Emissions
- ✓ Energy Management
- ✓ Waste and Water Management

Focus area for SB253/261

Governance

- ✓ Business Ethics & Regulatory Compliance
- ✓ Supply Chain Management
- ✓ Board Diversity
- ✓ Risk Management

 | Possible (Re)Defined

"Each company's prospects for growth are inextricable from its ability to operate sustainably and serve its full set of stakeholders"

– Larry Fink, CEO, Blackrock

ESG Policy & Regulatory Landscape

Key ESG Policies – Going into 2024

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US SEC: Climate Disclosure Final Rule

SB 253: California Climate Corporate Data Accountability Act

EU: Corporate Sustainability Reporting Directive
European Sustainability Reporting Standards

European Commission | EFRAG

IFRS: International Sustainability Accounting Standards
S1 Disclosure of Sustainability-related Financial Information
S2 Climate-related Disclosures

IFRS

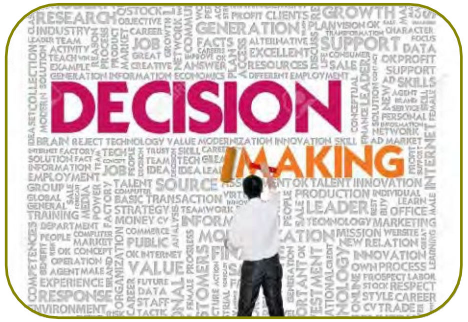
California Climate Corporate Data Accountability Act

The Why!

Climate Change

Risk Management

Transparency



Decision-Making

California

SB 253

Impacts companies with an annual revenue exceeding

$1 billion

estimated to be around

5,400

companies, 73% of which are private. Includes scope 3 emissions, which is expected to impact **10,000-20,000** mid-market companies in the US.

Notable Requirements

- A "reporting entity" is a partnership, corporation, limited liability corporation or other business entity formed in any U.S. state or D.C. that does business in California
- Companies are required to disclose their greenhouse Scope 1 and 2 emissions annually, starting in 2026, and Scope 3 starting 2027 using the GHG protocol
- Additionally, companies are required to publish the biennial climate-related financial risk disclosure publicly on its own website
- Reporting entities are also required to pay an annual fee that will be deposited into a newly created Climate Accountability and Emissions Disclosure Fund

Penalties for Noncompliance

- Noncompliant companies could incur administrative penalties, with fines of up to $500,000 annually

Audit Mandate

- Limited assurance by 2026 on scope 1 and 2, and reasonable + scope 3 limited assurance by 2030

If you are a supplier to large companies: Inclusion of Scope 3 emissions means that companies likely request emissions data from suppliers → Scope 3 emissions are typically 11.4 times that of Scope 1 & 2. For financial institutions, the implications are even more substantial, as Scope 3 includes financed emissions, which can be 700 times higher than Scopes 1 and 2.

California

SB 261

Targets companies with an annual revenue over

500 million

estimated to be around

10,000

companies, excluding insurance companies regulated by the California Department of Insurance.

Notable Requirements

- Covered entities will be required to submit a climate-related financial risk report every two years
- Borrowing from the Task Force on Climate-related Financial Disclosures (TCFD) framework on climate-related financial risk, California's climate-related financial risk reporting will begin in 2026. Both private and public companies will be required to disclose:
    - Measures the organization adopts to reduce and adapt to climate-related financial risk.
    - How the organization will address reporting gaps and complete disclosures if it misses reporting requirements
- Other SB 261 Measures:
    - SB 261 requires the covered entity to publish its biennial climate-related financial risk disclosure publicly on its own website.
    - Insurance companies regulated by the California Department of Insurance are exempt from this required financial risk report because they already have a similar requirement
    - The California climate-related financial risk reporting will allow for some overlap of existing disclosures for companies that provide publicly accessible reports, including climate-related financial risk disclosure information
    - SB 261 also calls for the state to contract with a third-party "climate reporting organization" to produce a public report every two years, reviewing the reported climate-related financial risks and analyzing those facing California

Our California Climate Legislation Business Guide

We can help!

California SB 253 and 261 will require a detailed review of a host of data. The ESG experts at Armanino — the only certified B corporation amongst the nation's top 20 accounting and business consulting firms — can assist with data audits, risk assurance and regulatory compliance as these new laws roll out.

We have subject matter expertise to develop a complete and accurate accounting of greenhouse gas emissions

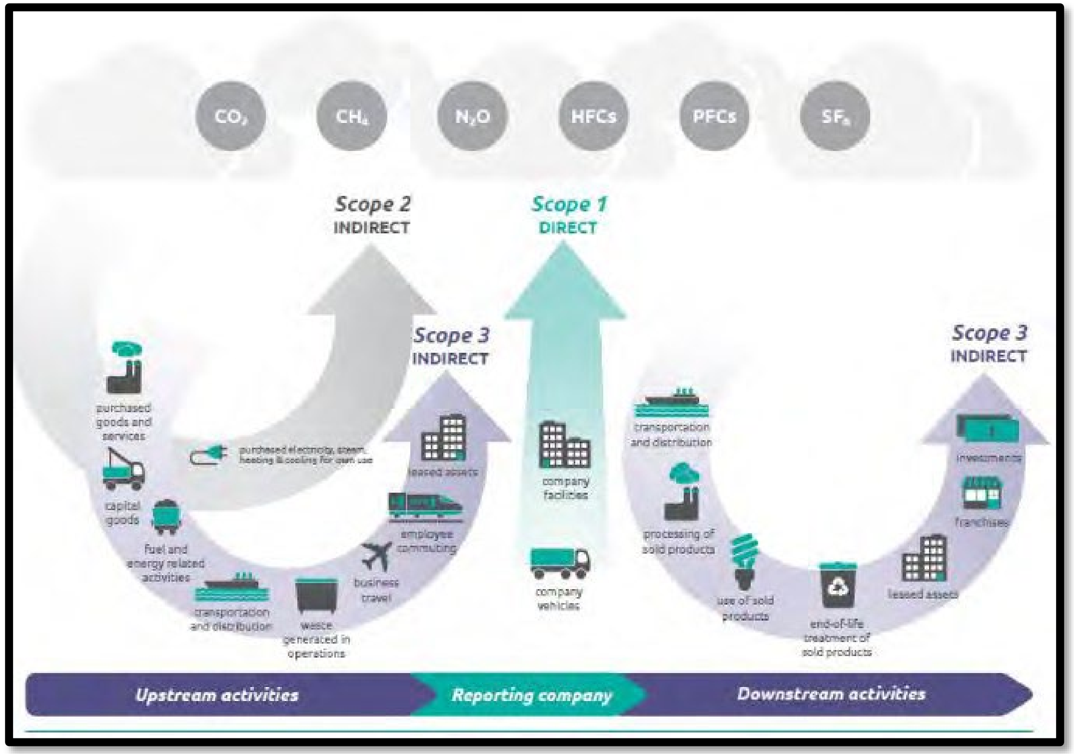
- Support in identifying a software solution to streamline data collection and reporting
- Assist with data verification and risk assurance
- Develop an ESG strategy and roadmap (and integrate with your strategic plan)

Greenhouse Gas (GHG) Emissions Explained

Greenhouse Gas Emissions (GHG)

3 Scopes of the SB253

- **Scope 1 Emissions:** All direct greenhouse gas emissions that stem from sources that a reporting entity owns or directly controls, regardless of location. Reporting is expected to be required starting in **2026**.
- **Scope 2 Emissions:** All indirect greenhouse gas emissions from consumed electricity, steam, heating, or cooling purchased or acquired by a reporting entity. Reporting is expected to be required starting in **2026**.
- **Scope 3 Emissions:** All indirect upstream and downstream greenhouse gas emissions, other than scope 2 emissions, from sources the entity does not own or directly control (e.g., purchased goods, business travel, employee commutes, and processing and use of sold products). Reporting is expected to be required starting in **2027**.



Greenhouse Gas Emissions (GHG)

Scope 1 and Scope 2 Emissions

1. Emissions from the combustion of fossil fuels to produce heat, steam, electricity

Facility Operations

2. Emissions from the fuel consumption by vehicles (owned or leased by the company)

Fleet Operations

3. Leaks of refrigerant gases from HVAC system, chillers, refrigerators.

Refrigerants

4. Emissions from purchased electricity (from local utility)

Purchased Electricity

Direct Emissions (Scope 1): 1–3

Indirect Emissions (Scope 2): 4

GHG Emissions Sources

Value Chain (Scope 3)

Value Chain

8 upstream categories

- **Scope 3 Emissions disclosure based on materiality**

Operations

- Scope 1 and Scope 2 Emissions are mandatory for all climate disclosure standards

Value Chain

7 downstream categories

- **Scope 3 Emissions disclosure based on materiality**

GHG Emissions Accounting

Scope 3 Materiality Test

- Company emissions reductions **goals and targets include Scope 3 Emissions**
- **Science-based Targets (SBTi):** Threshold of 40% of their overall GHG emissions when assessing the materiality of Scope 3 emissions
- **U.S. Securities and Exchange Commissions (SEC)**: *there is a substantial likelihood that a reasonable investor would consider them important when making an investment or voting decision*

GHG Emissions Sources

Upstream Value Chain (Scope 3)

Purchased goods & services
1. Emissions from the production of products and services purchased

Capital goods
2. Emissions from the production of capital goods purchased

Fuel & energy-related activities
3. Emissions related to the production of fuels and energy purchased and consumed

Upstream transportation & distribution
4. Emissions from transportation and distribution of products purchased

Waste generated in operations
5. Emissions from third-party disposal and treatment of waste generated

Business travel
6. Emissions from the transportation of employees for business related activities

Employee commuting
7. Emissions from transportation of employees between their homes and worksites

Upstream leased assets
8. Emissions from the operation of assets that are leased

GHG Emissions Sources

Downstream Value Chain (Scope 3)

Downstream transportation & distribution
9. Emissions from the transport of products sold

Processing of sold products
10. Emissions from the energy use of downstream companies

Use of sold products
11. Emissions related end use of goods and services

End of life of sold products
12. Emissions from waste treatment and disposal of products at end of life

Downstream leased assets
13. Emissions from assets leased to other entities

Franchises
14. Emissions from the operation of franchises

Investments
15. Emissions from investments (equity, debt, project finance)

Next Steps: What you need to do!

1:

Educate Board, Management & Set Up Governance

Skillset
- ✓ Climate-related expertise?
- ✓ Climate-related risk identification process?

Oversight
- ✓ Committee?
- ✓ Reporting?
- ✓ Frameworks?
- ✓ Reporting mechanisms?

Gaps
- ✓ Disclosure gaps?
- ✓ Additional disclosure requirements to consider?

Resources
- ✓ Resources needs (people, processes, technology)?
- ✓ Tools or outside services?

Disclosures
- ✓ What to publicly disclose?
- ✓ Goals to set?

Consider Board and Senior Management specific training – visit our page for more information on how we can help!

@ ESG - Environmental, Social and Governance Consulting | Armanino

2:

Measure GHG Emissions

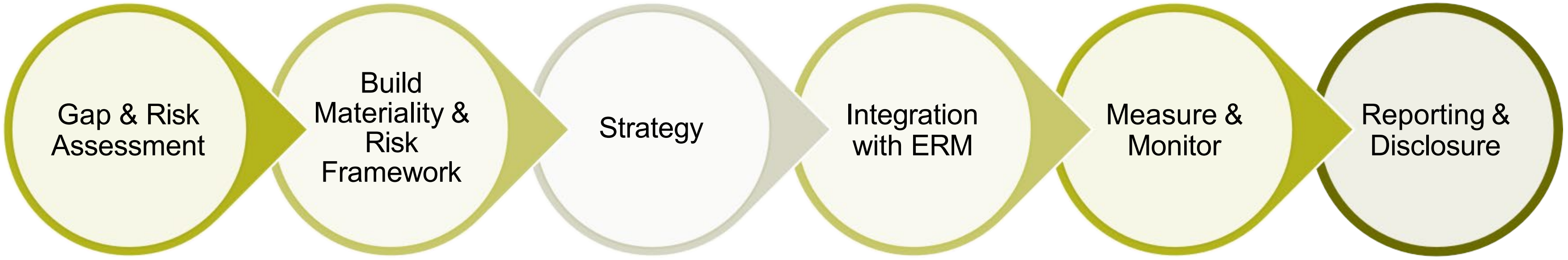
- Reflects the emissions of the company and serves internal and external decision-makers
- Accounts for all sources and activities within set organizational boundary (*justify exclusions*)
- Use consistent methodologies over time
- Establish clear audit trail (*disclose assumptions*)
- Achieve sufficient accuracy to support decisions (*reduce uncertainties*)

Set organizational boundary → Determine relevant emissions categories → Collect data → Calculate emissions → Report emissions

3:

Build a Process to Define Your Climate Related Risks

1. Understand climate change concepts and potential impacts and perform a Gap and Risk Assessment
2. Define "Material" climate related risks and the Risk Framework for identifying, measuring and reporting their impact
3. Develop a clear, comprehensive Strategy for managing climate related risks and the functions responsible
4. Integrate with your existing Enterprise Risk Management process to determine key risk indicators and metrics, building internal controls, and assigning ownership roles and responsibilities
5. Measure and Monitor climate risk indicators metrics as well as the achievement towards goals/targets
6. Develop a process for continuous Reporting and for final Disclosures on relevant information in accordance with TCFD



TCFD Framework

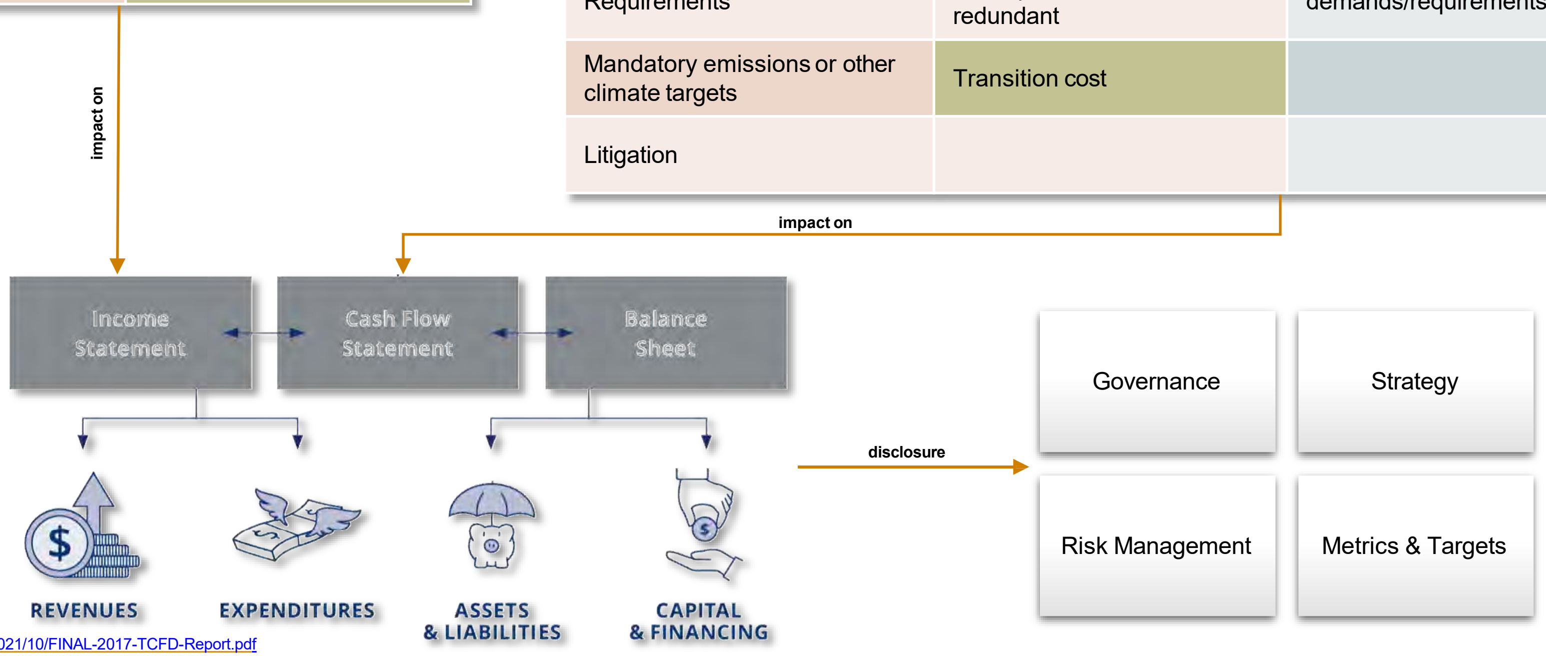
Financial Impact of Climate Related Risks

Physical Risks

Acute	Chronic
Hurricanes, Cyclones, Floods	Rising sea levels
Wildfires	Rising temperatures
Drought	Increased/reduced rainfall

Transition Risks

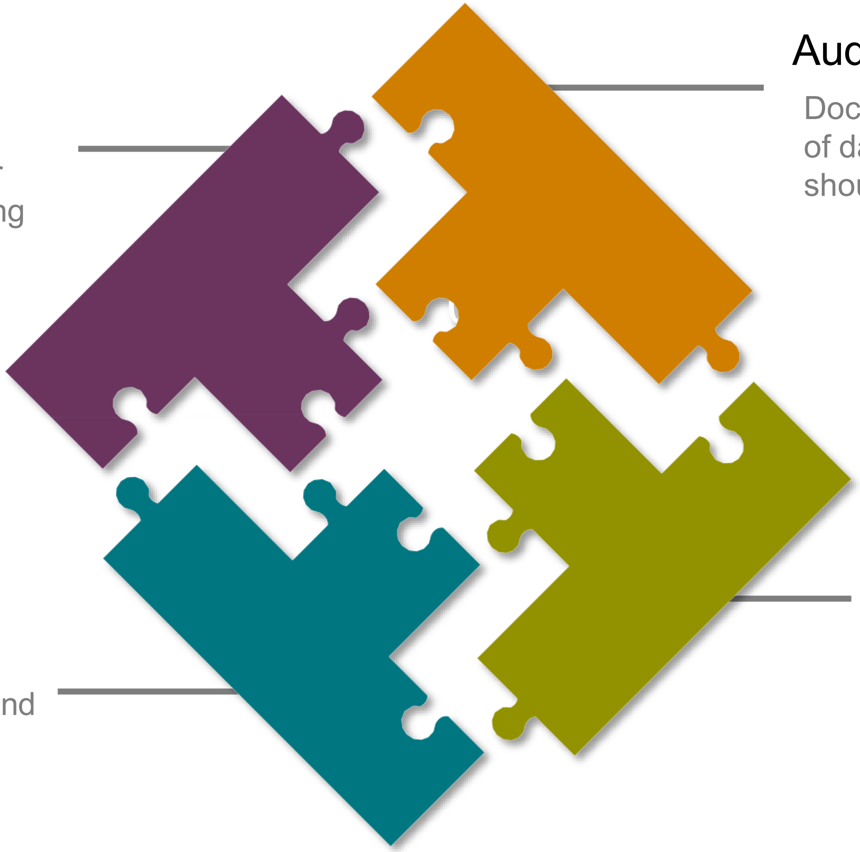
Policy and Legal Risks	Technology	Market	Reputation
Taxing on GHG Emissions	Investment in new technology	Changing customer demands/preferences	Stigma, negative connotation with products/services
Compliance and Reporting Requirements	Technological advancements make products/ services redundant	Changing investor demands/requirements	Stakeholder concerns
Mandatory emissions or other climate targets	Transition cost		24/7 news cycle
Litigation			Shift in consumer preferences



https://assets.bbhub.io/company/sites/60/2021/10/FINAL-2017-TCFD-Report.pdf

Data Needs

Data Requirements



Accurate

Data reported in Sustainability Reports or any other internal, external facing reporting should be based on accurate, factual information

Auditable

Documented procedures for identifying sources of data, including audit trails for data sources should be available

Consistent & Comparable

Data should be provided in a consistent and comparable format

Complete

Data sets should be based on complete periods and complete information

Polling Question

Readiness

What do I need to do today?

- Educate Board and Management on the requirements
- Appoint a climate disclosure leader and form a cross-functional team
- Establish your governance structure

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Possible (Re)Defined™
Delivering impactful, bold solutions that increase clarity
and spark success for today and tomorrow.

Armanino Operates in an Alternative Practice Structure:

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