In the loop

October 2022

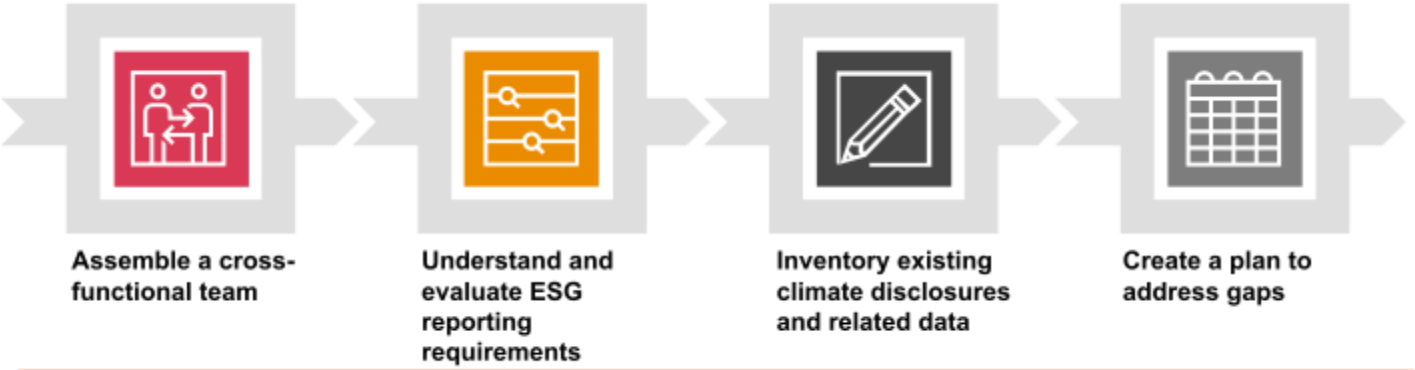
ESG reporting: Preparing for tomorrow's rules today

Regulators and standard setters around the world have proposed new disclosure requirements triggered by investor demand and, in some cases, designed to inspire efforts to combat climate change. The ESG reporting landscape is dominated by the "big three" proposals released this year: in the European Union (EU) as part of the Corporate Sustainability Reporting Directive (CSRD), internationally by the International Sustainability Standards Board (ISSB), and in the United States by the Securities and Exchange Commission (SEC). Nearly all public companies are expected to be subject to one or more of these rules, and some may be impacted by all three. Private companies are also likely to need to report in some form whether to investors with enhanced expectations, companies in their value chain, or perhaps mandatorily in jurisdictions like the EU. With final guidance around the corner, the big question is — what should companies be doing now?

The rules and standards are not yet final and the proposed requirements are expected to evolve as a result of the rule-making and standard setting process. Companies could take the approach of waiting until the uncertain is certain. But given the expected scope of the requirements, and effective dates that could be less than a year from issuance of the final rules and standards, that option is simply not feasible. This publication offers "no regrets" moves to prepare for new climate disclosures. Think of these actions as a head start: many of the steps to successful compliance can be started now to avoid a scramble when the rules and standards are finalized.

The topics in scope and specific requirements of the three proposals differ. The current SEC proposal is more narrowly focused on climate-related risks and opportunities, while the draft EU Sustainability Reporting Standards (ESRS) — which will formalize the reporting requirements of the CSRD — and draft ISSB standards address a broader population of sustainability issues. This publication focuses on the topic of climate common to all three proposals but the concepts it covers are broadly applicable.

No regrets moves



1 Assemble a cross-functional team

Although many companies currently report some ESG information voluntarily, today's sustainability reporting is typically not of the breadth or depth of the big three proposals. The reporting timeline may also be a challenge: instead of releasing a sustainability report six months or more after year end, the new requirements will likely demand more timely reporting — in many cases in line with current financial reporting requirements. In addition, reporting to a regulator brings new management and control certifications and related liability, warranting more formal processes and controls as well as education throughout the organization, including the board. At a minimum, establishing an effective process will necessitate holistic thinking and partnership between the finance and sustainability teams, as well as proactive leadership from the technology organization.

Possible challenges	Action items
• Compliance will require a cross-functional effort (e.g., accounting, disclosure committee, external reporting, enterprise risk management, internal audit, IT, legal) • Reporting timelines may be short and thus challenging • Existing governance strategy and documentation may need to be enhanced to formalize climate risk responsibilities	• Identify key stakeholders and business process owners, and set up a cross-functional working group with clear ownership and objectives • Develop a project plan and timeline • Assess current knowledge and understanding across the organization, and develop a plan to upskill resources • Engage with corporate directors on the plan, including education sessions as needed

2 Understand and evaluate ESG reporting requirements

Understanding and evaluating ESG reporting requirements is a three-part process: (a) assess applicability; (b) understand the detailed requirements; and (c) determine the expected reporting timelines. This evaluation should not be limited to the big three proposals, but instead should include a canvas of requirements in *all* jurisdictions in which the company operates.

Assess applicability

With the right team in place, the next step is to assess the applicability of the different frameworks. All US public companies and foreign private issuers would be in scope of the SEC rules, with specific disclosures and assurance requirements that may differ depending on filing status or circumstances (e.g., smaller reporting companies, as defined, would not be required to provide information about scope 3 greenhouse gas emissions). All companies listed on EU exchanges and non-EU entities with "large" (as defined) EU subsidiaries or operations would be in the scope of the ESRS requirements. And companies will need to monitor which countries adopt the ISSB standards or require other local sustainability disclosures. For example, countries including New Zealand, Switzerland, and the United Kingdom have adopted some form of mandatory disclosures aligned with the Task Force on Climate-related Financial Disclosures (TCFD).

Understand the detailed requirements

While the proposals have many of the same disclosure requirements, they differ in some significant respects. Understanding the *detailed* requirements of the applicable rules will be crucial in ensuring a complete and effective project plan. Although a general understanding of the rules and standards will be sufficient for many within the company, the project team needs to develop expertise on the proposals, including subtle differences if the company will be reporting under more than one framework. For example, the SEC proposal would require companies to disclose climate-related targets and goals if they have them; in contrast, companies subject to reporting in the EU will be required to actually have targets and goals. Digging into the requirements will contribute to both the completeness of the ultimate project plan, as well as the quality of the ultimate reporting. In addition, although the disclosure requirements are still evolving, time invested in understanding the rules now will ensure a rapid response when the final rules come out.

Determine the reporting timelines

The final component in this stage is understanding the expected reporting timelines. Although the proposed SEC rule included an illustrative timeline with compliance required as early as 2023 for large accelerated filers, given that the final rules have not yet been issued, we now expect the earliest compliance to begin in 2024 (although this remains to be seen when the final rules are issued). Similarly, "large" (as defined) companies in the EU with more than 500 employees and securities listed on an EU-regulated market would be required to begin reporting in fiscal year 2024 (filed in 2025). The effective date of ISSB standards would be determined by each jurisdiction that adopts them.

Although 2024 may seem distant, it is only a little over a year away. Careful planning will ensure companies are prepared when compliance is required.

3 Inventory existing climate disclosures and related data

A company's existing climate-related disclosures in regulatory filings, sustainability reports, and other public and internal reporting will be the foundation for enhanced voluntary reporting and the expanded disclosures called for by the proposals. Identifying reliable, repeatable sources of climate data, however, is often one of the primary challenges in cataloging existing information. Potential challenges include questions about the origin of data, inconsistencies in data culled from multiple or disparate sources, and the sufficiency of data to support extensive estimation. These challenges must be resolved to create robust process documentation that identifies relevant controls related to the mapping of data from the source to the final report.

The inventory of existing disclosures should focus on assessing data quality as well as evaluating whether the related processes and controls are sufficiently robust to support investor-grade reporting. During this phase, companies should also consider their future state data governance. Establishing pillars of high quality data — such as criteria for acceptable data sources, the scope of checks and validations, and expectations for processes and controls — early in the process of preparing for mandatory disclosures will allow companies to quickly ramp up once the final requirements are announced. Further, enhancing the quality of data reported now will help prevent changes in the future as a result of the implementation of additional processes and controls.

The goal: establishing a reporting process similar to that for financial reporting that provides high-quality information with repeatable, efficient, and effective processes.

?

A data source inventory should help answer important questions such as:

- *What data is required?*
- *How will the data be used in reporting?*
- *Where is the data maintained?*
- *Is the data reliable? Are additional controls and related processes needed?*
- *Where will the data reside over the long-term?*

4 Create a plan to address gaps

After determining which standards are expected to apply, considering the scope of reporting requirements, and assessing the data quality of current disclosures, companies will need to identify the reporting gaps between current state and future state focused on data, processes, and controls. In some cases, determining the gap may require tentative decisions about how to interpret unclear language or requirements in the proposals. And while the final rules and standards may provide some additional clarity, interpreting the requirements now will provide companies with foundational understanding when the final rules and standards are issued.

Some of the challenges in interpreting the proposals are highlighted in the following table, together with potential actions in response:

	Possible challenges	Action items
Climate risks	• What constitutes "climate-related" risk and opportunity may not be clear • What differentiates a disclosable target from less specific intentions to transition to a lower carbon economy may not be clear	• Establish group-wide definitions of climate- and transition risk-related activities • Evaluate the sufficiency of existing risk management processes that will be used to identify climate-related risks • Review scenario analysis and related processes • Enhance materiality determinations of climate-related risks to specifically address impacts across the short, medium, and long term

GHG emissions	• Existing organizational boundary for GHG may not be the same as the organizational boundary aligned to the financial statements in the SEC proposal and draft EU standards[1]
	• GHG emissions data may be incomplete
	• GHG data may be difficult to compile in time for a regulatory filing
	• GHG data quality and controls may not be sufficient for a regulatory filing
	• Current GHG reporting processes may not capture data from equity method investees or entities in the value chain
	• Significant technology and data governance updates may be needed
		• Inventory all related processes and systems to understand the company's ability to completely and accurately capture GHG emissions information; update infrastructure and technology as needed
		  ○ Begin discussions with equity method investees and entities in the value chain regarding the availability and timing of GHG emissions information
		  ○ Consider where the absence of available data would require estimation approaches (e.g., with entities in the value chain); develop processes to collect available data on a timeline consistent with meeting reporting requirements
		• Consider whether to recast existing climate-related metrics, goals, and targets for the new organizational boundaries (which would enhance consistency)
		• Determine whether scope 3 emissions are material (as this impacts the extent of disclosures under the SEC proposal) and whether they are included in any GHG emissions reduction targets or goals

Financial statement impacts **(for SEC proposed rule)**	• Current financial reporting processes may be insufficient to identify the financial impacts of (1) severe weather events and other natural conditions or (2) climate-related transition activities • Financial reporting business processes, systems, and controls may not be sufficient to meet the design and operating effectiveness benchmarks for internal control over financial reporting • Significant technology and data governance updates may be needed	• Identify financial statement line items most likely to be impacted by severe weather events and other natural conditions or transition activities • Inventory related processes and systems to understand the company's ability to completely and accurately capture the relevant data; update infrastructure and technology as needed • Consider creating a separate chart of accounts or cost centers to track and maintain costs associated with climate-related events • Consider how estimation approaches can be used when data is unavailable • Consider how the design of internal control over financial reporting and related process documentation may need to be updated

[1] The ISSB proposal includes an election to determine the organizational boundary using either a control (financial or operational) or equity share approach, consistent with the Greenhouse Gas Protocol. When possible, however, we believe that reporting of GHG emissions should be aligned with the accompanying financial statements.

What's next

When finalized, the big three ESG proposals will become the foundation of a new reporting ecosystem that supports the decision making of investors and other stakeholders. This new ecosystem is expected to come to fruition in a fraction of the time of its counterpart — the financial reporting ecosystem — which began decades ago and is still being enhanced. Given rapidly evolving expectations, a company that waits for final rules to be issued risks scrambling to meet the compliance timelines, potentially risking the quality of disclosures and missing an opportunity to best share the company's story. Although some aspects of the proposed rules are still evolving, their general expectations and direction have been established. While there is much we do not yet know, there is much that we do; companies would be wise to utilize the draft rules to prepare for final rules today.

Where to find more resources

Publications	Podcasts
The SEC wants me to disclose what?	Audio: The SEC wants me to disclose what?
Navigating the ESG landscape	Audio: Navigating the ESG landscape
What's CSRD? It's important to know	Audio: What's CSRD? It's important to know
ISSB proposes two sustainability standards	Beyond the SEC, global bodies are moving fast on ESG
ESG materiality: Gulf or gap?	Talking ESG: The data quality imperative

To have a deeper discussion, contact your local PwC ESG specialist or:

International clients

Scott Bandura
Partner
scott.bandura@pwc.com

Peter Flick
Partner
peter.flick@pwc.com

Andreas Ohl
Partner
andreas.ohl@pwc.com

US clients

Heather Horn
Partner
heather.horn@pwc.com

Kevin O'Connell
Partner
kevin.w.oconnell@pwc.com

Valerie Wieman
Partner
valerie.wieman@pwc.com