In the loop

National Office

# Navigating the ESG landscape

## Comparison of the “big three” sustainability frameworks

Updated November 2023

We responded to capital market and G20 demand for a common language of investor focused sustainability-related disclosure, working diligently to deliver standards that fulfil the global baseline.

ISSB Chair Emmanuel Faber
February 17, 2023

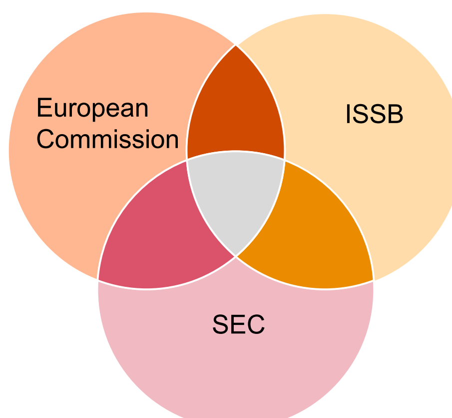
*In the loop* was updated as of October 9, 2023 and October 31, 2023 to highlight current developments related to climate disclosure bills signed into law in California and the end of the scrutiny period for the European Sustainability Reporting Standards.

After years of increasingly vocal demand for enhanced transparency about ESG matters from investors and other stakeholders, regulators and standard setters in various jurisdictions issued definitive proposals to transform ESG reporting in 2022. The year brought proposed ESG disclosures from 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 (US) by the Securities and Exchange Commission (SEC). These “big three” disclosure frameworks each detail expansive sustainability disclosure requirements — although their scopes and other details vary.

The sustainability disclosures required by the ISSB and in the EU were finalized in June and July 2023, respectively. And while the final SEC rule is still pending, three bills signed into law by the California Governor in October 2023 are poised to change the landscape of climate reporting in the US.

Given the geographic reach of these frameworks and their potential to encompass a broad spectrum of value chain contributors, most companies are expected to be impacted in some way. Proactive companies are in the process of assessing the applicability so that they are prepared to meet potentially short reporting deadlines.

An SEC registrant that has a subsidiary listed in the EU, and a subsidiary in a jurisdiction that requires ISSB™ reporting, for example, may be subject to all three requirements, plus the new California bills.




With equivalency — that is, whether disclosures for one reporting framework can satisfy some or all of the requirements of another — not yet determined, companies captured in multiple reporting regimes have a vested interest in understanding which reporting applies.

Further, understanding where the frameworks align and diverge will help companies develop the requisite reporting strategy, data gathering processes, and related controls, providing for a streamlined process and effective deployment of resources.

This publication compares and contrasts key provisions among the European Sustainability Reporting Standards (ESRS), the standards issued by the ISSB, and the SEC proposal, and includes select commentary on the California climate disclosure bills. By understanding the different requirements, preparers can develop the appropriate reporting strategy, one designed to capture the right data the first time.

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## Background

Each of the frameworks recognizes that enhanced sustainability disclosures are good for the capital markets. The transparency and accountability engendered by the new disclosures may — and in the case of the CSRD are intended to — influence behavior, and so may be good for the planet, too.

> The standards we have adopted today are ambitious and are an important tool underpinning the EU's sustainable finance agenda. They strike the right balance between limiting the burden on reporting companies while at the same time enabling companies to show the efforts they are making to meet the Green Deal Agenda, and accordingly have access to sustainable finance.
>
> Mairead McGuinness
> Commissioner for Financial Services, Financial Stability and Capital Markets Union
> July 31, 2023

### EU regulations and disclosure framework

The European Commission (EC), the European Parliament, and the Council of the European Union have made strides to ensure that sustainability regulations under the Corporate Sustainability Reporting Directive will be a reality. The CSRD was driven, in part, by the European Green Deal, a December 2019 European Commission package of policy initiatives designed to achieve climate neutrality by 2050 and protect Europe's natural habitat.

Although the EU's current Non-Financial Reporting Directive (NFRD) has imposed some requirements to disclose environmental and social impacts since 2017, the CSRD will result in more companies being included in scope and more detailed requirements. The CSRD was adopted by the European Parliament and the Council of the European Union in November 2022. The CSRD was effective on January 5, 2023; EU Member States now have 18 months to incorporate the CSRD's provisions into national law.

The scope of the CSRD includes EU subsidiaries of non-EU parent companies, including US companies and other global multinational companies. For these companies, the CSRD may require reporting at the global consolidated level in addition to reporting by EU subsidiaries. It applies to all companies listed on EU-regulated markets and to "large" — as defined in the directive — unlisted companies or groups in the EU. In addition, for companies potentially subject to more than one disclosure regime, CSRD provides more specific disclosure requirements than the SEC proposal or the standards issued by the ISSB.

The CSRD resulted in the development of the ESRS, as initially proposed by the European Financial Reporting Advisory Group (EFRAG). In November 2022, EFRAG submitted the first set of draft standards to the European Commission for review. The European Commission subsequently consulted with EU regulatory authorities, expert groups, and EU Member States, and, on June 9, 2023, released updated draft standards for an additional four-week public feedback period. The European Commission adopted the final standards on July 31, 2023. A two-month period of scrutiny from the European Parliament and Council of the European Union ended on October 21, 2023 and the ESRS are now final. The ESRS are not subject to separate transposition into law by the EU Member States; they will become law once published in the Official Journal of the European Union.

Following submission of the ESRS to the European Commission in 2022, EFRAG announced its planned focus on sector standards, including ten sector standards in development (e.g., agriculture, coal mining, food/beverages).[1] In March 2023, however, EFRAG indicated that it intends to focus its efforts on putting in place an "ESRS implementation support function," following a request from the European Commission to prioritize implementation support over development of sector standards. In meetings in August, September, and October 2023, EFRAG discussed its draft implementation guidance related to the value chain and materiality assessments, which will be issued in November 2023 for public feedback before being finalized.[2] In October 2023, the European Commission published a proposal to delay

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[1] EFRAG delivers the first set of draft ESRS to the European Commission.
[2] EFRAG update, August 2023, page 10. EFRAG update, September 2023, page 13. EFRAG Sustainability Reporting Board Meeting, October 25, 2023.

the adoption of the sector standards, as well as the dedicated standards for non-EU companies.[3]

Refer to our publications, *Worldwide impact of CSRD — are you ready?*, *Take the next step - decide how to report under CSRD*, and *Final European Sustainability Reporting Standards have been adopted*, for more information about the CSRD and the ESRS.

> The ISSB Standards have been designed to help companies tell their sustainability story in a robust, comparable and verifiable manner. We have consulted closely with the market to ensure the Standards are proportionate and will result in disclosures that are relevant for investment decision-making.
>
> ISSB Chair Emmanuel Faber
> June 26, 2023

### IFRS Sustainability Disclosure Standards

The ISSB sits alongside the International Accounting Standards Board (IASB), with both boards overseen by the IFRS Foundation. The formation of the ISSB was announced at COP26 — the United Nations global summit to address climate change — in November 2021. The IFRS Foundation trustees acknowledged the importance of collaborating with organizations that have already developed sustainability reporting standards and building upon that foundation. The most recent development is the July 2023 announcement that the IFRS Foundation will take over monitoring climate-related disclosure for progress against the recommendations of the Task Force on Climate-Related Disclosures (TCFD) beginning in 2024.[4]

Similar to the IASB's effectuation of standard setting through the issuance of IFRS Accounting Standards, the ISSB's objective in issuing IFRS Sustainability Disclosure Standards is delivering a global baseline of sustainability disclosures that satisfy capital market needs.

The ISSB published its first two final standards in June 2023: one on climate-related disclosure requirements (IFRS S2) and one on general disclosure requirements addressing governance and other sustainability matters (IFRS S1). More thematic standards will be developed in due course. The results of the ISSB agenda consultation completed on September 1, 2023 may provide further insight into which topics the ISSB intends to tackle next. The agenda consultation focused on four potential priorities: research projects on sustainability-related risks and opportunities associated with biodiversity, ecosystems, and ecosystem services; human capital; and human rights, as well as a potential research project on the integration of financial reporting and sustainability reporting.[5] We may see discussion of themes from the comment letters at upcoming board meetings in November 2023.

In the meantime, IFRS S1 requires companies to "refer to and consider" the applicability of the disclosure topics and related metrics in the industry-based standards issued by the Sustainability Accounting Standards Board (SASB). Other sources, such as the Climate Disclosure Standards Board Framework, pronouncements from other standard setting bodies, and the ESRS and Global Reporting Initiative (GRI) standards may also be considered.

IFRS S1 and IFRS S2 are effective for periods beginning on or after January 1, 2024, which could mean reporting as early as 2025. The ISSB provided transition relief, however, requiring only climate-related disclosures in the first year of reporting. Thus, companies would be required to provide disclosures in accordance with IFRS S2, as

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[3] European Commission: Proposal for a Decision of the European Parliament and of the Council amending Directive 2013/34/EU as regards to the time limits for the adoption of sustainability reporting standards for certain sectors and for certain third-country undertaking.European Commission: Opening remarks by Commissioner McGuinness at the European Parliament's Committee on Legal Affairs, September 7, 2023

[4] IFRS Foundation welcomes culmination of TCFD work and transfer of TCFD monitoring responsibilities to ISSB from 2024

[5] IFRS Foundation, ISSB Consultation on Agenda Priorities

well as the general disclosures under IFRS S1, only to the extent they relate to climate risks and opportunities.[6]

Individual jurisdictions will determine if application of the IFRS Sustainability Disclosure Standards are required or permitted as a basis for sustainability reporting, akin to the process for adopting IFRS Accounting Standards for financial reporting. In July 2023, the International Organization of Securities Commissions (IOSCO) announced its endorsement of the standards, and has now called on its 130 member jurisdictions, regulating more than 95% of the world's financial markets, to consider ways in which they might adopt, apply, or otherwise be informed by the ISSB standards in their jurisdictions.[7] Most recently, in October 2023, the Brazilian Ministry of Finance and the Comissão de Valores Mobiliários (CVM) announced that the standards will be incorporated into the Brazilian regulatory framework, progressing from voluntary application in 2024 to mandatory application in 2026.[8] Brazil joins Nigeria, which previously announced adoption of the ISSB standards. Other territories, including the United Kingdom and Japan, announced support for the standards to form the baseline in the development of their own local standards. We expect announcements around the world to accelerate with the release of the final standards.

Refer to our In depths, *IFRS Sustainability Disclosure Standards – Guidance, insights and where to begin*, and *Navigating sustainability reporting: Practical application and analysis*, as well as our podcast, *Talking ESG: Inside look at the ISSB's launch of final standards*, for more information.

> Today's proposal would help issuers more efficiently and effectively disclose [climate] risks and meet investor demand, as many issuers already seek to do... I believe the SEC has a role to play when there's this level of demand for consistent and comparable information that may affect financial performance.
>
> SEC Chair Gary Gensler
> March 21, 2022

## SEC proposal

In a 2010 interpretive release, the SEC outlined how its existing disclosure requirements apply to climate change matters. The release addressed how the rules governing the Management's Discussion and Analysis and Risk factors sections in a registrant's Form 10-K, for example, could reasonably be expected to include references to material exposures or impacts of climate change. At the time, the SEC noted that "climate change has become a topic of intense public discussion in recent years."

That intensity has continued to increase exponentially. The enforcement of existing rules was only going to move the disclosure needle so far. In March 2021, the SEC reiterated the importance of the 2010 interpretive guidance and in a public statement, then Acting SEC Chair Allison Lee issued a request for input on the need for climate-related disclosures. After evaluating the admittedly mixed responses to the request for input — with strong opinions in both support and opposition — the SEC issued a proposal in March 2022 that would significantly enhance climate-related disclosures in annual filings and registration statements.

The SEC's proposal focuses specifically on how climate risks are identified, assessed, managed, and disclosed; the financial impact of severe weather and other natural events as well as transition activities; and greenhouse gas (GHG) emissions. A final rule was initially expected in late 2022, but is now expected sometime in 2023, as is a proposal for enhanced human capital disclosures.

Refer to our publication, *The SEC wants me to disclose what?*, for more information on the SEC climate disclosure proposal.

[6] IFRS Foundation, IFRS S1 *General Requirements for Disclosure of Sustainability-related Financial Information*, paragraph E5, page 44.
[7] International Organization of Securities Commissions, IOSCO endorses the ISSB's Sustainability-related Financial Disclosures Standards.
[8] IFRS Foundation, Brazil adopts ISSB global baseline, as IFRS Foundation Trustees meet in Latin America.

### California climate disclosure bills

On October 7, 2023, the California Governor signed into law landmark climate legislation that will require (1) GHG emissions reporting in compliance with the Greenhouse Gas Protocol (GHG Protocol), (2) climate-related financial risk reporting in line with the recommendations of the TCFD, and (3) information about certain emissions claims and the sale and use of carbon offsets.[9] Over 10,000 US companies — including both public and private companies as well as subsidiaries of non-US headquartered companies — are expected to be impacted by the climate disclosure requirements in the near term.

| | AB 1305 — Voluntary carbon market disclosures | SB 253 — Climate Corporate Data Accountability Act | SB 261 — Greenhouse gases: climate-related financial risk |
|---|---|---|---|
| **Primary disclosure topic** | (1) Emissions claims, (2) use of carbon offsets, and (3) sale of carbon offsets | Scope 1, scope 2, and scope 3 greenhouse gas emissions | (1) Climate-related financial risks and (2) the measures a company has adopted to reduce and adapt to such risks |
| **Framework** | Not applicable | GHG Protocol | TCFD |
| **Scope** | Entities that (1) operate and make emissions claims within California, (2) buy or sell carbon offsets in California | Business entities* with annual revenue over $1 billion that do business in California | Business entities* with annual revenue over $500 million that do business in California |
| **Where filed** | Publicly available on company's website | Publicly available digital platform | Publicly available on company's website |
| **Assurance** | No, although certain disclosures are required about any independent third-party verification obtained | Yes, phased requirements beginning with limited assurance | No |
| **Compliance date** | January 1, 2024, with information updated at least annually | Annual reporting of scope 1 and scope 2 in 2026 (on prior fiscal year information); scope 3 starting in 2027 | On or before January 1, 2026 and biennially thereafter |

* A partnership, corporation, limited liability company, or other business entity formed under the laws of California, the laws of any other state of the United States or the District of Columbia, or under an act of the Congress of the United States.

The bills are brief — only a few pages each — and lack answers to some questions regarding how and when to apply the requirements. Further, the governor's approvals of SB 253 and SB 261 were accompanied by signing messages indicating that he plans to work with the California Legislature next year to address certain concerns including the implementation deadlines.[10] Given that the bills would apply as soon as January 1, 2024, however, we recommend that companies evaluate applicability and reporting requirements based on what is known now.

Refer to our publication, *California's not waiting for the SEC's climate disclosure rules*, for more information on the bills.

[9] Senate Bill (SB) 253, Climate Corporate Data Accountability Act, SB 261, Greenhouse gases: climate-related financial risk, and Assembly Bill (AB) 1305, Voluntary carbon market disclosures.

[10] California Governor Gavin Newsom October 7, 2023 signing messages on SB 253 and SB 261

## General features of the proposals

One of the foundational points of alignment among the three frameworks is the incorporation of elements based on the Task Force on Climate-related Financial Disclosures framework. Leveraging this popular framework provides a point of continuity with voluntary reporting and unites the disclosure frameworks through key themes, including required disclosure of the broad impacts of sustainability-related risks as well as governance and oversight of the related risks and opportunities. California SB 261 also requires reporting using the TCFD framework. Connectivity between sustainability information and financial information also echoes throughout the frameworks.

| Theme | European Commission | ISSB | SEC |
|---|---|---|---|
| **Topics in scope** | Standards span a broad list of environmental, social, and governance topics, including one dedicated to climate disclosures | Standards address climate and other sustainability risks<br><br>Additional thematic standards are expected in the future | Proposed rule addresses climate-related risks<br><br>A rule addressing human capital is expected in the future |
| **Industry standards** | Ten sector-specific standards have been announced and are in development | A company is required to "refer to and consider" the applicability of the disclosure topics in the SASB standards[11] | Industry-specific disclosures are not required |
| **Location of disclosures** | Disclosure would be included within a dedicated section of the management report<br><br>No financial statement footnote disclosure would be required | Disclosure would be included as part of general purpose financial reporting — such as in management commentary<br><br>No financial statement footnote disclosure would currently be required | Disclosure would be included in a separate section of the annual report or registration statement<br><br>A financial statement footnote would include disclosure of the impact of severe weather and transition-related activities |

### Observations

One striking difference among the frameworks is the breadth of topics in scope, although there may be further alignment in the future if the SEC and ISSB issue further guidance as expected. Industry standards are another point of potential future alignment. Industry is already an explicit focus of the IFRS Sustainability Disclosure Standards; IFRS S1 requires a company to consider the applicability of the SASB standards when identifying sustainability-related risks and opportunities. And, although proposed to be delayed from 2024 to 2026, ESRS will also include sector standards.[12]

Another key difference among the frameworks is the SEC's requirement to include specified disclosures in the notes to the financial statements, a proposal which sparked strong stakeholder feedback on both sides of the debate. We support standardized climate-related disclosures in the footnotes to the financial statements because we believe this information would aid investors in better understanding the impact of climate risks on the financial statements (although as discussed in the "Materiality" section, we do not agree with the SEC's proposed 1% disclosure threshold).

The final ESRS and ISSB standards refer to the importance of interconnectedness between sustainability disclosures and general purpose financial reporting. The IASB and FASB have each released guidance emphasizing the current accounting standards that could reasonably be expected to elicit disclosures about the impact of climate events and risks.[13] In addition, in March 2023, the IASB decided to undertake a project to evaluate stakeholder concerns about disclosures of climate-related risks in the financial statements.[14]

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[11] IFRS Foundation, IFRS S1 *General Requirements for Disclosure of Sustainability-related Financial Information*, para 55, page 17.
[12] European Commission: Opening remarks by Commissioner McGuinness at the European Parliament's Committee on Legal Affairs, September 7, 2023
[13] IFRS Foundation, Effects of climate-related matters on financial statements; FASB Staff Educational Paper: Intersection of Environmental, Social, and Governance Matters with Financial Accounting Standards
[14] IASB Chair Dr Andreas Barckow, Connectivity in practice: the IASB's new project on Climate-related Risks in the Financial Statements

## Materiality

As in traditional financial reporting, sustainability disclosures will be driven, in large part, by an assessment of what's material. The approach to materiality, however, is one of the key differences among the three disclosure frameworks. The IFRS Sustainability Disclosure Standards consider the impact of sustainability on the company through an investor lens, requiring information about how it could impact financial performance. The SEC proposal also applies an investor lens; in contrast, however, CSRD widens the definition of materiality to also require a company to consider how it has impacted, or will impact, people or the environment (including impacts in relation to environmental, social, and governance matters).

| Theme | European Commission | ISSB | SEC |
|---|---|---|---|
| **Materiality** | Materiality would be assessed based on "double materiality," consisting of "financial materiality" (an outside in perspective) and "impact materiality" (an inside out perspective) | Materiality would be assessed based on factors that could reasonably be expected to influence decisions that the primary users make based on that information | Materiality would be assessed based on the definition of materiality in existing securities laws / Supreme Court precedent<br><br>A 1% bright-line threshold would be applied for financial statement footnote quantitative disclosures |
| **Time horizons for specific disclosures** | Time horizons of short, medium, and long term are prescribed, although the entity may adapt the periods; the definition of long term in the climate standard may be applied differently | Time horizons for disclosure of risks and opportunities over the short, medium, and long term are not defined | Time horizons for disclosure of risks and opportunities over the short, medium, and long term are not defined |

### Observations

Each of the frameworks requires companies to consider risks that may occur over the short, medium, and long term, which requires an assessment of materiality over these time periods. Today, materiality is typically considered in the context of a company's current financial condition and may not explicitly consider future periods, especially periods that extend as far into the future as many potential climate-related impacts. We believe additional guidance in this area — such as specifying that time horizons should be limited to those periods when the impact on future cash flows could have a material effect on investors, or in the case of double materiality, a material effect on stakeholders — would be helpful to ensure consistency and comparability.

We also believe that investor-focused materiality will assist in achieving comparability of reporting. While the SEC and ISSB have leveraged the definition of materiality used in today's financial reporting, there may be uncertainty as to how traditional concepts of materiality would translate to climate and GHG emissions reporting. In addition, there are questions about whether the application of the different definitions of materiality will actually result in significant differences, particularly as practice evolves. Recent developments may also impact application; the final ESRS specify that "a sustainability matter is material from a financial perspective if it triggers or could reasonably be expected to trigger material financial effects."[15] The ESRS also require additional disclosures if the company concludes that climate change is not material, including forward-looking analysis of the factors that could lead to climate change becoming material to the company in the future.

*SEC "bright-line" threshold*

In our view — which is shared by numerous other commenters — the SEC's current proposed financial statement footnote disclosure threshold of 1% would not provide the type of meaningful information that investors are demanding and would be difficult for registrants to implement. Applying the traditional concepts of materiality would result in more cohesive disclosures and greater focus on the information that would be important to investors.

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[15] EC, Delegated Regulation, July 2023, Annex I, *European Sustainability Reporting Standards*, ESRS 1, *General Requirements*, paragraph 49, page 8.

## Targets, transition plans, and resilience

The frameworks all include required disclosure of a company's targets or goals, how it intends to meet its targets and goals, and related progress toward applicable milestones. A key difference, however, is the CSRD requirement for companies to set emission target values as of prescribed dates and for transition plans aimed at "the limiting of global warming to 1.5°C," with an intent to drive behavioral change.[16] The ISSB standards and SEC proposal do not prescribe specific targets or dates, instead requiring disclosure of any targets set by the company. California SB 261 also requires additional disclosures related to the measures a company has adopted to reduce and adapt to the disclosed climate-related financial risks. And, although the bill includes transition provisions for companies unable to fully comply with TCFD reporting in the first year, there is no similar relief given for this requirement.

| Theme | European Commission | ISSB | SEC |
|---|---|---|---|
| **Targets and transition plans** | Commitment to and disclosure of GHG emissions reduction targets would be required in five-year rolling periods, including target values for at least 2030 and, if available, 2050<br><br>Disclosure about the transition plan's compatibility with the Paris Agreement (or updated international agreement on climate change) would also be required | Disclosure would be required of any climate-related targets set by the company, including how such targets were informed by the "latest international agreement on climate change" (currently the Paris Agreement)<br><br>Such targets or goals would include those set in response to regulatory requirements or climate-related treaty or law | Disclosure would be required of any climate-related targets or goals set by the company<br><br>Such targets or goals would include those set in response to regulatory requirements or climate-related treaty or law |
| **Use of scenario analysis** | The use of scenario analysis would be required to assess resilience<br><br>Explanation is required of whether and how scenario analysis is consistent with the Paris Agreement and limiting climate change to 1.5°C | The use of scenario analysis would be required to assess resilience<br><br>Disclosure of whether the company used a scenario that aligns with the "latest international agreement on climate change" would be required | Any means could be used to assess resilience<br><br>Additional disclosures would be required if scenario analysis is used<br><br>The proposal does not require consideration of specific scenarios |

### Observations

The disclosure of targets or goals is an important element of the disclosure requirements. These disclosures provide a degree of accountability, both with regard to behavioral changes and also to help alleviate greenwashing. The flexibility afforded by the ISSB and SEC regarding scenario analysis allows management to choose the variables most impactful to its business, or alternatively, choose widely accepted scenarios, such as those detailed in the Paris Agreement. The fundamental ambition of the Paris Agreement is to limit global warming to well-below 2°C above pre-industrial levels by the end of this century, and to pursue efforts to limit global warming even further to 1.5°C.

Instead of choosing company-specific scenarios, some argue that adopting targets, models, and calculation methods that are universally applied will enhance comparability, consistency, and reliability of the reported disclosures. For example, the ESRS definition of "net zero" is consistent with the Science Based Targets initiative (SBTi). The SBTi also provides criteria and guidelines to companies in line with the latest climate science as a pathway towards meeting the goals of the Paris Agreement.

[16] Proposal for a Directive of the European Parliament and of the Council, amending Directive 2013/34/EU, Directive 2004/109/EC, Directive 2006/43/EC and Regulation (EU) No 537/2014, as regards to corporate sustainability reporting, pages 49 and 50.

## GHG emissions — general

All three frameworks, and California SB 253, would require GHG emissions disclosures and reference the Greenhouse Gas Protocol, although use of the GHG Protocol is not required by the SEC, and the ISSB allows for other methods to be used only if required by an exchange or jurisdictional authority. One notable difference among the frameworks is with respect to the required organizational boundary (i.e., the scope of entities included in the GHG disclosures). The SEC proposal would require alignment with the financial statements, whereas the ISSB Sustainability Disclosure Standards and the California climate disclosure bills provide the flexibility allowed by the GHG Protocol. The ESRS require the parent to use organizational boundaries consistent with the financial statements, but presentation of GHG emissions for associates, joint ventures, and other unconsolidated arrangements would depend on whether the company has operational control. SB 253 is the only one of the frameworks that mandates full compliance with the GHG Protocol.

| Theme | European Commission | ISSB | SEC |
|---|---|---|---|
| **GHG Protocol** | Consideration of the GHG Protocol is required<br><br>The environmental footprint methods proposed by the EC or the framework for GHG accounting stipulated in International Organization for Standardization (ISO) 14064 may also be considered[17] | Use of the GHG Protocol would be required, unless a different method is required by a jurisdictional authority or exchange | Use of the GHG Protocol would not be required, although the proposed requirements are based on its concepts |
| **GHG emissions organiza-tional boundaries** | Emissions of the parent and consolidated subsidiaries would follow the organizational boundaries of the consolidated financial statements<br><br>Emissions of associates, joint ventures, and other unconsolidated arrangements would be presented based on operational control | Emissions would be reported using either a control or equity share approach (consistent with optionality described in the GHG Protocol) | Emissions would be reported following the organizational boundaries of the consolidated financial statements |

### Observations

We support the use of a set of globally accepted standards for the measurement of greenhouse gases to provide enhanced comparability and usefulness of company-specific data. We recommend that ESG standard setters and regulators work together to ensure that key elements that support high quality standards are more formally incorporated into the maintenance and ongoing development of the GHG Protocol, such as establishing formal due process, amending for the impact of current accounting standards, and implementing a continuous update process. To this end, in March 2022, the World Resource Institute announced its intention to assess the need for incremental guidance, a key focus of which would be alignment with accounting rules.[18] For example, the GHG Protocol predates changes to lease and consolidation accounting. And, on November 23, 2022, the GHG Protocol launched four surveys on potential updates to its corporate standards and guidance. Comments were due March 14, 2023.[19]

[17] EC, Delegated Regulation, Annex I, ESRS E1, *Climate Change*, paragraph AR 39, page 90.
[18] GHG Protocol to assess the need for additional guidance building on existing corporate standards
[19] Greenhouse Gas Protocol opens surveys on standards and guidance

## GHG emissions — scope 1 and scope 2 disclosures

All three disclosure frameworks, and California SB 253, include requirements to disclose scope 1 and scope 2 GHG emissions in carbon dioxide equivalent ($CO_2e$) tons; the ESRS and SEC proposal also require presentation of one or more intensity metrics (a ratio of emissions to specific financial statement measures), excluding the impact of purchased or generated offsets. The disclosures also include the same seven gases — which are consistent with those included in most major reduction schemes — although only the SEC proposal would require disclosure of scope 1 and scope 2 emissions by each type of gas on a disaggregated basis. Unlike the other frameworks, California SB 253 requires full compliance with the GHG Protocol, including reporting of both location-based and market-based scope 2 information.

| Theme | European Commission | ISSB | SEC |
|---|---|---|---|
| **Scope 1 and scope 2 GHG emissions** | Disclosure of gross scope 1 and scope 2 emissions for the parent and consolidated subsidiaries as well as entities over which it has operational control<br><br>The percentage of scope 1 emissions under regulated emission trading schemes would be separately disclosed<br><br>Scope 2 emissions would be separately disclosed using both the location-based and market-based methods<br><br>No requirement to disaggregate emissions by type of GHG | Disclosure of gross scope 1 and scope 2 GHG emissions for the consolidated group and separately for the investees excluded from consolidation, such as its associates and joint ventures<br><br>Scope 2 emissions would be disclosed using the location-based method<br><br>No requirement to disaggregate emissions by type of GHG | Proposed disclosure of gross scope 1 and scope 2 GHG emissions for the consolidated group, including equity method investments<br><br>Scope 2 emissions would be disclosed using either the location-based or market-based method (or a combination)<br><br>Would require emissions to be disaggregated by type of GHG |
| **GHG emissions intensity** | Disclosure of total GHG emissions per net revenue would be required | No requirement to disclose GHG emissions intensity | Disclosure of total scope 1 and scope 2 GHG emissions per unit of total revenue and per unit of production (or an alternative, if not available) would be required |

### Observations

GHG emissions are among the most common disclosures provided by companies that issue voluntary sustainability reporting. We support the SEC's proposed requirement to require disaggregated information about the type of greenhouse gases emitted by a registrant because this would be meaningful information for investors given the differing levels of global warming potential among the different gases. Disaggregated data may also aid investors in understanding a company's risk profile because different gases may be subject to varying regulations. In addition, as the science and methodology for monitoring and measuring greenhouse gases continue to evolve, we support flexibility to allow for the expansion of reported gases to keep pace with broader scientific and societal developments.

We acknowledge that a GHG emissions intensity measure is a widely used metric. In the context of a net zero or other substantial greenhouse gas reduction commitment, however, the absolute quantity of GHG emissions released into the atmosphere — and progress toward the goal — is more meaningful than a GHG intensity measure. Further, an intensity metric may mask emissions growth: for example, if a company is increasing revenue by raising prices, its revenue-based intensity metric may show a decline even if emissions have increased for the same number of units sold. Therefore, we support the ISSB's decision to omit required disclosure of intensity metrics.

## GHG emissions — scope 3 disclosures

Scope 3 emissions include a company's upstream and downstream activities, which the GHG Protocol classifies into 15 categories based on the activities giving rise to the emissions. All three disclosure frameworks, and California SB 253, include specific requirements to disclose scope 3 GHG emissions, although smaller reporting companies would be exempt from the SEC's proposed scope 3 requirements. In accordance with the final ESRS, the reporting entity's scope 3 emissions would include the scope 3 emissions from associates, joint ventures, and unconsolidated subsidiaries over which it has operational control. Its scope 3 emissions would also include the scope 1, scope 2, and scope 3 emissions of those associates, joint ventures, and unconsolidated subsidiaries (a) in its value chain *and* (b) over which it does not have operational control. The ESRS provide a specific format that is to be followed for disclosure of all GHG emissions and related targets and goals.[20]

The ISSB and California SB 253 provide for a one year delay on reporting of scope 3 emissions for all companies, while the ESRS offer a one year delay on scope 3 reporting for companies with fewer than 750 employees.

| Theme | European Commission | ISSB | SEC |
|---|---|---|---|
| **Scope 3 GHG emissions** | Scope 3 emissions would be disclosed in total for the parent and consolidated subsidiaries as well as entities over which it has operational control, including significant scope 3 categories<br><br>Scope 3 emissions would include scope 1, scope 2, and scope 3 emissions of associates, joint ventures, and unconsolidated subsidiaries in its value chain over which it does not have operational control | Scope 3 emissions would be disclosed in total, including component categories | Scope 3 emissions would be disclosed in total, including component categories if (1) they are material or (2) the company has set an emissions reduction target or goal that includes scope 3 emissions<br><br>Emissions related to significant scope 3 categories would also be disclosed (if scope 3 disclosures are required) |
| **GHG emissions intensity** | Disclosure of total GHG emissions per net revenue would be required | No requirement to disclose GHG emissions intensity | Disclosure of scope 3 GHG emissions per unit of total revenue and per unit of production (or an alternative if not available) would be required if scope 3 disclosures are required |

### Observations

Investors are interested in scope 3 emissions data, particularly in circumstances when a company's upstream or downstream activities are emissions intensive. Reporting of scope 3 emissions, however, may be challenging for many companies, given their reliance on upstream and downstream entities for the underlying data. Further, the disparate sources of information, as well as level of estimation required, may create challenges in developing the scope 3 amounts in a reliable and timely manner.

We believe the needs of investors should be balanced against the potential difficulties for preparers in producing reliable, timely information. For example, when there is a related announced target or goal that includes scope 3 emissions, disclosure may be relevant to investors because of the accountability it creates. In the absence of a target or goal related to scope 3 emissions, we believe allowing alternative approaches that may balance investor needs against preparer challenges would be helpful.

[20] EC, Delegated Regulation, Annex I, ESRS E1, *Climate Change*, paragraph AR 48, page 94.

## Assurance

Confidence in the information disclosed by registrants is a critical component of efficient capital markets. Providing investors with comparable confidence in both sustainability and financial information is a driver of the assurance requirements under the CSRD and in the SEC proposal, although there are key differences in the scope of the disclosure frameworks. Whether similar assurance will be required for those applying the IFRS Sustainability Disclosure Standards will be decided by the jurisdictions adopting the standards.

Both the CSRD and SEC would include a phased assurance approach, beginning with limited assurance and increasing to reasonable assurance at a later date. Limited assurance is a negative form of assurance stating that no matter has been identified by the auditor to conclude that the subject matter is materially misstated (a review). Reasonable assurance will require more extensive procedures, including consideration of a company's internal controls (an audit). California SB 253 includes phased assurance requirements for scope 1 and scope 2 emissions, beginning with limited assurance in the first year of reporting and progressing to reasonable assurance. Limited assurance on scope 3 emissions is also required on a phased timeline.

| Theme | European Commission | ISSB | SEC |
|---|---|---|---|
| **Assurance, excluding GHG emissions** | Sustainability information would initially be subject to limited assurance, transitioning to reasonable assurance at an unspecified date | Sustainability information would be subject to assurance based on the rules of the jurisdictions adopting the standards | Footnote disclosure would be subject to assurance through the financial statement audit and internal control over financial reporting attestation requirements<br><br>Outside of the footnotes, only scope 1 and scope 2 GHG emissions would be subject to required assurance |
| **Assurance on GHG emissions** | GHG emissions would be subject to the same assurance as other sustainability information | GHG emissions would be subject to assurance based on the rules of the jurisdictions adopting the standards | Scope 1 and scope 2 emissions would be subject to limited assurance in year two and three for large accelerated and accelerated filers, transitioning to reasonable assurance beginning in year four |

### Observations

In our global investor survey completed in fall 2022, we found that investors value assurance as a way to give them confidence in corporate reporting on sustainability. At the top of their list is reasonable assurance, which is the same level as the financial statement audit; 75% of respondents report more confidence in ESG information if it has been subject to reasonable assurance. Investors also want to know that a company has actually done what it says it has done (79%), as well as that the reporting is in line with a recognized reporting framework (77%).[21]

Further, we believe that certain aspects of the attestation standards may require clarification to enable assurance on the entirety of the sustainability information as envisioned by the CSRD.[22] Reporting on, and assurance of, compatibility with global or territory goals may be particularly complex as there are multiple future factors to be considered which are not under the control of a reporting entity. Setting specific scenarios, models, and/or calculation methods to use (e.g., Science Based Targets initiative for climate change) would enhance comparability, consistency, and reliability of the reporting and increase the likelihood of reasonable assurance being achievable.

[21] PwC's Global Investor Survey 2022: The ESG execution gap

[22] The International Auditing and Assurance Standards Board is currently undertaking a project to develop international standards on sustainability assurance. An exposure draft was issued on August 2, 2023 and the comment period closes on December 1, 2023. Refer to the announcement, IAASB launches public consultation on landmark proposed global sustainability assurance standard, for more information.

## Effective dates and transition

Once all have been finalized, the three frameworks would introduce a new era of reporting by requiring sustainability-related information to be issued together with annual financial statement reporting. And, companies do not have much time to prepare. Effective dates are approaching rapidly with the earliest CSRD reports required for 2024. California SB 261 requires companies to make their first TCFD report publicly available by January 1, 2026. Further, California SB 253 requires initial reporting on GHG emissions in 2026 on prior fiscal year information, although the date of the reporting deadline is yet to be determined.

| Theme | European Commission | ISSB | SEC |
|---|---|---|---|
| **Timing of application** | Timing is established by the CSRD and would be phased by type of entity<br><br>Disclosure requirements would be applicable in 2024 (filing in 2025) for a "large undertaking," as defined, that has securities listed on an EU-regulated market and more than 500 employees | Timing will depend on how standards are implemented in each jurisdiction<br><br>Disclosure requirements of IFRS S2 are effective for annual reporting periods beginning on or after January 1, 2024, with early adoption permitted<br><br>In the first year of reporting, entities are permitted to apply IFRS S1 only to the extent it relates to the disclosure of climate-related information | Timing is expected to be phased by type of filer, with disclosure requirements potentially applicable as early as 2024 (filing in 2025) for large accelerated filers<br><br>Scope 3 disclosures would be required a year after other disclosures |
| **Comparative information** | Comparative information would not be required in the first year of adoption, but required thereafter | Comparative information would not be required in the first year of adoption, but required thereafter | Comparative information would be required for all periods presented<br><br>Information that is not reasonably available could be omitted under existing SEC guidance[23] |

### Observations

The timing of adoption of the CSRD and California climate bills is aggressive, and provides minimal time for companies to prepare for sweeping changes in the scope of reporting. Although the ISSB also established an aggressive effective date, companies may have more time, depending on the individual jurisdictions adopting the standards. Responding to concerns around timing, the European Commission provided various transition reliefs in the ESRS (e.g., a two year delay for some companies to report certain environmental and social disclosures).

Given the demand for sustainability information from investors, as well as the EU's intention to make meaningful progress on the Green Deal in the near term, we understand the appeal of rapid implementation. We also, however, understand that companies need time before initial adoption to develop the new systems, processes, and controls necessary to produce information of the scope required by the disclosures at a level of quality commensurate with that needed in regulatory filings.

While the European Commission and the ISSB acknowledged the challenges in preparing comparative information in the initial year of adoption, and provided for prospective application, as proposed, SEC registrants would be required to provide comparative information for all years presented (unless they qualify for the accommodations provided in the SEC rules). In our response to the SEC, we recommend omitting comparatives in the first year.

[23] SEC, Proposed rule, The Enhancement and Standardization of Climate-Related Disclosures for Investors, page 113, "A registrant, however, would not need to provide a corresponding historical metric for a fiscal year preceding its current reporting fiscal year if it is eligible to take advantage of the accommodation in 17 CFR 230.409 ('Rule 409') or 17 CFR 240.12b-21 ('Rule 12b-21')."

## Final thoughts

The SEC proposal is still pending, even as the ESRS and IFRS Sustainability Disclosure Standards are now final. Comment letter respondents to all three sets of draft proposals frequently highlighted the practical need for international collaboration and consistency, including equivalency determinations when appropriate. To this objective, the EC, EFRAG, and the ISSB have announced that they are working together on interoperability guidance intended to assist companies that apply both ESRS and IFRS Sustainability Disclosure Standards.[24] How the SEC guidance will address interoperability, however, and whether equivalence or similar relief will ultimately be available — especially given the differing objectives of the three frameworks — is still unknown. In the meantime, however, the California climate reporting requirements scope in more companies than the SEC proposal and accelerate climate reporting in the US. And, although two of the California bills allow a company to satisfy its reporting requirements by leveraging disclosures prepared to meet other national and international reporting requirements as long as those reports meet the requirements of the respective bills, managing a company's sustainability reporting obligations is becoming increasingly difficult given the growing number of reporting requirements worldwide. Proposals such as those by the Australian Accounting Standards Board — which recently released proposed standards for climate reporting which would remove references to the SASB from the IFRS Sustainability Disclosure Standards — further complicate reporting for multinational companies.[25]

Companies should develop processes to monitor developments and should also consider developing reporting processes that enable flexibility to respond to multiple requirements with the same underlying data. The pace of change is expected to continue to accelerate and companies should begin to prepare for what they know now, with the ability to layer in additional proposals as needed. Preparing for the new reporting requirements may span a year or more, depending on current readiness and the number of reporting regimes that will be applicable. And, with the effective dates for several requirements looming for some companies, now is the time to focus on understanding the scope and potential impact of the rules.

## Where to find more resources

Our publications, comment letters, and podcasts offer additional information and insight.

**Publications**

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|---|---|
| *Worldwide impact of CSRD - are you ready?* | *Navigating sustainability reporting: Practical application and analysis* |
| *IFRS Sustainability Disclosure Standards – Guidance, insights and where to begin* | *Take the next step - decide how to report under CSRD* |
| *The SEC wants me to disclose what?* | |
| *California's not waiting for the SEC's climate disclosure rules* | |

**Podcasts**

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|---|---|
| *Talking ESG: Inside look at the ISSB's launch of final standards* | *Audio: ESG reporting: Preparing for tomorrow's rules today* |
| *PwC IFRS Talks October 2023: Speaking Sustainability* | *CSRD spotlight: Updates and essentials for preparers* |

For more PwC accounting and reporting content specific to ESG matters, visit our Environmental, Social and Governance (ESG) page at viewpoint.pwc.com.

[24] IFRS Foundation, European Commission, EFRAG and ISSB confirm high degree of climate-disclosure alignment
[25] Australian Accounting Standards Board release of Exposure Draft ED SR1 Australian Sustainability Reporting Standards – Disclosure of Climate-related Financial Information on October 23, 2023

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


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