Building trust in the climate transition

The race to consistent corporate reporting on climate change

Why collaboration between regulators and standard setters is critical to achieving net zero emissions

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The Business Briefings series

This series

The Business Briefings series is a series of papers by PwC that provides a constructive breakdown of causes of mistrust in climate reporting by businesses today. Its intention is to support business leaders, boards and financial markets to build trust and support the flow of capital that will drive the transition to a net zero economy.

This paper

The past eighteen months has seen a rapid rise in commitments from business to tackle climate change. But the lack of common rules governing what information companies should disclose around climate change – such as the volume of emissions they create or the commercial risks they face – is creating confusion.

Regulators in the US and the EU, alongside the new International Sustainability Standards Board (ISSB), are each moving quickly to create new detailed rules to ensure companies disclose the right information. Together, these rules should help to determine a common baseline to understand how companies are responding to climate change, which in turn will allow stakeholders to distinguish meaningful action from corporate rhetoric.

The ultimate prize is for these standards to be globally aligned and consistent with each other. Like financial reporting, there may never be one set of rules – but if the rules share common foundations then it will mean it is easier to compare and contrast the information between companies and between countries.

The time left to respond to climate change is short. The risk is that instead of cooperating to create a common baseline, regulators and standard setters inadvertently diverge.

This risk goes to the heart of the climate transition. A common foundation shared between sustainability reporting standards globally is vitally important because it will be key to understanding how companies are responding to climate change in a consistent way, where investors can allocate capital, and understanding whether the world is on track to meet its climate targets. As we identified in the first paper in this series, without it, businesses, investors and all other stakeholders will lack a common understanding of what action is needed and what action is being taken in practice.

This paper explains how global alignment and consistency in reporting standards can help build trust in the climate transition; in what areas the three main bodies risk going in separate directions; and why collaboration between them is critical to achieving that consistency.

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1 The opportunity for consistent sustainability reporting

A growing call for clarity

As the expectations of businesses and their role in society have changed, so too have the needs of their reporting and disclosure practices. No issue reflects this better than climate change.

Businesses today are expected to report regularly and credibly on climate topics, and there is little sign that the rising tide of new reporting requirements will subside. The G7's **2021 communiqué** signalled that mandatory climate-related reporting would be extended across the G7, while mandatory company transition plans are being introduced in countries such as the UK. Globally, new reporting agendas include expectations to provide a diversity of climate-related information such as the level of greenhouse gas emissions they create, how a changing climate would impact the business, and the steps that are being taken to contribute to the climate transition. For many companies, this is all new territory.

The expectations of businesses have grown in the past two years, especially as more and more companies commit to reducing their emissions. PwC's recent **Global CEO Survey**, for example, found that nearly two-thirds of companies with revenues of US$25bn+ have committed to reduce their emissions to net zero. And increasingly stakeholders are asking how companies will deliver on their commitments.

All of this underlines the need for consistent and comparable climate-related information from business to business. For years, financial information that has been subject to assurance has been the bedrock of how businesses function and how capital is allocated. As climate change becomes an ever-more important issue for businesses and investors, non-financial information now has to be put on a similar footing. And that includes international consistency in the standards around the information companies need to disclose.

How consistency in standards can help tackle climate change

Companies and investors will play a critical role in tackling climate change. Given how most greenhouse gas emissions are created, it will be businesses which need to innovate and change to reduce emissions. And the sheer scale of investment needed to enable the net zero transition means that private capital will need to be deployed at scale.

International consistency in sustainability reporting standards will make a real difference, by making it much easier to better understand where and how companies are reducing their emissions and taking action. That both allows stakeholders to hold companies to account for their commitments and makes it easier for investors to determine risks and opportunities when allocating capital.

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Global consistency for global action

In a global economy, where goods and capital flow easily across borders, it really matters that data can be compared and contrasted between countries. Having different rules in a few major economies can vastly increase the complexity and difficulty of comparison unless those rules share a common baseline. The Chair of the Securities and Exchange Commission (SEC), Gary Gensler, recently **made the point** through analogy, writing that climate standards ‘should be consistent & comparable. Like the Olympics, fans compare skiers across heats, countries, & generations. Investors today are asking for the ability to compare companies [with] each other [on climate].’

Ensuring that standards are based on the same foundations and core reporting requirements therefore creates an opportunity to unlock a shared conception of corporate climate action globally. This would provide a basis for accountability worldwide. And, if built to be practicable for big businesses and SMEs alike – and developed in partnership with relevant stakeholders in emerging economies – it could facilitate the kind and scale of climate action being called for by many governments, investors, and civil society.

Similarly, on a global footing, while climate reporting is the most urgent of non-financial reporting agendas, stakeholders are hoping that done properly, it can provide a meaningful blueprint for non-financial reporting on other issues, such as nature and biodiversity or the social impact of a business. A consistent reporting regime on climate could provide the basis for progress towards consistent reporting regimes on these other global issues rising up boardroom and investor agendas.

2 Today's race to climate standards

Progress to date

The call for consistency in standards has been growing for some time.

A recent wave of consolidation between several of the voluntary bodies working on such standards was driven by a recognition that more simplicity and consistency was needed. This saw the International Integrated Reporting Council (IIRC) and the Sustainability Accounting Standards Board (SASB) merge into the Value Reporting Foundation (VRF), and then in turn the VRF merge with the Climate Disclosure Standards Board (CDSB) to become the ISSB.

The progress made in the past year has been far-reaching, fast, and has vastly outstripped the cumulative progress made in the decade preceding it. But the challenge now is to set a clear direction forward.

Momentum today

In the pursuit of a solution, three organisations have come to the fore: the European Financial Reporting Advisory Group (EFRAG) in the EU; the Securities and Exchange Commission (SEC) in the US; and, since its launch at COP26, the new International Sustainability Standards Board (ISSB).

The work of these three bodies provides a critical opportunity to realise comparable and consistent climate reporting worldwide – through, for example, broad alignment in what they measure, how they measure it, and what is mandatory for businesses to disclose.

> "In the race for consistent corporate climate reporting, collaboration between EFRAG, the SEC and the ISSB is vitally important.

Crucially, the collaboration will have to happen at speed. The launch of the ISSB last November is an opportunity to go further and faster in making global progress, as expertise is pooled and the IFRS Foundation works to position the ISSB as a mainstream counterpart to the International Accounting Standards Board (IASB) in the global reporting ecosystem. That's why **PwC welcomed** the creation of the ISSB as a **'transformational event for ESG reporting'**.

And further faster is also the intention of the global business and investor communities. Both seek clarity on climate reporting standards as a matter of urgency, in order to inform and develop their climate strategies and future-proof business and investment models.

The ISSB is already reflecting urgency in its plans. While it typically takes years to develop a new financial reporting standard, the ISSB's aim is to move more quickly. Since its launch last year, the ISSB has already published prototype standards and exposure drafts, and the intent is to publish final versions of the standards by the end of 2022.

It will be important that the organisations move further towards frequent and structured communications, either through making more of existing channels and forums for communication, or the construction of new ones. Without this, there is a risk that the pace of the race to consistent standards is not matched by the frequency of communication between the bodies involved. If the different organisations are in dialogue once every few months, for example, then major developments will be designed and announced between these intervals, without sufficient discussion between the organisations to allow for consistency.

Areas with potential risk of divergence

We have highlighted three areas where there could be a risk of divergence between the different bodies, to illustrate the general risk. These are not exhaustive and there are other important areas where alignment is needed to ensure consistency, but they are helpful markers of where and in what ways the bodies risk moving in different directions. They also reflect announcements to date by the respective bodies on their proposed reporting regimes, including the **SEC's announcement** in March 2022.

1 Double materiality:

Traditionally, 'materiality' has referred to the relevance or impact of external topics on a business. Recently, and especially with reference to climate change, the concept of 'double materiality' has emerged. This is where, in addition to traditional materiality, the impact of the business on the external topic is taken into account. In this context, this means companies disclosing both the climate-related risks, impacts and opportunities for their business, and the impact of their business on the climate. The EU is a significant proponent of double materiality, including the concept in their Corporate Sustainability Reporting Directive (CSRD). In contrast, the early work of the ISSB and SEC suggest their focus will in the first instance at least put more of the emphasis on the climate-related impacts on the company.

2 The role of assurance:

Across the different bodies, there is broad agreement that assurance has a role to play in climate-related information. In short, assurance in this context refers to the practice of a qualified and independent third-party expressing a conclusion on the degree of confidence someone can have in that information. However, there risks disagreement over the level of assurance. In the SEC's proposed disclosure rules, they will require external assurance by an independent third-party for climate-related financial statement metrics and related disclosures as part of the company's audited financial statements – but **note** that **'Current market practice appears to favor obtaining limited assurance over sustainability reports'**. EFRAG, by contrast, are much more likely to require 'reasonable assurance' within a shorter timeframe (as noted **here** by ICAEW).

3 The number of mandatory metrics:

In Europe, there have been suggestions that companies may have to report against as many as twenty-eight standards which would involve reporting hundreds of new non-financial metrics as part of their annual reporting cycle. It is highly unlikely that the ISSB and SEC will mandate so many. This, for example, could introduce a situation whereby European companies are asking non-European suppliers to measure and disclose information on these numerous fronts, in order to aggregate them into their data, when the suppliers' own climate reporting requirements are considerably less extensive – causing tensions and disalignment.

The risk of divergences such as those described here signals the potential for vastly different reporting requirements for businesses in different jurisdictions. And, given the globalised structure of international business today, it also risks causing conflicting requirements for individual companies.

The CSRD, for example, is **expected to impact** upon more than 49,000 entities in the EU, including foreign subsidiaries. Those multinational, non-European entities for which whole or part of their business will be captured by CSRD are also likely over time to come under the coverage of other mandatory climate reporting requirements elsewhere that are different in nature. This reinforces the need for common shared foundations between the main standards.

The role of business and investors

In practice, collaboration would also be fostered further through the increased involvement of businesses and investors. Elevated levels of business and investor engagement with the key regulators and standard setters will allow them to shape the standards in line with what they need to guide decisive and fast action, in line with the pace and scale of the transition.

The investor community is becoming more vocal and will be a key user of climate related data in its decision-making, and so there needs to be structured, clear dialogue and feedback between investors and regulators on what investors require and what matters most to them.

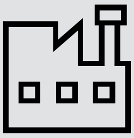
And off the back of COP26, where business was front and centre, companies can continue this increased engagement on climate change and contribute actively to the process of standard setting as we reach a seminal moment in its development.

3 Taking action: Where next to deliver a solution?

The launch of the ISSB and the progress made has helped to accelerate progress and encourage collaboration to avoid divergent standards. We are now at a turning point where the ISSB, EFRAG and SEC can work together towards independent but globally aligned and consistent climate reporting standards.

In the short term, we see a few immediate steps that would greatly help.

ISSB/EFRAG/SEC:
Continue and enhance collaboration to prevent duplication of effort and reap the benefit that alignment of sustainability reporting standards globally can bring to meeting climate commitments at the global, national and individual business levels. Engagement with stakeholders will be critical to understanding what information they need to assess progress and encourage change.



Companies:
Critically assess your climate disclosures and consider where you may need to improve them – with a frank and open dialogue with your stakeholders, as well as with the standard setters and regulators on what is needed from globally-aligned sustainability standards and why.

Investors:
Make clear what matters in pursuit of globally-aligned and consistent standards and the areas where greatest level of information is needed. Importantly, the largest asset managers, asset owners and financial institutions can play a critical role as they align their investment strategies to support financing the transition to a low-carbon economy.

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