# Planning an IPO? Time to get ready for ESG disclosures

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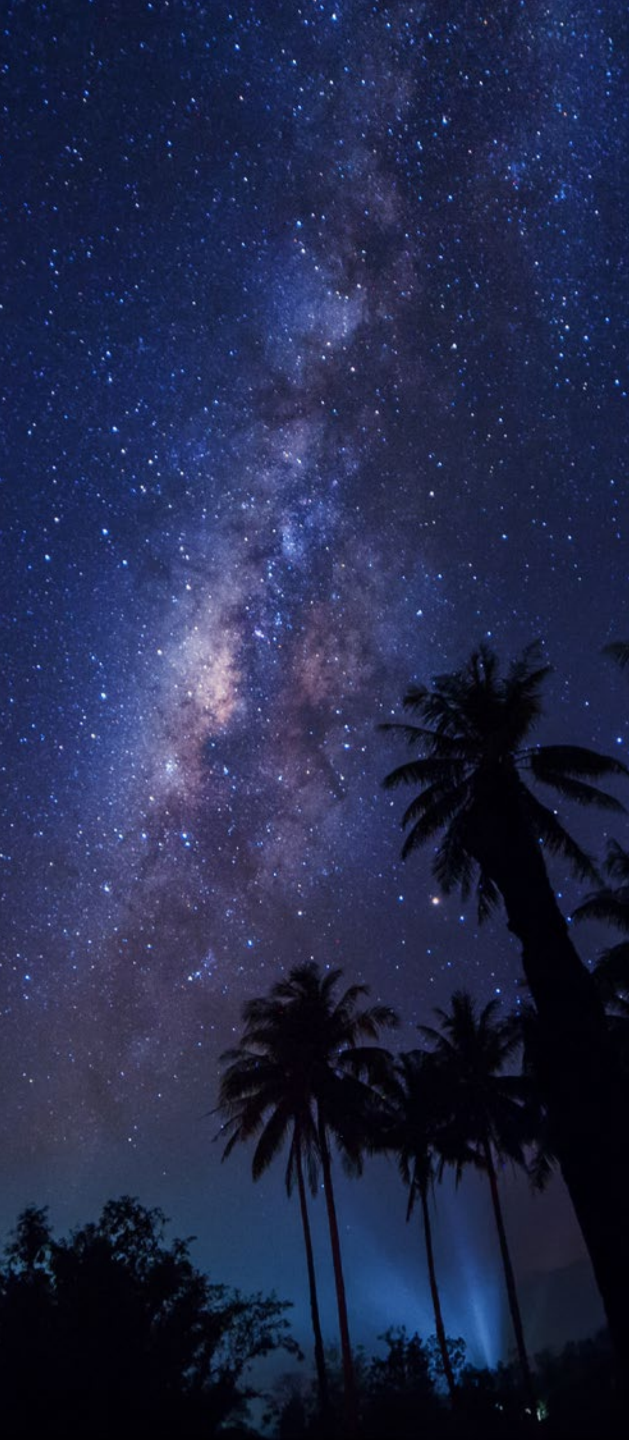


# Introduction



## Are you looking to go public? If so, it's time to get your environmental, social, and governance (ESG) house in order.

### Stakeholder demand for sustainability data and reporting for newly public companies

The conversation around ESG tends to gravitate toward regulatory requirements and assurance readiness. But keep in mind that the recent push for these requirements is in response to investor demand for more transparent, comparable sustainability data and disclosures. Investors aren't necessarily waiting on regulators to get the information they need. Some investors are already incorporating ESG data requests into their investment diligence procedures. In general, it is important to be able to develop your equity story in order to drive a successful IPO transaction. With this increased focus on ESG data from regulators and investors alike, building sustainability into that story has become even more important.

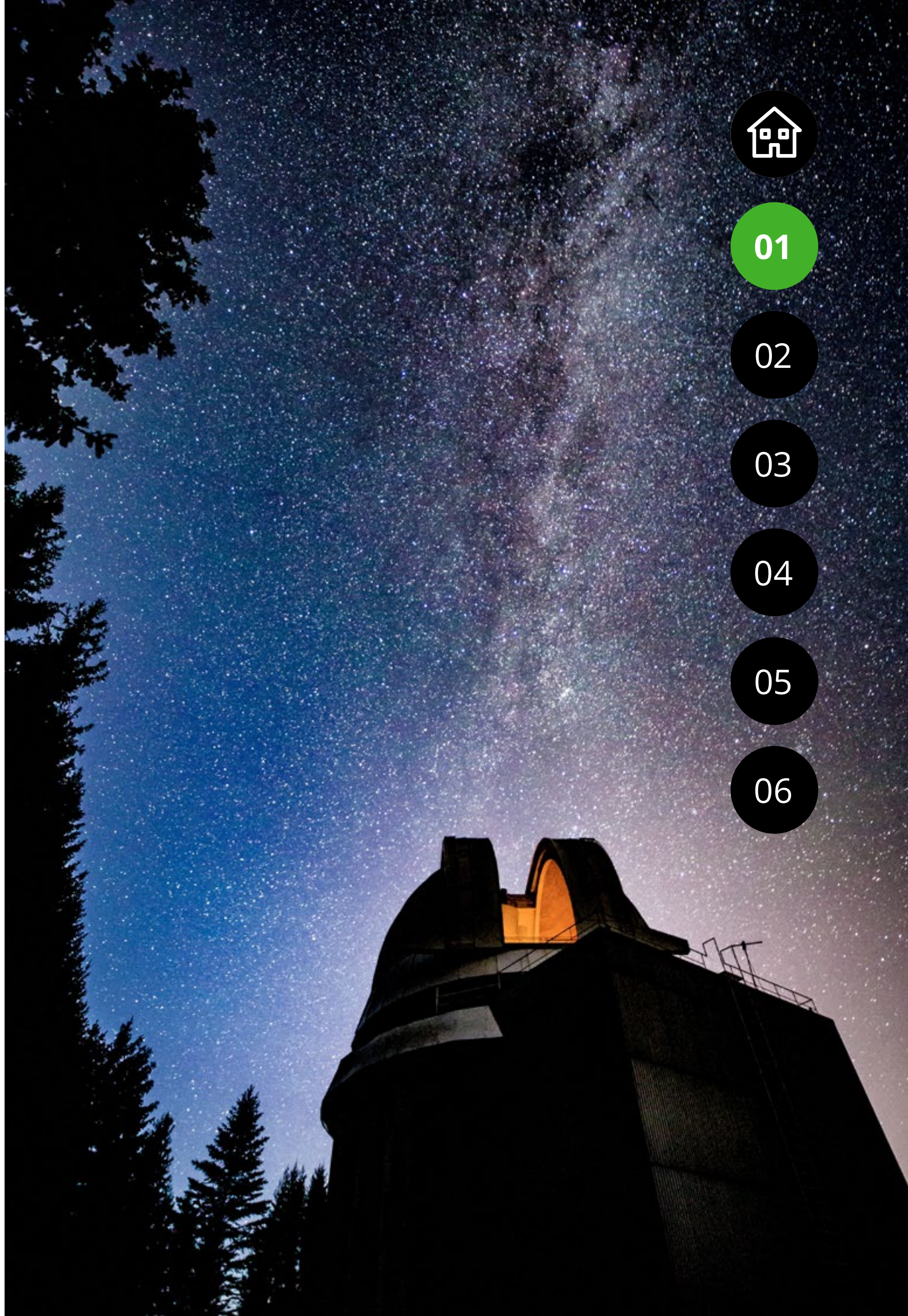
The more prepared you are to respond to these requests, the smoother your IPO process may go—and the better your position may be to comply with any ESG regulation that becomes relevant once your company is no longer private.

In this article, we'll discuss what various stakeholders are looking for in terms of ESG disclosure. Then we'll provide a step-by-step approach to organizing your ESG priorities.

Regardless of whether a company will be imminently affected by regulations, sustainability initiatives within a company's strategy and operations can create or protect business value, such as optimizing process efficiencies, reducing operating costs, and developing new products/technologies/services to enable societal decarbonization and top-line growth. These may lead to positive market reputation, attraction and retention of talent, strategic relationships with value chain participants, and capital market attractiveness that you can build into your equity story.

When considering which sustainability efforts and activities to focus on, pre-IPO companies should consider key stakeholders' priorities and how it may affect them if your ESG performance falls short. As a starting point, a company should consider investor targets, industry sector priorities, and the sustainability initiatives of a competitive peer group, as this relative comparison may influence how investors make capital allocation decisions in the sector.

Through careful consideration of these expectations as newly public companies, pre-IPO companies can develop a sustainability strategy for their entrance to public markets and beyond. The idea for pre-IPO companies is not to focus on every possible sustainability-related topic, but instead to focus time and resources on areas that can drive value for the business.



02

# Understanding stakeholders' hot buttons

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As a pre-IPO company, you'll want to consider what key public market stakeholders expect from your ESG performance and the likely impact of falling short relative to your peer group. This group of stakeholders includes public market investors, raters and rankers, proxy advisers, and regulators.

## Public market investors

have historically been one of the main drivers of ESG adoption at public companies. Despite some investors taking a step back on ESG, the largest investors still publicly disclose that ESG and sustainability considerations are integral to their business, and they're taking steps to improve on these factors. Some of the largest global asset managers[1] have disclosed a variety of drivers for ESG integration within their business (table 1).

**Table 1. Drivers for ESG integration among a sample of 10 large global asset managers**

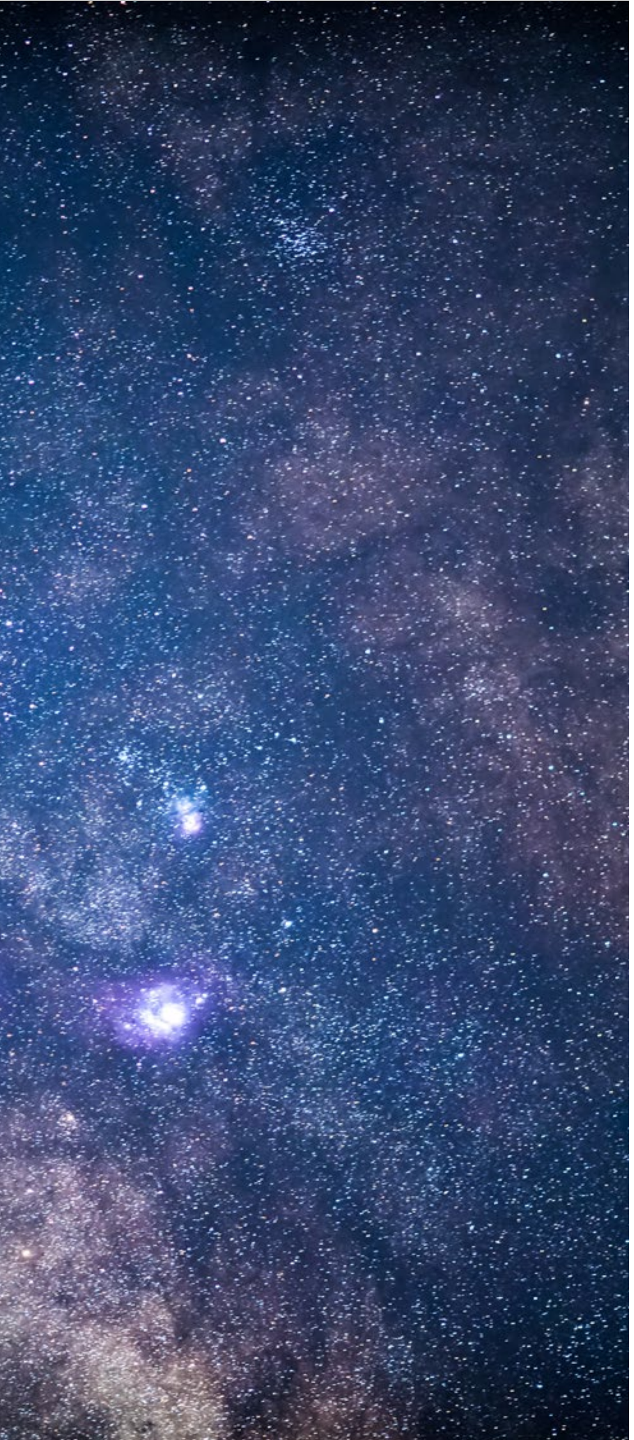
| ESG driver | Number of citations |
|---|---|
| Create value and seize opportunities | 100% |
| Carry out a fiduciary responsibility to clients | 100% |
| Shape specific sustainability outcomes* | 100% |
| Manage ESG and/or climate-related risks | 80% |

* For example, creating positive or reducing negative impacts for the environment, community, or society.

**Table 2. Top activities and disclosures required by large global asset managers**

| ESG requirement | Number of requests |
|---|---|
| Disclosure of GHG emissions | 80% |
| Climate risk disclosure aligned with the TCFD | 80% |
| GHG emission reduction targets | 60% |
| A materiality assessment aligned with the Sustainability Accounting Standards Board (SASB) | 50% |
| A climate transition plan | 10% |
| Net-zero target-setting | 10% |

Meanwhile, top investors have ESG priorities for their portfolio companies, and they may impose consequences for nonalignment (which may include proxy voting ramifications, such as votes against board directors or for shareholder proposals). Table 2 shows some of the top activities and disclosures that large global asset managers request from their portfolio companies. While some of these activities are not common among all large global asset managers, many are. For example, they often encourage the disclosure of greenhouse gas (GHG) emissions and climate-related financial risks in line with recommendations from the Task Force on Climate-related Financial Disclosures (TCFD).



## Raters and rankers

As ESG matters have risen in importance to the investor community, we have seen a rise in third-party companies that create ESG ratings and proprietary ranking systems, including, but not limited to, MSCI ESG Ratings and Morningstar's Sustainalytics. These ratings systems are used in investment decision-making to help facilitate benchmarking analysis and to evaluate risk. To attract investors and build awareness of how they would be rated once public, its recommended that pre-IPO companies consider seeking a private company provisional ESG rating prior to listing on a stock exchange. Each rating agency typically provides a grace period for newly public companies (which varies by firm) and off-cycle engagement with rating agencies (as company policy updates may be possible).

Because many public equity investors use these ratings to perform initial investment screens of public companies as part of evaluating their investment criteria, pre-IPO companies may also find it helpful to understand the key disclosures and metrics that will be assessed once they go public, along with the scoring methodology of different providers. Doing so gives pre-IPO companies an opportunity to identify and address disclosure, policy, and activity gaps so they can boost their score relative to peers and, in turn, improve their access to capital (e.g., through inclusion in indices, exchange-traded funds [ETFs], and investment vehicles with ESG scoring requirements).

## Proxy advisers

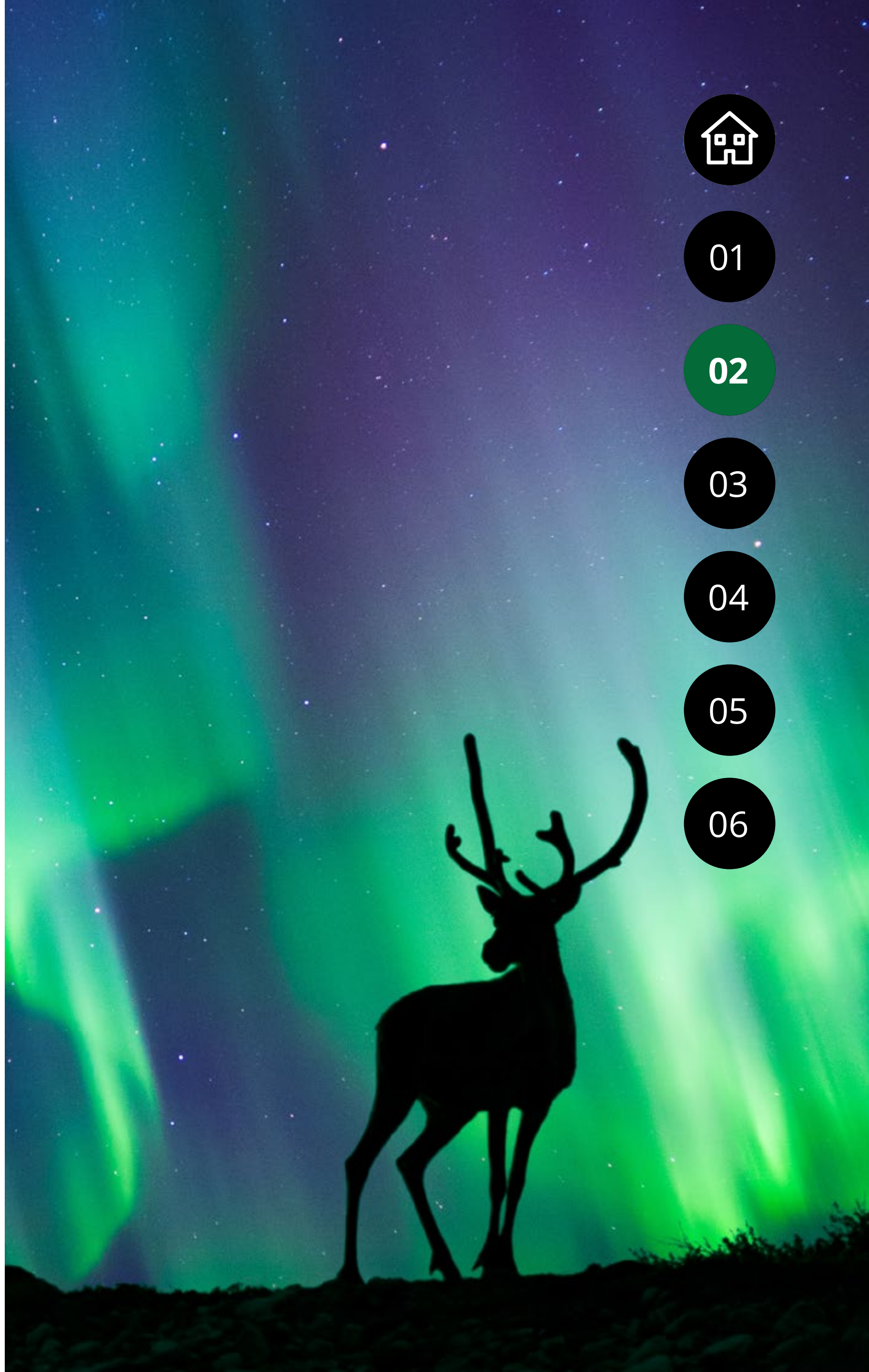
Proxy advisory firms are third parties that can guide institutional investors on sustainability and governance matters through research and proxy voting recommendations. They include firms like Glass Lewis and Institutional Shareholder Services (ISS). The firms publish their annual proxy voting guidelines and methodology, which may be of interest to pre-IPO companies to understand what the dominant proxy advisers are suggesting in relation to governance and other ESG topics.

In general, firms are supporting shareholder resolutions seeking greater transparency on ESG matters. They also encourage greater adherence to internationally recognized ESG standards and principles. While many shareholder resolutions need to be evaluated on a case-by-case basis, these firms have often guided investors to vote in favor of ESG initiatives such as setting GHG emission reduction goals, adopting climate risk mitigation strategies, and establishing policies related to human rights.

The firms don't often discuss IPO readiness in their guidelines. But Glass Lewis notes in its *2024 Benchmark Policy Guidelines*[2] that it typically advocates for a one-year grace period for newly public companies to focus on meeting baseline regulatory governance requirements before voting in favor of additional efforts.

## Regulators

Companies considering an IPO need to prepare for greater disclosure requirements under US Securities and Exchange Commission (SEC) rules and regulations.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## Final SEC climate rule

On March 6, 2024, the SEC adopted rules to require disclosure of climate-related information for all registrants, including S-1 filers. The rule requires amendments to both Regulations S-X and S-K, and applies to both registration statements and annual filings.[3] The new rules go well beyond previous SEC interpretive guidance from 2010,[4] requiring specific climate-related disclosures rather than merely highlighting areas where climate information may be relevant for disclosure, as had previously been the case. The required disclosures now include the following:

- For large accelerated filers and accelerated filers, material scope 1 and scope 2 GHG emissions, subject to assurance requirements that will be phased in.
- Governance and oversight of material climate-related risks.
- The material impact of climate risks on the company's strategy, business model, and outlook.
- Risk management processes for material climate-related risks.
- Material climate targets and goals. Financial statement impacts and material impacts on financial estimates and assumptions due to severe weather events and other natural conditions.
- A roll forward of carbon offsets and renewable energy credits or certificates (RECs), if carbon offsets and RECs are a material component of meeting climate-related targets and goals.
- Whether and how severe weather events or climate-related targets or transition plans have materially affected estimates and assumptions used in the financial statements.

The rules go into effect starting with most disclosures for fiscal years ended December 31, 2025, for large accelerated filers, with phase-ins for other registrant types and certain disclosure requirements. Scope 1 and 2 emission data may be published at a later date than all other disclosures. Registrants will have a safe harbor from liability for disclosures related to transition plans, scenario analysis, internal carbon pricing, and targets and goals, other than disclosures that relate to historical facts.

Additional rules related to human capital and board diversity disclosures are expected to be proposed.

## Other global considerations

While the SEC requirements are not yet finalized, US companies may also be subject to ESG-related disclosure regulation in certain states and in other international jurisdictions. California recently passed a series of laws requiring GHG emission disclosure and climate risk disclosure by both private and public companies exceeding certain revenue thresholds. And European reporting requirements through the Corporate Sustainability Reporting Directive (CSRD) are expected to affect more than 3,000 public and private US-based companies with significant operations and turnover in the region, according to a Refinitiv study.

A broader set of European Sustainability Reporting Standards (ESRS) includes up to 84 key performance indicators (KPIs) and approximately 1,100 ESG metrics across a set of 12 cross-cutting and topical standards, only one of which is climate-related. The ESRS disclosures are based upon a concept of a "double materiality" assessment, which is another key difference from the SEC climate rule and International Financial Reporting Standards' (IFRS) sustainability disclosure standards being adopted by securities regulators globally. Whether or not you meet the reporting requirements yourself, understanding your exposure—be it through European Union-based customers, suppliers, investors, or lenders, as well as potential EU growth strategies—is essential.

*Refer to the Resources section for additional information on the growing landscape of global ESG regulatory requirements.*

Preparing for mandated reporting and assurance is becoming necessary for a growing number of companies, public or not. Many of the requirements, including quantifying GHG emissions and managing and disclosing climate-related financial risks, are common across regulators, including requirements by the SEC. Taking steps to meet these baseline requirements is an action that will put you on a course to meet the needs of investors and regulators now and in the future.

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# Getting your ESG priorities in order

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Against that backdrop, what steps can pre-IPO companies take now to demonstrate their commitment to sustainability goals?

**1. Integrate ESG into corporate strategy and your equity story.** Start by creating a strategic ESG action and disclosure roadmap that aligns with your overall business strategy. From there, conduct sector analysis and competitor benchmarking to identify nonnegotiable disclosures and activities in your peer group. Then complete an ESG materiality or double materiality* assessment to identify the most relevant and significant ESG-related topics for your business. This will help you direct your time and resources to what matters most, leveraging leading voluntary standards from SASB and the Global Reporting Initiative (GRI). You'll then be in a position to begin integrating material ESG impacts, risks, and opportunities into your enterprise risk management strategy and resource planning. The results of these efforts can help you establish a credible narrative around strategic ESG priorities, aligned with your purpose and business value. Work with your investors and stakeholders (including eventual investment banker advisers) to position your sustainability strengths and focus within the broader equity story that you will tell potential public investors as part of your IPO.

**2. Establish a governance structure.** Think about the governance framework for your ESG strategy—overall and for each defined component—amid increasing political, regulatory, and stakeholder expectations. Stakeholders expect clear ESG oversight at the board level, with ESG explicitly disclosed in one or more committee charters. Deloitte research indicates that companies are increasingly opting for ESG governance frameworks that allocate responsibilities to various combinations of board committees and the full board.[6] Under a strong ESG governance structure, ESG matters would be regularly discussed in board meetings, with management overseeing and implementing ESG programs and reporting to the board on ESG issues. Board diversity is also something to consider, and you may need to comply with exchange-level or proxy adviser minimum diversity requirements.

**3. Assess climate risk.** Risks related to climate change can broadly be considered as physical (e.g., extreme weather events affecting operations) or transition-related (such as regulation to decarbonize your industry). By assessing these risks, you can determine which ones need mitigation sooner and how they all fit into your company's enterprise risk management and risk disclosure process. Additionally, any climate change effects deemed material are to be disclosed in your company's IPO registration documents (Form S-1). (See the Regulators section for more disclosure requirements.)

**4. Identify, track, and develop controls over key sustainability metrics.** You'll need KPIs to track ESG performance against targets related to your material topics. For GHG emissions specifically, companies preparing for IPO should be working toward assurance-ready disclosure of scope 1 and 2 GHG emissions and conducting a relevancy assessment over their scope 3 emissions. The Greenhouse Gas Protocol Corporate Standard provides guidance to companies on how to calculate a GHG emissions inventory. It's also critical to begin establishing clear internal processes and controls for GHG emission data management. This includes establishing reporting boundaries, creating a reporting baseline, and identifying data owners. It also includes documenting calculation methodologies, exclusions, risk areas, estimations, and assumptions. Effective controls and processes over both financial and nonfinancial data can help you prepare for the stricter assurance requirements imposed on public filers. (See the Regulators section for more SEC requirements related to climate information.)

**5. Prepare to disclose your sustainability performance.** Global and domestic ESG reporting requirements are either in effect or on the horizon (see the Regulators section). A critical step in meeting all applicable ESG reporting requirements is to complete a scoping assessment to confirm which regulations apply to your company both before and after an IPO. Certain ESG disclosure regulations, including those in California and Europe, apply to private companies as well as public companies, so the time to start evaluating your compliance requirements is now if you intend to operate in markets with existing requirements. Many ESG disclosure regulations have leveraged preexisting voluntary standards and frameworks such as the Greenhouse Gas Protocol, TCFD, GRI, and SASB. Voluntary reporting now may therefore help your company prepare for required disclosures once you go public.

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# Value beyond compliance

# Value beyond compliance

The landscape of ESG expectations is shifting rapidly. Laws in California and Europe have the potential to affect even companies that stay private. Meanwhile, companies that plan to go public face the possibility of even greater reporting requirements under the SEC.

When weighing which sustainability efforts and activities your pre-IPO company should focus on, consider key stakeholders' priorities and how it may affect them if your ESG performance falls short. Start with an assessment of investor targets, industry sector priorities, and the sustainability initiatives of a competitive peer group. This last item is important because it may influence how investors make capital allocation decisions in your sector.

Through careful consideration of these expectations as newly public companies, you can develop a sustainability strategy for your company's entrance to public markets and beyond. The idea is not to take on every possible sustainability-related topic, but instead to focus time and resources on areas that will drive value for the business.

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# Resources

- Heads Up — Comprehensive Analysis of the SEC's Landmark Climate Disclosure Rule
- Heads Up — Executive Summary of the SEC's Landmark Climate Disclosure Rule
- Heads Up — #DeloitteESGNow — The Sweeping Impacts of California's Climate Legislation
- Heads Up — #DeloitteESGNow — Frequently Asked Questions About the E.U. Corporate Sustainability Reporting Directive
- Heads Up — #DeloitteESGNow — Global Reach of the E.U. Corporate Sustainability Reporting Directive and the Impact on U.S. Companies
- Heads Up — #DeloitteESGNow — Global ESG Disclosure Standards Converge: ISSB Finalizes IFRS S1 and IFRS S2
- iGAAP in Focus — Sustainability reporting: ISSB publishes first IFRS Sustainability Disclosure Standards
- Heads Up — #DeloitteESGNow — The Disclosure Heat Is On: The Move Toward International Standardization of Sustainability and Climate Reporting

# Endnotes

[1] Largest global asset managers, ranked by assets under management (AUM).

[2] 2024 Benchmark Policy Guidelines – United States, 2023.

[3] US Securities and Exchange Commission (SEC), The Enhancement and Standardization of Climate-Related Disclosures for Investors, March 2024.

[4] SEC, Interpretation: Commission Guidance Regarding Disclosure Related to Climate Change, February 2010.

[5] Dieter Holger, " At least 10,000 foreign companies to be hit by EU sustainability rules," Sustainable Business for the Wall Street Journal, April 5, 2023.

[6] Deloitte, Sustainability action report: Survey findings on ESG disclosure and preparedness, July 2024.

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