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HOT TOPIC

ESG in the US

California introduces climate disclosures and assurance

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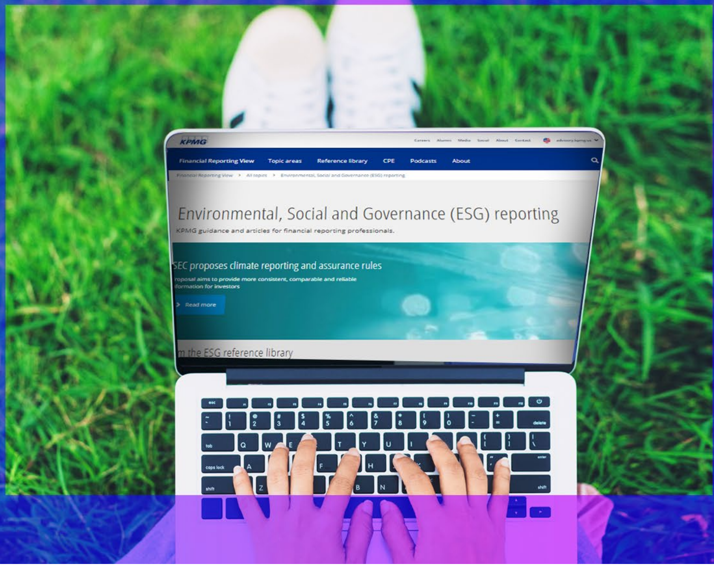

The ESG reporting landscape expands with the addition of broad reaching state-level climate disclosure rules.

Source and applicability

- Climate Corporate Data Accountability Act (SB-253)
- Greenhouse gases: Climate-Related Financial Risk Act (SB-261)
- US business entities (including US subsidiaries of non-US companies)

Fast facts, impacts, actions

On October 7, 2023, the California Governor signed two climate disclosure laws that will shape climate disclosure practices beyond the state's borders. The laws apply to US businesses that meet specified revenue thresholds and do business in California.

	SB-253 (GHG emissions)	SB-261 (climate risks)
Revenue:	> $1 billion annually	> $500 million annually
Exclusions:	None	Insurance companies
Disclosures:	Scopes 1, 2 and 3 GHG emissions	Climate-related financial risks, response
Effective:	• Scopes 1, 2: 2026 (FY25 data) • Scope 3: 2027 (FY26 data)	On or before Jan 1, 2026
Reporting:	Annual	Biennial
Assurance:	Scopes 1 and 2: limited assurance from 2026; reasonable assurance from 2030	No requirement

While US discussions have been dominated by the SEC's climate proposal and the timing of the final rule, these California laws have emerged to break new ground for the US market – with thousands of public and private companies in scope. **Get ready now.**

Background

There has been mounting pressure from governments and shareholders for companies to disclose their greenhouse gas (GHG) emissions and report on climate-related risks. For most US companies, the current approach for such disclosures relies largely on voluntary reporting.

This is changing, as evidenced by reporting requirements on the national level (the SEC's climate proposal) and international developments (standards from the International Sustainability Standards Board (ISSB) and European Sustainability Reporting Standards). The California laws add a new dimension, with state-level requirements that have national and international implications.

In the movement to improve transparency and standardize climate-related disclosures, California has passed the following laws.

- **GHG emissions law.** SB-253, the Climate Corporate Data Accountability Act, mandates the disclosure of GHG emissions.
- **Climate risks law.** SB-261, the Climate-Related Financial Risk Act, mandates the disclosure of climate-related financial risks and measures adopted to reduce and adapt to such risks.

The laws were proposed in January 2023, passed by the California Legislature in September 2023, and signed by the California Governor in October 2023. The laws apply to both public and private US companies (and other business entities) that do business in California – whether or not they are physically present in the state.

The next step is for the California Air Resources Board (CARB) to develop and adopt regulations that implement the laws. In addition, the Governor indicated that the costs of implementation and timeline to implementation will be looked at further.

A broad scope

There are four elements to the respective scopes, which are partially aligned.

	SB-253 (GHG emissions)	SB-261 (climate risks)
Types of entities:	Corporation, partnership, limited liability company or other business entity formed under the laws of California, any other US state or the District of Columbia, or under an act of Congress	
Exclusions:	None	Insurance companies
Revenue:	> $1 billion annually	> $500 million annually
Nexus to California:	Doing business in California	

Revenue is calculated as 'total revenue' and not simply the revenue attributable to California. And while it is not specified whether revenue is the amount recorded for financial reporting, many are currently using total revenue as reported in a company's financial statements to evaluate the law's applicability. The phrase 'doing business in California' is similarly not explained, but there may be precedent set by the California Franchise Tax Board, which defines 'doing business' in California as actively engaging in any transaction in the state for the purpose of financial or pecuniary gain or profit.

We expect CARB to resolve these questions and others as it develops regulations to support implementation.

Targeted disclosures

The disclosures leverage existing frameworks with additional reliefs for companies already reporting climate risk information.

	SB-253 (GHG emissions)	SB-261 (climate risks)
Disclosures:	Scopes 1, 2 and 3 GHG emissions	Climate-related financial risks and measures adopted to reduce and adapt to such risks
Framework:	GHG Protocol	Task Force on Climate-related Financial Disclosures (TCFD)
Framework relief:	--	Application of equivalent frameworks permitted
Reporting relief:	Using other prepared reports	Reporting at the parent level permitted
Penalties:	Non-filing, late filing or other failure to meet requirements – up to $500,000 per year	Failure to make report publicly available or publishing an inadequate or insufficient report – up to $50,000 per year

GHG emissions

SB-253 requires companies (and other business entities) to report GHG emissions in accordance with the GHG Protocol, including the Corporate Accounting and Reporting Standard and the Corporate Value Chain (Scope 3) Accounting and Reporting Standard, developed by the World Resources Institute and the World Business Council for Sustainability Development. That Act allows companies to meet its reporting obligation using reports prepared under other national or international reporting requirements, as long as those reports satisfy all of the Act's requirements.

The following definitions are relevant to GHG emissions reporting.

- **Scope 1.** All direct GHG emissions that stem from sources that a reporting entity owns or directly controls, regardless of location, including but not limited to fuel combustion activities.
- **Scope 2.** All indirect GHG emissions from consumed electricity, steam, heating, cooling purchased or acquired by a reporting entity, regardless of location.
- **Scope 3.** Indirect upstream and downstream GHG emissions other than scope 2 emissions, from sources that the reporting entity does not own or directly control and may include, but are not limited to, purchased goods and services, business travel, employee commutes, and processing and use of sold products.

These concepts and the accounting under the GHG Protocol are explained in our Handbook, GHG emissions reporting.

Climate risks

SB-261 requires entities to report under the recommendations of the TCFD or successor body. The TCFD framework includes recommended disclosures within four core pillars: governance, strategy, risk management, and metrics and targets.

Regarding a successor body, the TCFD is currently winding down operations and its monitoring activities are being taken over by the IFRS Foundation, which governs the activities of the ISSB. The Act specifically refers to compliance with the ISSB™ Standards as an acceptable alternative, but does not rule out other laws and regulations; this may include the SEC's climate rule once finalized. Both the ISSB Standards and the SEC's climate proposal – in addition to the European Sustainability Reporting Standards – leverage the TCFD framework.

If the disclosures are made at a parent level, a subsidiary in scope of SB-261 need not make its own separate disclosures.

Penalties

During a transition period between 2027 and 2030, penalties related to scope 3 disclosures will be for non-filing only; and on an ongoing basis there will be no penalties for any misstatements related to scope 3 disclosures made with a reasonable basis and disclosed in good faith.

Effective dates are coming soon

In signing the bills into law, the California Governor highlighted concern about the tight implementation timeline and we expect the effective dates to be further considered.

	SB-253 (GHG emissions)	SB-261 (climate risks)
Effective dates:	• Scopes 1, 2: 2026 (FY25 data) • Scope 3: 2027 (FY26 data)	On or before Jan 1, 2026
Reporting frequency:	Annual	Biennial
Reporting location:	Digital reporting platform	Company website

The filing date in 2026 from which GHG emissions will need to be reported is still to be determined, but will be in relation to data for the company's (or business entity's) prior fiscal year – i.e. fiscal 2025 data for scope 1 and 2 GHG emissions. In setting the reporting timelines, CARB is required to consider both the typical period for receiving emissions data (e.g. from suppliers) and the capacity for independent assurance engagement (see Assurance required from the outset).

Reporting of scope 3 GHG emissions will begin one year later, in 2027, and will be required no later than 180 days after public disclosure of scopes 1 and 2 each year. This reporting lag will be reviewed by CARB in 2029 and possibly tightened.

The first report on climate risks is due on or before January 1, 2026 – i.e. before the first reporting of GHG emissions.

Given the time needed to prepare robust processes and controls to support formal reporting – including assurance – any potential change in the effective dates does not affect the need to **start preparing now**.

Assurance required from the outset

Assurance over GHG emissions is graduated, starting with limited assurance and scopes 1 and 2 GHG emissions.

	SB-253 (GHG emissions)	SB-261 (climate risks)
Assurance:	• Scopes 1 and 2: limited assurance from 2026; reasonable assurance from 2030 • Scope 3: TBD	No requirement
Assurance provider:	Independent third party	N/A

Although assurance over scope 3 GHG emissions is not immediately required, SB-253 includes a requirement for CARB to make a decision in that regard by January 1, 2027. If CARB decides that scope 3 GHG emissions should be assured, a requirement for limited assurance would begin in 2030.

SB-253 requires the assurance provider to be an independent third party, and to have “significant experience in measuring, analyzing, reporting, or attesting to the emission of greenhouse gasses and sufficient competence and capabilities necessary to perform engagements in accordance with professional standards and applicable legal and regulatory requirements.” However, the Act does not mandate the use of specific assurance standards.

CARB is required to review the qualifications for third-party assurance providers during 2029, and to implement any updates by January 1, 2030.

Comparison to the SEC proposal

The following is a high-level summary of how the requirements of the California climate laws compare to the SEC’s climate proposal, ignoring effective dates and transition provisions.

	California laws	SEC proposal
Scope 1 GHG emissions	✓	✓
Scope 2 GHG emissions	✓	✓
Scope 3 GHG emissions	✓	✓ if material or included in a reduction target/goal
Assurance: Scopes 1 and 2 GHG emissions	✓	✓ accelerated and large accelerated filers
Assurance: Scope 3 GHG emissions	TBD	✘
Climate-related financial risks	✓	✓
Climate-related financial opportunities	✘	✘

It's all about the value chain

These California climate laws add to the growing body of ESG reporting standards that are affecting US companies – either directly by virtue of being in scope, or indirectly via a company's value chain. The latter is particularly important because customers are requesting information from suppliers to help them meet their own obligations.

The following resources focus on international developments and how US companies can be affected:

- Hot Topic, Impact of EU ESG reporting on US companies
- Hot Topic, Impact of EU supply chain laws on US companies
- Podcast, ESG reporting update (ISSB focus)
- Webcast replay, International ESG reporting: ISSB and EU standards.

In addition, CDP (formerly, Carbon Disclosure Project) announced that it will incorporate the ISSB's climate standard (IFRS S2) into its global environmental disclosure platform.

This growing interconnectedness between business needs and reporting is putting increased pressure on interoperability between reporting standards or frameworks. The California climate laws take this into consideration in using the GHG Protocol as a basis for GHG emissions and allowing climate risk disclosure frameworks equivalent to the TCFD (see Targeted disclosures).

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