ESG for newly public companies

Develop an ESG plan pre-IPO to set up a better offering and a more successful public company

Introduction

Capital markets readiness efforts have become inextricably connected with environmental, social, and governance (ESG) principles.

ESG principles touch every aspect of a company's operations, including strategy, finance, supply chain, human resources, and cyber-security. Public companies should understand how ESG risks and opportunities impact enterprise value, and now organizations preparing for an initial public offering (IPO) are incorporating ESG principles into their capital markets readiness checklists. In line with this trend, the Securities and Exchange Commission (SEC) is expected to propose rules around social-related disclosures and finalize their rules around climate-related disclosures and cybersecuirty-related disclosures in the near future.

However, ESG and sustainability represent more than a reporting exercise. Companies that focus on ESG metrics can increase efficiencies, reduce risks, raise credit ratings, and attract investors. For companies going to the public markets today, ESG is now a primary feature in the equity story. Organizations that demonstrate strong ESG strategies and disclosures can stand out from the crowd of companies looking to attract long-term investment.

While going public and integrating ESG may seem like different priorities, they are actually complementary activities. Private companies that understand the transformational nature of the IPO process will find parallels in the ESG journey and can do better on both fronts by pursuing the IPO and ESG as one coordinated effort. Today, companies that are undertaking an IPO face the decision to either control how the ESG story of the organization is told or let other market participants tell it instead.

In this paper, we outline how organizations on the IPO journey are embedding ESG principles into their readiness plans, starting with a corporate strategy that unlocks opportunities and mitigates risks.

Embed an ESG strategy into capital markets readiness plans

Companies going public have an opportunity to incorporate ESG principles from the top down while they prepare for an IPO. As they follow the traditional roadmap of capital markets readiness activities, companies can also implement ESG practices.

Incorporate ESG into overall business strategy

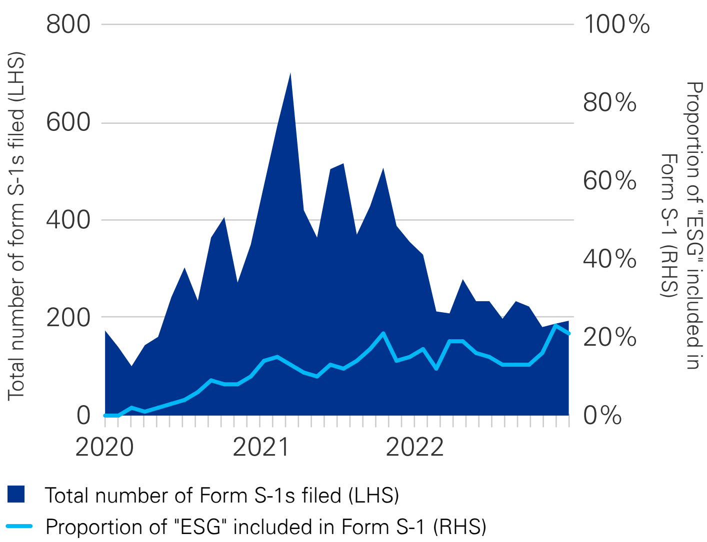
Developing an effective ESG strategy begins with these three elements:

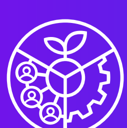
1 **Mapping your world:** Understanding the material ESG topics that are most impactful to the business. This should be considered within the context of industry peers and in conjunction with the needs of investors and other stakeholders involved in IPO planning, which include proxy advisors, ESG indices, and potential lenders. Further, private companies need to measure the cashflow implications of action or inaction with respect to these material topics for the business, pre- and post-IPO.

2 **Corporate ESG profile:** Agreeing on the vision of the company's ESG profile—i.e., post-IPO, is the objective to be viewed as an industry leader with ambitious sustainability goals, focused on compliance alone, or somewhere in-between? Public companies should also prepare for scrutiny by ratings agencies, which involves understanding different ratings methodologies.

3 **ESG in the operating model:** Addressing material sustainability topics can lead to operating model enhancements, for example, in the identification of previously unknown supply chain weaknesses. These vulnerabilities can be proactively addressed to build organizational resiliency before going public.

Exhibit 1: More than 20 percent of SEC S-1 registration statements now refer to ESG





75% of executives say that their organizations have either developed or are currently developing a corporate-wide ESG strategy.

KPMG 2022 Chief Accounting Officer (CAO) Survey

Establish the right corporate governance structure

Corporate governance must evolve to deal with matters where ESG intersects with business functions. Corporate tax, for example, should consider how to take advantage of ESG-related tax incentives. Several companies have added or appointed board- and executive-level sustainability, Diversity, Equity and Inclusion (DEI), and/or other ESG leaders, as well as controllers and business unit leaders who are accountable for related activities.

At the board level, shareholders increasingly expect directors tasked with ESG-related matters to have real experience. Companies going public need to have the appropriate people with the right expertise in place on board committees, and they should anticipate scrutiny of their backgrounds and contributions.

Overall, more company leaders are positioning their organizations to capture ESG's value from the top-down. A large majority of Chief Executive Officers (CEOs) surveyed by KPMG say that corporate purpose has the greatest impact on performance over the next three years, and the percentage of CEOs who believe ESG improves performance is on the rise.[1]

73% of CEOs say they expect corporate purpose will have the greatest impact on driving financial performance over the next three years.

KPMG 2022 CEO Outlook

That means it is critical that newly public companies have the right corporate oversight to measure and assess progress in terms of corporate ESG commitments, Key Performance Indicators (KPIs), and goals such as addressing the gender-pay gap, board diversity, and de-carbonization targets. Companies must be transparent with investors about their progress on achieving these goals. Communicating appropriate financial and non-financial targets is critical to avoid the risk of withdrawing guidance or missing targets on these ESG factors.That situation could create uncertainty, a loss of confidence, and changes to analyst forecasts, all of which could lead to stock price volatility.

Build a comprehensive risk management function that incorporates ESG

In practice, we have seen that ESG principles can be the catalyst for the evolution of a company's risk management function. As a starting point, private companies on the IPO path need to address evolving compliance risks and identify, assess, manage, and mitigate a wide variety of other ESG-related risks.

The task often requires a robust enterprise risk management system and enhancements to pre-existing processes. This work can also include new roles and responsibilities, additional risk analysis and modelling capabilities, and stress testing such as climate related scenario analysis. Effective ESG practices can protect against reputational risks, which is critical for a newly public company building its brand and goodwill.

[1] Source: KPMG 2022 CEO Outlook

Leverage ESG to unlock new sources of capital

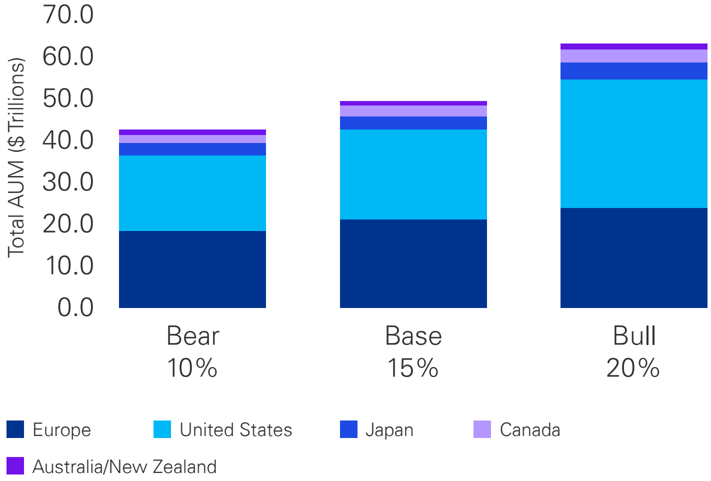
Once the strategy is laid out and appropriate corporate governance surrounds the ESG commitments, the question becomes how can a private company fund these transformational activities.

Private companies considering seed or series funding that meet ESG criteria can access a giant pool of investor dollars, new and growing avenues for financing debt, and potentially lower corporate financing costs. Lenders are willing to offer competitive pricing based on ESG practices in part because high corporate governance standards are known to reduce default risk,[2] and because companies that adhere to ESG principles tend to maintain profitability and repay debt.[3]

Moreover, ESG investment focus isn't limited to certain funds, which means there is a lot more capital available. Using its own index, MSCI found their high-ESG-rated companies were "more profitable, paid higher dividends and showed slightly higher valuation levels" over 10 years.[4]

ESG assets are projected to reach $53 trillion by 2025—a third of all global assets under management. Bloomberg also has indicated continued growth for ESG Assets Under Management (AUM) globally.

Exhibit 2: ESG global projected AUM by country in 2024



Source: Global Sustainable Investment Alliance, Bloomberg

[2] Source: Ashish Lodh, "ESG and the cost of capital," MSCI Inc., February 25, 2020

[3] Source: Jacqueline Poh, "How ESG-Linked Loans Help to Hold Firms Accountable," Bloomberg, August 31, 2022

[4] Source: Guido Giese and Linda-Eling Lee, "Weighing the Evidence: ESG and Equity Returns," MSCI Inc., April 2019

45% of CEOs say ESG improves financial performance, up from 37% a year ago.

KPMG 2022 CEO Outlook

Preparing investor-grade ESG disclosures

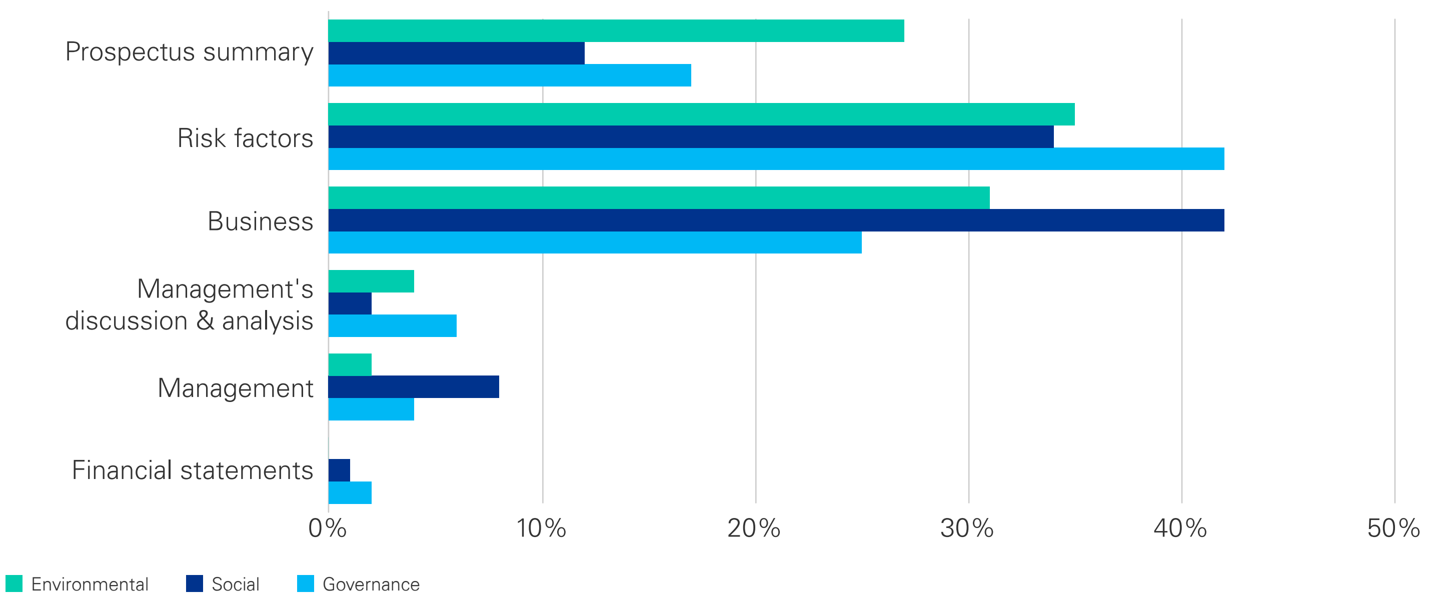
A look at ESG disclosures in SEC registration statements

In 2022, the SEC proposed rules for climate and cybersecurity-related disclosures for public companies. We found that some of the key themes in these proposals were covered in the registration statements filed by companies in 2022.

Under the SEC's proposed climate disclosure rule, the same disclosures required for registrants would apply to companies filing registration statements in connection with the registration of a security, a securities offering, or an investment company. Therefore, registration statements would be required to include (subject to certain exemptions): financial statement metrics and related disclosures, greenhouse gas (GHG) emissions disclosures, and disclosures that are broadly aligned to the Task Force on Climate-related Financial Disclosures (TCFD) framework. For more information, see our Talk book on understanding the SEC's climate proposal.[5]

ESG mentions in Form S-1s filed with the SEC

Exhibit 3. Outlined below are the proportion of filings in 2022 that contained ESG-related themes embedded in key sections of company Form S-1 filings, based on our review of more than 1,000 Form S-1s filed in 2022 across all industries.



*Please note that the above includes amended filings.

[5] Source: "Understanding the SEC's climate proposal," KPMG.us, March 2022

Based on our results, ESG-related themes were most prominent in the Risk Factors section, particularly with over a third of Form S-1s referencing climate-related risks. As expected, these references highlight not only how specific climate risks can result in financial and operational risks to the business but also how some of them can result in critical external risks to the environment.

The data also show that there is a lack of connectivity between disclosures associated with ESG-related matters and how risks associated with them emanate in the financial statements.

The interconnectivity between sustainability reporting and the financial statements could impact how companies undertaking an IPO choose to approach the Management Discussion and Analysis (MD&A) section of their registration statement. Understanding how the tone and scope of a public company's MD&A section in connection with the company's vision of its ESG profile will be critical to a well-articulated equity story.

Further, based on our results, ESG was referenced in the Management, Prospectus and particularly the Business sections of registration statements. The data show that new registrants are demonstrating their understanding of the overlap between business priorities and ESG topics. Seldom does ESG apply to an organization in a corporate silo, particularly for those on the IPO path.

The interconnectivity between SEC filings and corporate sustainability reports

Regulators around the world, including the SEC, are moving at a fast pace to start requiring ESG-related disclosures on topics important to their stakeholders. In 2021, the SEC staff released a sample letter indicating extensive questioning of the quality of public companies' climate-related disclosures. The first question in the letter highlights the staff's interest in the differences between companies' ESG or sustainability reports and their SEC filings, specifically, "what consideration you gave to providing the same type of climate-related disclosure in your SEC filings as you provided in your Corporate social responsibility report?"[6]

Pre-IPO companies can look at ESG topics that are voluntarily disclosed in abundance to start to get their house in order and prepare investor/SEC-grade disclosures on these topics.

[6] Source: "Sample Letter to Companies Regarding Climate Change Disclosures," U.S. Securities and Exchange Commission, September 22, 2021

Common themes between S-1 filings and ESG or sustainability reports in 2022

Taking a deeper look at ESG topics commonly disclosed in Form S-1s and ESG or sustainability reports, we reviewed a sample of more than 1,000 S-1 filings and over 3,000 ESG or sustainability reports published in 2022 across all industries. The results below show how key ESG themes are disclosed and/or referenced within the two separate corporate reporting landscapes: (1) SEC reporting in terms of S-1 filings and (2) publicly available ESG or sustainability reports.

The voluntary reporting highlights key ESG themes, as outlined below. Many organizations are recognizing the interconnectivity between business risks and sustainability risks. Companies that include investor-grade ESG disclosures on these topics in their registration statements will have a head start in meeting upcoming SEC requirements.

ESG topics	The proportion of S-1 Forms that included disclosure and/or referenced the topic	The proportion of ESG or sustainability reports that included disclosure and/or referenced the topic
Environmental: Climate change	32%	88%

As expected, the predominant feature in ESG or sustainability reports is climate-related matters and how the organization has or will take steps to limit the effects of climate-related risks. For example, we noted many ESG or sustainability reports included the measurement and recognition of various scopes of greenhouse gas emissions and goals or commitments related to decarbonization timeframes ranging from 2030 to 2050. This trend flows through in Form S-1s, with 32 percent of S-1s sampled including a disclosure around climate risks.

ESG topics	S-1 Forms	ESG or sustainability reports
Social: Labor practices	29%	72%
Social: Diversity, equity, and inclusion	24%	75%

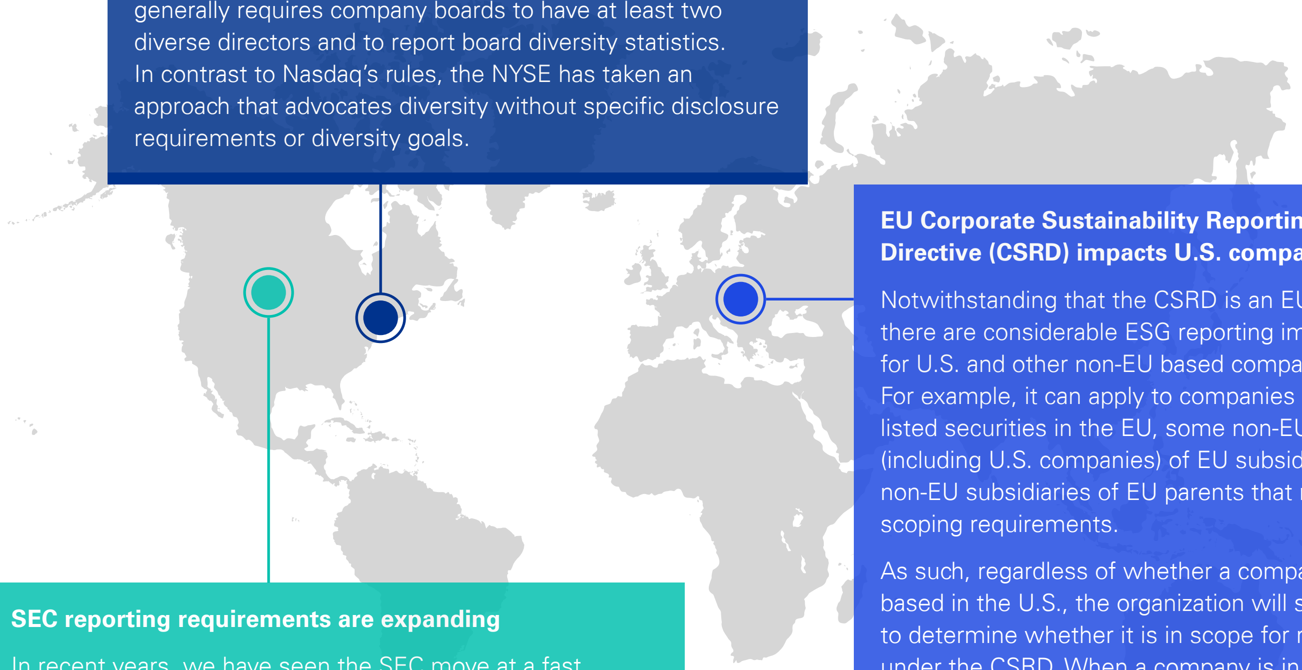
Between Form S-1s and ESG or sustainability reports, the topics regarding labor practices and workplace health and safety have always been a priority item to attract and retain talent to support the growth and transition to becoming a public company. For example, within ESG or sustainability reports, some of the topics disclosed related to increasing board diversity and demonstrating an increased focus around workforce demographics including diversity.

ESG topics	S-1 Forms	ESG or sustainability reports
Governance: Supply chain & sourcing	61%	47%
Governance: Data/cyber security	25%	61%

Corporations are continuing to build resiliency in response to a variety of external pressures. Cybersecurity threats and incidents are an escalating risk to public companies, investors, and market participants, hence a quarter of S-1 registration statements already include cybersecurity disclosures. Further, considering the disruptions brought about from the pandemic, many newly public companies are looking at their supply chains in different ways to not only measure greenhouse gas emissions but also to unlock a competitive edge.

Disclosures are going global

Sustainability reporting continues to develop at a fast pace. 2022 saw the publication of three sets of proposed ESG-themed standards: from the International Sustainability Standards Board (ISSB), the SEC and the European Financial Reporting Advisory Group (EFRAG). International companies, and those that maintain non-U.S. operations or have plans to expand across jurisdictions, need to stay abreast of global regulatory reporting developments.



U.S. Exchanges headquartered in New York

Several international securities markets and exchanges have introduced their own ESG-related requirements and disclosure guidelines for their listed companies. Nasdaq generally requires company boards to have at least two diverse directors and to report board diversity statistics. In contrast to Nasdaq's rules, the NYSE has taken an approach that advocates diversity without specific disclosure requirements or diversity goals.

SEC reporting requirements are expanding

In recent years, we have seen the SEC move at a fast pace, proposing rules around climate-related disclosures and cybersecurity. The SEC is also expected to propose rules around human capital disclosures in 2023. Companies contemplating an IPO need to consider how these rules could impact their timing, level of effort needed, and approach now, while there is time to plan.

EU Corporate Sustainability Reporting Directive (CSRD) impacts U.S. companies

Notwithstanding that the CSRD is an EU directive, there are considerable ESG reporting implications for U.S. and other non-EU based companies. For example, it can apply to companies with listed securities in the EU, some non-EU parents (including U.S. companies) of EU subsidiaries, and non-EU subsidiaries of EU parents that meet the scoping requirements.

As such, regardless of whether a company is based in the U.S., the organization will still need to determine whether it is in scope for reporting under the CSRD. When a company is in scope of the CSRD at any reporting level, due consideration should be applied in regard to how to leverage the data and EU disclosures prepared for the purposes of achieving compliance with the forthcoming U.S. SEC disclosure requirements regarding climate, cybersecurity, and human capital.

85% of CAOs in the U.S. say their accounting and finance functions have already assessed or are currently assessing how the emerging ESG regulatory landscape will impact their companies' financial reporting.

KPMG 2022 CAO Survey

Upgrade technology and data capabilities for ESG reporting

Companies planning to IPO will need robust ESG-reporting policies and processes with an effective internal control environment that are of the same caliber and rigor of that expected from financial reporting functions. This step is critical to ensure organizations can measure progress to the established strategy and ESG-related goals.

Sarbanes-Oxley (SOX) certification can be a post-close milestone, but those at the beginning of the IPO process should note that implementing SOX-like controls over ESG reporting could be a significant challenge.

Even with the best systems in place for reporting ESG disclosures, reporting outputs will only be as good as the data. Data quality is a challenge for all public companies, often derived from multiple entities and from non-traditional sources, such as sensor readings and utility bills. This challenge involves addressing how an organization can efficiently capture, analyze, and organize the growing amount of structured and unstructured ESG-related data to report investor-grade ESG disclosures.

First, companies planning to go public should ensure that both internal and external data flow through the organization in a manner that enables the preparation of complete and accurate disclosures in a timely fashion. Non-financial data, including much of what's used for ESG reporting, has not typically been subject to the same robust processes and controls compared to data for financial reporting. For example, considering the energy consumption usage outlined in a utility bill. Now that non-financial reporting is being considered as part of regulatory compliance efforts, organizations need to introduce greater rigor to those processes and controls.

The right IT infrastructure and expertise to navigate the evolving technology ecosystem and regulatory environment can help in these matters as companies prepare to go public. ESG-related needs should be part of the overall planning for introducing automation, facilitating intercompany reporting, and avoiding repetitive systems, as well as reducing human intervention. Newly public companies should consider how the organization can manage the complexity of ESG reporting without being dependent on manually driven spreadsheets. Ultimately, the company's goal should be an effective and sustainable IT control environment.

Finally, obtaining external assurance will be considerably more difficult without robust data and strong non-financial reporting processes that produce a cleaner audit trail. Organizations will have to align with those that are providing assurance on the scope of estimates and assumptions that are reasonable given the context of the specific sustainability topic and industry.

Pay attention to internal reporting

Including ESG-related metrics and data into management reporting can enhance insights for management. However, it is important to note that enhanced management reports can change the way management views the business, which in turn can lead to changes in segment reporting required for public companies in accordance with *ASC 280, Segment reporting.*

Understanding the IPO timeframe for ESG-related disclosures

Investors have continued to express interest in obtaining information to help them better evaluate the impact of ESG-related matters on organizations. As a result, regulators are proposing rules and standards to help provide more consistent, comparable and reliable information. New registrants that understand the relevant timeframes and are ready to prepare and disclose on ESG-related matters at the same time as the financial statements can help investors support their needs in a timely manner.

Potential activities during IPO preparations and after closing

Pre-IPO

- Determine the company's IPO priorities and material ESG topics and build a best-in-class strategy around those topics.
- Understand the extent of resourcing, new processes, and data needed to execute the strategy for an IPO in a timely manner.
- Execute rounds of seed/series funding and build an attractive debt/equity and ESG profile to access favorable financing.
- Prepare financial statements, MD&A, and risk factors including any mandated sustainability-related disclosures or ESG/sustainability report.
- Secure audit clearance on financial statements and consider any voluntary or required assurance needs over ESG/sustainability reporting.
- Sign and execute legal agreements, including financing arrangements.
- Initial confidential filing with the SEC, receive and respond to SEC comment letters that may include ESG-related comments.
- Second (and potentially subsequent) confidential filing with the SEC.
- Coordinate investor roadshows that can include ESG themes.

- SEC deems the registration statement effective, and trading begins. **Close IPO.**

Post-IPO

- Ongoing press and quarterly earnings releases that may include company progress toward achieving ESG goals.
- SOX certification (in due course), including consideration around ESG-related controls.

How KPMG can help

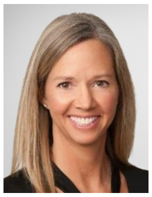
The KPMG Capital Markets Readiness team brings together diverse and experienced professionals to help companies take a holistic approach when preparing to go public.

Private company executives exploring the idea of entering the public markets have much to evaluate, and adherence to ESG principles is just one growing consideration on their already full plates. KPMG can help by starting with a capital markets readiness assessment to identify needs and gaps, and to help company leaders develop or refine their equity story, including ESG-related considerations.

The KPMG Capital Markets Readiness team uses public company peer benchmarking analysis to guide organizations, help them build a competitive edge, and provide insights into industry best practices. No matter where your company is on its IPO-ESG Journey, we offer a roadmap to optimize operations and processes, including financial reporting, strategy, IT systems, corporate governance, human resources, investor relations, and legal and regulatory solutions.

Finally, the Capital Markets Readiness team taps our innovative technology capabilities and industry-leading intelligent automation and data analytics tools on behalf of clients. With knowledge and analysis from our subject matter experts, we can better provide recommendations to expedite the IPO process, addressing your needs effectively to facilitate a successful IPO.

Authors



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Shari specializes in the delivery of capital markets readiness, buy-side and sell-side accounting, finance integration, and separation services in the technology industry. Shari regularly advises clients on technical accounting matters, including business combinations, revenue recognition, lease accounting, debt/equity transactions, consolidation assessments, IFRS/U.S. GAAP conversions, and various other accounting and SEC-related issues.

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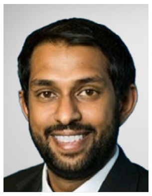
Ashley provides accounting and financial reporting advice to both private and public companies, drawing on her combined experience in advisory, audit and industry. She has worked with clients in the technology and consumer and retail industries, specializing in providing capital markets readiness, ESG reporting, acquisition support and technical accounting advice.



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Theshan brings more than 12 years' experience providing financial reporting, audit and ESG services to companies across the globe. He has worked with clients across various industries and partners with public and private companies on their ESG journey. Theshan helps companies achieve their strategic and financial goals based on his corporate accounting background in conjunction with the Sustainability leadership expertise gained from Harvard University.

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