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SPECIAL REPORT

Corporate Sustainability Reporting Directive (CSRD)

22 March 2023

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CSRD: TRANSFORMING THE REPORTING LANDSCAPE FOR THE BUSINESS COMMUNITY

Key Points

- In line with the European Green Deal, the Corporate Sustainability Reporting Directive (CSRD) aims to modernise and improve the existing requirements of the EU's Non-Financial Reporting Directive (NFRD), driving sustainable activities across the bloc.
- The directive significantly expands the scope of companies subject to EU sustainability reporting requirements, including a broader set of large companies and listed small and medium-sized enterprises (SMEs). Around 50,000 entities are likely to be covered, accounting for roughly 75% of EU companies' turnover.
- Companies will be required to include sustainability-related information in their annual reports. These are to be submitted in electronic format in accordance with the European Single Electronic Format Regulation. The CSRD will also introduce a mandatory requirement for sustainability disclosures to be certified by an independent auditor.
- The new rules will go into effect during FY 2024; they will require companies already subject to the NFRD to publish reports in 2025.

Context

Environmental, Social and Governance (ESG) considerations are now an ever-prominent part of business operations. Globally, there is a growing number of stakeholders, from investors and shareholders to consumers and regulators, demanding improved transparency and corporate accountability concerning the ESG risks and opportunities facing companies.

As part of the European Green Deal, the European Commission (EC) adopted the Sustainable Finance Package on 21 April 2021, laying the foundations to improve capital flow towards sustainable activities and ensuring a green transition across the EU. One of the key policy initiatives proposed within the package was the CSRD. Arising at a critical juncture with regard to ESG's maturity, this new directive…

'*…modernises and strengthens the rules about the social and environmental information that companies have to report*.'

On 21 June 2022, the EC, European Council and European Parliament reached an agreement on the provisions of the CSRD, which was endorsed by EU member states on 30 June 2022. Reflecting the significant steps taken by the EU to materialise ESG into reporting requirements and regulations, the CSRD was then published in the Official Journal of the EU in December 2022, entering into force on 5 January 2023.

This report highlights the key features of the CSRD and outlines the impact it will have on the business community in terms of sustainability reporting requirements.

Scope

Since FY 2017/18, the provisions of the NFRD (the EU's current reporting requirement) have been in effect in all EU member states. This requires all listed companies and other public interest entities with more than 500 employees to disclose certain types of non-financial information, including environmental and social impact, anti-bribery and anti-corruption, diversity and human rights.

The CSRD builds on the existing NFRD; it introduces more detailed reporting requirements and expands the scope of covered companies. Reporting requirements now apply to all SMEs with securities listed on regulated markets (excluding micro-enterprises with fewer than ten employees or a net turnover below EUR 20 million), as well as large entities which meet two of the following three criteria:

1. A net turnover exceeding EUR 40 million;
2. More than EUR 20 million in balance sheet total assets; and/or
3. More than 250 employees

International companies generating more than EUR 150 million annually within the EU jurisdiction for two financial years in a row, or which have at least one subsidiary or branch in the EU generating more than EUR 40 million, will also have to abide by CSRD requirements. While this is a pivotal piece of EU legislation, non-EU companies which fall under the CSRD's scope cannot overlook the strict requirements they must now follow. Under such criteria, the number of companies required to follow the sustainability reporting standards have now quadrupled. Approximately 50,000 companies (accounting for around 75% of all EU companies' turnover) are now expected to adhere to the CSRD, up from around 12,000 companies under the NFRD.

Disclosures

Developed by the European Financial Reporting Advisory Group (EFRAG), the CSRD will function via the European Sustainability Reporting Standards (ESRS), which the EC must adopt by June. The proposed draft standards of the ESRS include standards for both requirements (ESRS 1) and disclosures (ESRS 2), as well as ten subject matter-specific standards across all three pillars of ESG (see Figure 1).

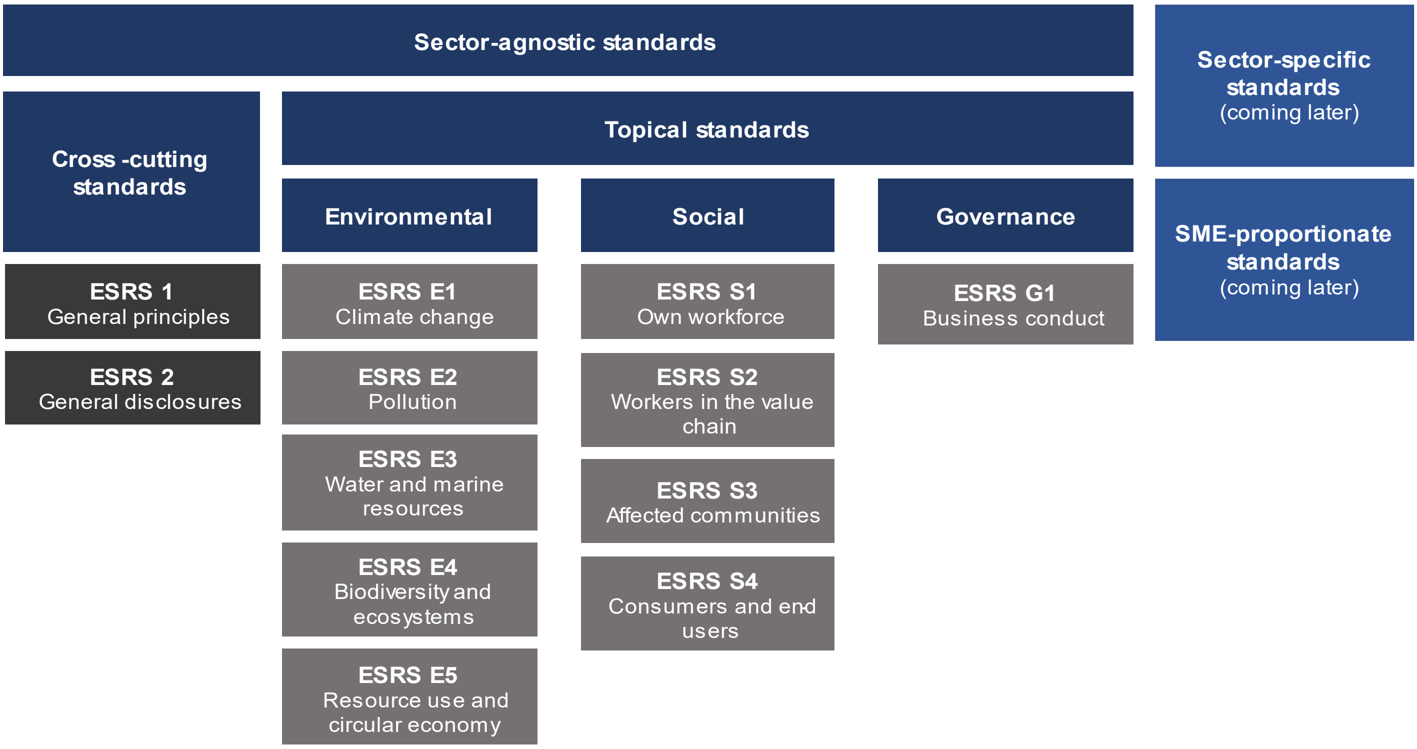

Figure 1: Draft ESRS; the above standards will be complemented by sector-specific reporting standards developed by EFRAG throughout 2023

As previously mentioned, companies under the CSRD are subject to more reporting requirements. Building off the NFRD, the CSRD obliges companies to publish information relating to the following additional requirements:

- A ‘double materiality’ concept (sustainability risk, including climate change, affecting companies’ impact on society and environment);
- Processes for selecting material topics for stakeholders;
- More forward-looking information, including targets and progress;
- The disclosure of information relating to intangibles (social, human and intellectual capital);
- Reporting in line with Sustainable Finance Disclosure Regulation (SFDR) and the EU Taxonomy Regulation

Double materiality is an extension of the accounting concept of materiality, meaning corporate entities will not only have to consider the financial risks posed by sustainability issues, but also their impact on society and the environment. The proposed standards also require companies to incorporate material impacts, risks and opportunities across their entire value chain into their own reporting. Another key feature is that companies must submit sustainability-related information in their annual reports in XHTML format, aligned with the European Single Electronic Format Regulation. This information will be subject to mandatory assurance by an independent auditor to ensure information complies with the certification standards adopted by the EU. With such significant changes to requirements, both EU- and non-EU-based companies will need to make substantial and timely adjustments to their sustainability reporting considerations.

Timeline and sanctions

Notably, EFRAG is drawing upon several pre-existing standards and frameworks for its reporting disclosures. This is reflected by its involvement in ongoing technical discussions with the EC and the International Sustainability Standards Board (ISSB). These discussions seek to achieve a high degree of harmony between the global sustainability standards of the ISSB and the European framework as part of an overall drive to limit the disruption for entities which already report sustainability information.

Each EU member state has until 16 June 2024 to adopt the directive into its national laws. In addition, the directive is responsible for setting and defining the limits of sanctions within a state’s jurisdiction. However, the CSRD requires member states to implement (as a minimum) the following three levels of administrative sanctions in the event a company is found guilty of non-compliance:

- A public declaration describing the nature of the breach and identifying the responsible individual(s)/entity(ies);
- A cease-and-desist order against the responsible individual(s)/entity(ies);
- Regulatory fine against the responsible individual(s)/entity(ies)

Business impacts

Filing the gaps which exist in current corporate sustainability reporting, the CSRD will help deliver reliable and comparable sustainability information, fostering a business culture centred around transparency and responsibility. The CSRD was established because the EU recognises the importance of the role companies play in trying to achieve low carbon economies, and believes that businesses must be held accountable for their sustainability impact.

Companies in the EU, or with an EU presence, should already be accelerating their ESG tracking and disclosure procedures. To reduce the operational burden and ensure compliance with CSRD requirements, businesses must develop the mechanisms to collect, monitor, and assess relevant sustainability disclosure information. The changes brought about by the introduction of the CSRD will prompt companies to rethink their approach around ESG and their current reporting practices. Beyond a legal reporting requirement, the CSRD should be seen as an opportunity for businesses to measure their resilience and create long-term value by aligning their corporate purpose with ESG considerations.

Figure 2: CSRD timeline; the first companies subject to the CSRD must apply the new requirements during FY 2024, with reports published in 2025

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