EU REPORTING - CORPORATE SUSTAINABILITY REPORTING DIRECTIVE (CSRD) REQUIREMENTS (As of October 2022)

INTERNATIONAL SUSTAINABILITY REPORTING BULLETIN

2022/05

INTRODUCTION

In April 2021, the European Commission published a proposed new Corporate Sustainability Reporting Directive (CSRD). The proposals were designed to revise and strengthen the existing requirements of the Non-Financial Reporting Directive (NFRD) to ensure that companies report reliable and comparable sustainability information that investors and other stakeholders need.

As part of the legislative process, the European Commission's proposals were subject to review by the European Parliament and the European Council (which is made up of representatives from each EU Member State). Both the Parliament and the Council proposed amendments to the Commission's proposals.

EXECUTIVE SUMMARY

The Corporate Sustainability Reporting Directive will significantly expand both the scope of the existing NFRD (including to non-EU undertakings) and the sustainability reporting requirements, including the need to obtain assurance on disclosed information.

In the second quarter of 2022, the so-called Trilogue discussions took place. These are discussions among the European Parliament, the European Council and the European Commission at which a compromise is sought, in order to finalise the text which will form the basis of the requirements of the new legislation.

This publication sets out an overview of key changes that will be introduced by the CSRD in comparison to the existing Non-Financial Reporting Directive (NFRD), based on the agreed compromise text, together with a more detailed explanation of the very significantly expanded scope, a summary of what companies need to prepare for, and when.

KEY CHANGES INTRODUCED BY THE CSRD

Requirement	NFRD	CSRD
Companies that are required to report	Large public interest entities with more than 500 employees Public interest entities are: • Listed companies • Banks and insurance companies	Listed companies (except for listed micro entities). All large companies, defined as those meeting two out of the following three criteria: • More than 250 employees • More than EUR 40m turnover • More than EUR 20m total assets This includes subsidiaries of non-EU groups. Insurance undertakings and credit institutions regardless of their legal form. Non-EU groups which generate more than EUR 150m turnover in the EU and which have a subsidiary or branch in the EU (if a subsidiary, either a large - as defined above - or a listed entity and, if a branch, one which generates more that EUR 40m turnover).
When do the requirements apply?	Years ended 31 December 2018 onwards	**Year ending 31 December 2024** • Entities currently within the scope of the NFRD **Year ending 31 December 2025** • All other large entities **Year ending 31 December 2027** • Listed SMEs, small and non-complex credit institutions and captive insurance undertakings **Year ending 31 December 2028** • Non-EU undertakings
How many EU companies will need to comply with the requirements?	11,600	49,000
Scope of the requirements	• Environmental protection • Social responsibility and treatment of employees • Human rights • Anti-corruption and bribery • Diversity on company boards	NFRD requirements plus: • Disclosure of information about intangibles (including social, human and intellectual capital) • Additional forward looking information • Reporting that is consistent with the Sustainable Finance Disclosure Regulation and the EU Taxonomy • Double materiality concept, which expands the consideration of sustainability beyond an entity's capital market value, to include the entity's wider effects on society and the environment
Assurance	Not required	Mandatory • Initially limited assurance, to be expanded to reasonable (audit) assurance in future.

SCOPE

The scope of the CSRD is considerably wider than the existing NFRD, and extends to cover all entities listed on regulated markets (except listed micro entities) and all large entities. There are also linked, additional reporting requirements; if an entity falls within the scope of the CSRD, then it is also required to report in accordance with Article 8 of the Taxonomy regulation. This requires disclosures about the extent to which an entity's operations are associated with environmentally sustainable economic activities (with reference to the related amounts of turnover, operating expenditure and capital expenditure).

Although listed SMEs will be required to report in accordance with the CSRD, they will be permitted to apply simplified sustainability reporting standards which are proportionate to the capacities and resources of SMEs, and relevant to the scale and complexity of their activities. These simplified sustainability reporting standards have not yet been developed and will form part of the second batch of sustainability standards that are required to be adopted by the European Commission by 30 June 2024.

BDO's Insight

The scope of the CSRD is such that certain entities that are not domiciled in the EU will be required to provide sustainability disclosures.

Non-EU entities which have significant activity in the EU will also be required to publish sustainability reports. These are non-EU entities which have at least one subsidiary or branch in the EU and generate EUR 150 million net revenue or more in the EU as a whole. To ensure proportionality, a subsidiary needs to be large or listed, and there is an additional threshold for branches of net turnover of EUR 40 million or more. The sustainability reports are required to cover the consolidated group of the ultimate non-EU parent, with the responsibility for publication in the EU being with the subsidiary or branch. They will need to be prepared in accordance with sustainability standards that are applicable to EU entities, or in accordance with sustainability standards which are deemed to be equivalent by the European Commission.

The European Commission is required to adopt sustainability reporting standards that specify the information to be included in reports prepared by non-EU entities by 30 June 2024.

A non-EU parent may have multiple subsidiaries in the EU that are within the scope of the CSRD. As a transitional provision, for the first seven years in which the CSRD is in force, one of those EU subsidiaries will prepare a consolidated sustainability report that includes all EU subsidiaries that are within the scope of the CSRD. The EU subsidiary which prepares the sustainability report will be one of the subsidiaries that generated the greatest amount of turnover in the EU in at least one of the preceding five years, on an unconsolidated basis.

There are some exemptions to the application of the CSRD. An unlisted subsidiary will be exempt if it is included in a consolidated group sustainability report prepared by its ultimate parent company that complies with the CSRD (or other standards that are recognised as equivalent). However, additional disclosures will be required in the consolidated group report to provide an adequate understanding if the circumstances (that is, the sustainability risks or effects) of the group and the subsidiary are significantly different (or the circumstances of subsidiaries in different geographies are significantly different). If the parent does not report in accordance with the CSRD, and the EU has not granted equivalence to the sustainability reporting framework adopted by the parent, the subsidiary will have to prepare a report in accordance with the CSRD.

If an unlisted subsidiary of a non-EU parent does qualify for and take advantage of the exemption, it will need to include in its management report the name and registered office of the parent entity that is reporting consolidated sustainability information at group level and related website links, together with a statement that the subsidiary is exempt from reporting sustainability information. There is a member state option to require the consolidated sustainability report to be translated into any language that they accept.

For the purposes of equivalence, the European Commission will be able to establish a mechanism for sustainability reporting standards applied by non-EU entities. This will be similar to the existing regulation which sets out the criteria for the equivalence of accounting standards applied by non-EU entities.

KEY AREAS OF REPORTING

Entities will be required to report information which is necessary to understand their impacts on sustainability matters, and information necessary to understand how sustainability matters affect their development, performance and position. The information will need to be disclosed in a clearly defined section of the management report, and include:

- A brief description of the business model and strategy
- A description of time bound targets related to sustainability matters, including (where appropriate) absolute greenhouse gas emission reduction targets for at least 2030 and 2050, together with a description of the progress made in achieving those targets
- A description of the role of the administrative, management and supervisory bodies with regard to sustainability matters
- A description of the entity's policies in relation to sustainability matters
- The existence of incentive schemes offered to members of the administrative, management and supervisory bodies which are linked to sustainability matters
- The due diligence process implemented with regard to sustainability matters, the principal actual or potential adverse effects connected with an entity's own operations and value chain, and any actions taken (and the result of those actions) to prevent, mitigate, remediate or bring an end to actual or potential adverse effects.
- Principal risks to the entity associated with sustainability matters, including dependencies, and how such risks are managed
- The process carried out to identify the information included in the sustainability report, including information related to short, medium and long-term time horizons as applicable
- Turnover, capex and opex in accordance with the Taxonomy Regulation

SUSTAINABILITY REPORTING STANDARDS

European Sustainability Reporting Standards (ESRS) have been under development by a Project Task Force at the European Financial Reporting Advisory Group (EFRAG). Exposure drafts were published in April 2022 with a comment deadline of early August 2022. The proposals are complex and detailed, and cover the following topics:

Cross cutting

- ESRS 1 General Principles
- ESRS 2 General, strategy, governance and materiality assessment

Topical standards – environment

- ESRS E1 Climate change
- ESRS E2 Pollution
- ESRS E3 Water and marine resources
- ESRS E4 Biodiversity
- ESRS E5 Resource and circular economy

Topical standards – social

- ESRS S1 Own workforce
- ESRS S2 Workers in the value chain
- ESRS S3 Affected communities
- ESRS S4 Consumers and end-users

Topical standards – governance

- ESRS G1 Governance, risk management and internal control
- ESRS G2 Business conduct

The ESRS incorporate the so-called double materiality concept, which expands the consideration of sustainability beyond an entity's enterprise (or capital market) value, to include the entity's wider effects on society and the environment. Views differ about the extent to which double materiality differs from enterprise value materiality; some consider that there are significant differences, while others consider that the differences are relatively small (for example, because an entity's employment of slave labour would be likely to affect its reputation in the marketplace and, in consequence its future sales and profits).

The exposure drafts are currently being redeliberated by the EFRAG Sustainability Reporting Board and the EFRAG Sustainability Reporting Technical Expert Group. This first set of ESRS is required to be adopted by the European Commission no later than 30 June 2023.

A second set of sector specific standards will also be developed, to be adopted by the European Commission no later than 30 June 2024, as will standards for SMEs.

As part of the process to ensure that the ESRS take account of the views of EU Member States, the European Commission will need to consult the Member State Expert Group on Sustainable Finance and the Accounting Regulatory Committee (note that consultation with this Committee is also part of the process for the EU endorsement of IFRS Accounting Standards). The European Securities and Markets Authority (ESMA), European Banking Authority (EBA) and the European Insurance and Occupational Pensions Authority (EIOPA) will be required to give an opinion on EFRAG's technical advice to the European Commission. These organisations will have a period of two months to respond.

The European Commission will also be required to consult the European Environment Agency, the European Union Agency for Fundamental Rights, the European Central Bank, the Committee of European Auditing Oversight Bodies and the Platform on Sustainable Finance, with those organisations being given two months to submit any comments or opinions.

Information about a company's value chain will be required. However, for the first three years after the application of the CSRD, if the necessary information is not available, companies do not need to publish value chain information. However, in that case, they are required to provide an explanation of the efforts made to obtain that information, and set out the reasons why the information could not be obtained together with plans about how the information will be obtained in future.

Companies will need to report more widely about key intangible resources on which the business model depends. The potential scope of reporting is wide; examples are information about employees' skills, competencies, experience, and motivation for improving processes, goods and services. Information about the quality of relationships between the entity and its stakeholders, including customers, suppliers and communities affected by an entity's activities that is relevant to social or governance matters could also be viewed as being information about intangible resources.

There will also be a requirement to disclose plans about the business model and strategy that are linked to the transition to a sustainable economy, and with the objective of limiting global warming to 1.5°C above pre-industrial levels in accordance with the Paris Agreement.

Once the ESRS have been issued, the European Commission is required to undertake a review of the standards, including those for SMEs, every three years to take account of relevant developments, including the development of international standards.

RELATIONSHIP WITH INTERNATIONAL SUSTAINABILITY REPORTING STANDARDS

The exposure drafts of ESRS were developed by EFRAG during a period in which there were also significant international developments, including the formation of the International Sustainability Standards Board at the IFRS Foundation. The final compromise text of the CSRD includes references to the need for the ESRS to take account of both existing standards (including the GRI, SASB, IIRC, IASB, TCFD, CDSB and CDP) as well as any sustainability reporting standards developed under the IFRS Foundation. Recital 37 notes that:

> 'To avoid unnecessary regulatory fragmentation that may have negative consequences for undertakings operating globally, European standards should contribute to the process of convergence of sustainability reporting standards at global level, by supporting the work of the International Sustainability Standards Board (ISSB). European standards should reduce the risk of inconsistent reporting requirements on undertakings that operate globally by integrating the content of global baseline standards to be developed by the ISSB, to the extent that the content of the ISSB baseline standards is consistent with the EU's legal framework and the objectives of the European Green Deal.'

Recitals to EU law are not themselves legally binding in the way that the operative provisions (the Articles) are. However, Article 29b(3)(a) states that:

> '…the Commission shall to the greatest extent possible take account of the work of global standard setting initiatives for sustainability reporting, and existing standards and frameworks for natural capital accounting and for greenhouse gas accounting, responsible business conduct, corporate social responsibility, and sustainable development.'

ASSURANCE

The CSRD introduces requirements for the assurance of sustainability reports. The European Commission is to adopt assurance standards for limited assurance by October 2026, with assurance standards for reasonable assurance following by October 2028 (subject to an assessment of whether reasonable assurance is feasible for auditors and for entities).

When an entity is required by EU legislation to have some elements of its sustainability reporting assured, the assurance report is to be made available either as an annex to the management report or by some other publicly accessible means.

ASSURANCE PROVIDERS

The statutory auditor will be able to provide an opinion on sustainability reporting.

In addition, Member States are to be given two options. These are:

- to allow a statutory auditor other than the one(s) carrying out the statutory audit to express an opinion on sustainability reporting, and
- to accredit Independent Assurance Service Providers (IASPs) which are assurance providers that are not statutory auditors.

However, if a Member State accredits IASPs, it is then also required to allow a statutory auditor other than the one(s) carrying out the statutory audit to express an opinion on sustainability reporting.