Corporate Sustainability Reporting Directive (CSRD) Approved by European Council; More Than 50,000 Organizations Affected

30 November
2022

On 28 November, the European Union (EU) Council (Council) gave its final approval to the Corporate Sustainability Reporting Directive (CSRD), which will require new, standardized and detailed sustainability reporting by companies.[1] The CSRD represents a significant expansion from the earlier Non-Financial Reporting Directive (NFRD), which it replaces, and exceeds all previous sustainability reporting requirements, both in the number of companies affected — from around 12,000 today to approximately 50,000 — and in the scope of its reporting requirements.

The EU has set a goal, in the European Green Deal, to make Europe the first climate-neutral continent.[2] Sustainability disclosures mandated by the CSRD will likely play a crucial role as a basis for investment decisions regarding this transformation toward climate neutrality.

Following the signing of the legislative act by the President of the European Parliament and the President of the Council, the CSRD will be published in the *Official Journal of the European Union* and will enter into force 20 days thereafter. EU member states will have 18 months to codify the directive into national law.

Background

The goal of the CSRD is to have companies provide the sustainability information investors and other stakeholders consider important. The focus is on improving standardization, verifiability and accountability in reporting, as well as creating greater alignment with other existing regulations — the Sustainable Finance Disclosure Regulation (SFDR) and the Taxonomy Regulation in particular.

[1] https://www.consilium.europa.eu/en/press/press-releases/2022/11/28/council-gives-final-green-light-to-corporate-sustainability-reporting-directive/

[2] https://climate.ec.europa.eu/eu-action/european-green-deal/european-climate-law_en.

The CSRD requires reporting on a significantly increased level of detail compared to the NFRD and other sustainability reporting standards or frameworks. In essence, it puts sustainability reporting on the same level as financial reporting.

The reporting requirements of the CSRD will be specified in the European Sustainability Reporting Standards (ESRS), which are expected to be released in the first half of 2023. The standards will define in detail what companies will need to report, including key performance indicators (KPIs). The European Financial Reporting Advisory Group (EFRAG), in its role as technical adviser to the European Commission Sustainability Reporting Board, adopted the first set of the ESRS standards and handed it over to the EU Commission for approval on 22 November 2022.[3] After final review, the Commission is expected to adopt the ESRS drafts as a delegated act, meaning an amendment or supplement to the legislation. For companies within scope of the CSRD, implementation of the standards will begin in fiscal year 2024 based on specified criteria, as described below.

What's in the CSRD?

The CSRD requires inclusion of corporate sustainability reporting in a dedicated section of the management report. The report must provide the information necessary to understand both the impacts of the business on sustainability matters (inside-out perspective) and how sustainability matters affect the business' development, performance and position (outside-in perspective). Where applicable, it should contain references to, and additional explanations of, other information included in the management report or the annual financial statements related to sustainability.

Reported information should take into account short-, medium- and long-term time horizons and include the entity's entire value chain, including its own operations, products and services, its business relationships, and its supply chain, as applicable in the descriptions of:

- The business model and strategy relating to sustainability matters, including:
    - The resilience of the business model and strategy to unexpected risks
    - The opportunities related to sustainability

[3] www.efrag.org/News/Public-387/EFRAG-delivers-the-first-set-of-draft-ESRS-to-the-European-Commission.

- The plans to ensure that the business model and strategy are compatible with the transition to a sustainable economy and the goal of limiting global warming to 1.5° C in line with the Paris Agreement
- How stakeholder interests and impacts on sustainability matters are taken account of in the business model and strategy
- How the strategy has been implemented

- The time-bound targets and the progress towards achieving those targets
- The role of administrative, management and supervisory bodies and their expertise and skills to fulfil this role
- The policies in relation to sustainability matters and incentive schemes
- The due diligence process implemented (i.e., the principal actual or potential adverse impacts connected with the operations of the business and its value chain as well as the actions taken to identify and track these impacts and to prevent, mitigate, remediate or bring them to an end).[4]

Moreover, the undertakings in scope of these reporting obligations will also have to comply with Article 8 of the EU's Taxonomy Regulation, which establishes a classification system in the EU to identify economic activities that are considered sustainable.

Which Companies Are in Scope?

The new sustainability reporting rules will apply to all large companies and to all companies listed on regulated markets in the EU except listed micro-undertakings. These companies are also responsible for assessing the information applicable to their subsidiaries — a consolidated view.

The rules apply to listed SMEs (small and medium-sized enterprises), taking into account their specific characteristics. An opt-out will be possible for listed SMEs during a transitional period, exempting them from the application of the directive until 2028.

In addition to the listed companies, nonlisted companies with more than 250 employees and more than €40M turnover (or, in the case of financial institutions, more than €20M in total assets) must also report under the CSRD.

[4] CSRD, Article 19a, https://data.consilium.europa.eu/doc/document/PE-35-2022-INIT/en/pdf.

Nonlisted companies will need to include the required information in their management report. At a future point, the EU will establish a European Single Access Point (ESAP) for reporting this information.[5]

For non-European companies, the requirement applies to all companies generating a net turnover of €150 million in the EU which have at least one subsidiary or branch in the EU exceeding certain thresholds. As a result, multinationals doing business in the EU are also affected.

When Does Reporting Begin?

The implementation of the reporting requirements is being rolled out as follows:

- **Reporting in 2025 (FY 2024)** for companies currently subject to the NFRD
- **Reporting in 2026 (FY 2025)** for companies which are not subject to the NFRD but meet the in-scope criteria as defined above
- **Reporting in 2027 (FY 2026)** for listed SMEs, except micro-undertakings, small, noncomplex credit institutions, and captive insurance undertakings
- **Reporting in 2029 (FY 2028)** for non-EU companies with EU branches or EU subsidiaries, as defined in the previous section
- **Opt-out possibility** for listed SMEs, with first-time application possible in FY 2028. (These companies are exempt from the CSRD until 2028.)

Relation of the Directive to Other Sustainability Reporting Standards

The CSRD adds a comprehensive set of requirements to those already existing or underway in other parts of the world. For example, the U.S. Securities and Exchange Commission has issued a proposal for the disclosure of climate-related information for consultation, with a final rule expected before the end of 2022. Additionally, the International Sustainability Standards Board (ISSB) has received more than 1,300 comment letters on its two proposed sustainability disclosure standards, which it plans to issue as early as possible in 2023.[6] The ISSB is working with the European Commission and EFRAG toward a shared objective for a

[5] www.consilium.europa.eu/en/press/press-releases/2022/06/29/easier-access-to-corporate-information-for-investors-council-agrees-its-position-on-a-single-access-platform/.

[6] www.ifrs.org/news-and-events/news/2022/11/issb-cop27-progress-implementation-climate-related-disclosure-standards-in-2023/.

framework to maximize interoperability of their standards and alignment on key climate disclosures.

Key Concepts in the CSRD — Areas of Special Consideration

Double materiality is the basis for sustainability/ESG disclosures

The materiality assessment is not only relevant for sustainability reporting but is also of strategic relevance when it comes to sustainability management and provides a blueprint for the organization's sustainability/ESG strategy. The CSRD incorporates the concept of double materiality: Companies have to report not only on how sustainability issues might create financial risks for the company (financial materiality) but also on how the company impacts people and the environment (impact materiality). Given the diverse range of stakeholders who require information on an organization's sustainability performance, companies must report matters which are material either to the undertaking's financial side or are material in their impacts — or for both (outside-in and inside-out perspective)

Location of reporting is prescribed in the (combined) management report

The CSRD requires that the sustainability report is part of the (combined) management report as a specific section. In addition, the reporting must be machine-readable. Key figures and information will be transmitted and published in a standardized digital format. For this purpose, the sustainability information must be tagged in accordance with the European Single Electronic Format (ESEF).

An audit requirement (limited assurance) is intended to enhance disclosure quality

To ensure that companies comply with the reporting requirements, an independent auditor or certifier must be engaged to report on the sustainability information and its conformity with the certification standards adopted by the EU. As a first step, limited assurance for sustainability information will be required. Over time, the level of assurance is expected to gradually increase, from limited to reasonable assurance. The Commission will adopt standards for reasonable assurance no later than 1 October 2028 following an assessment to determine whether reasonable assurance is feasible for auditors and for undertakings.[7]

[7] CSRD, Article 26a (3), https://data.consilium.europa.eu/doc/document/PE-35-2022-INIT/en/pdf.

Penalties are imposed for noncompliance

If a reporting company fails to comply with the obligation to publish the information, official sanctions may be imposed in the form of fines.

Final Thoughts

There is no time to waste. The CSRD and ESRS are introducing new, extensive sustainability/ESG disclosure requirements for a larger number of organizations than ever before. This disclosure information will need to be provided in a standardized manner, with the same import as financial information disclosures. It will need to be published in the management report and must be audited (starting with limited assurance, but likely graduating to reasonable assurance).

The reality of the planned transitional periods is that companies are faced with having to act quickly. At this point, sustainability/ESG priorities need to be part of an organization's governance, decision-making and business model while establishing a high level of transparency into its activities and how those activities affect its results. The effective disclosure of reliable sustainability information will require a robust sustainability *programme*. To properly prepare, in-scope organizations will need to:

- Assess their current status and design a sustainability strategy as a solid basis for complying with the upcoming reporting requirements
- Develop KPIs responsive to that strategy and the reporting rules
- Perform a gap analysis of their ability to execute the strategy and produce the required information
- Put in place project plans to complete their readiness to report.

Until greater alignment is achieved, at present, companies have several different sustainability standards to deal with. Ultimately, the CSRD's goal is to help organizations be more sustainable and have a positive impact on the environment and society; as such, companies should seize this opportunity to be not just compliant but also impactful.

Read the full text of the Corporate Sustainability Reporting Directive at *https://data.consilium.europa.eu/doc/document/PE-35-2022-INIT/en/pdf*.

About Protiviti

Protiviti (www.protiviti.com) is a global consulting firm that delivers deep expertise, objective insights, a tailored approach and unparalleled collaboration to help leaders confidently face the future. Protiviti and its independent and locally owned Member Firms provide clients with consulting and managed solutions in finance, technology, operations, data, digital, legal, governance, risk and internal audit through its network of more than 85 offices in over 25 countries.

Named to the 2022 Fortune 100 Best Companies to Work For® list, Protiviti has served more than 80 percent of *Fortune* 100 and nearly 80 percent of *Fortune* 500 companies. The firm also works with smaller, growing companies, including those looking to go public, as well as with government agencies. Protiviti is a wholly owned subsidiary of Robert Half (NYSE: RHI). Founded in 1948, Robert Half is a member of the S&P 500 index.

protiviti®