Fact Sheets Sustainability

Corporate Sustainability Reporting Directive (CSRD)

MANAGEMENT SUMMARY

The CSRD replaces previous regulations on corporate sustainability reporting that applied to large corporations. It expands the regulations in terms of content, states the requirements more precisely, regulates the audit obligations (analogous to the review of financial indicators by auditors), and gradually extends them to most medium sized, and many small companies. The first CSRD reports using ESRS standards are to be published by all undertakings already subject to the NFRD in 2025 regarding the fiscal year 2024. In many countries, Germany among them, the Directive still has to be implemented into national legislation, which is expected to be completed by middle of 2024.

FACTS

Status of the legislative process (last update March 2022)

In April 2021, the European Commission presented a proposal to revise and extend the existing Non-Financial Reporting Directive (NFRD). This new directive, named the Corporate Social Responsibility Reporting Directive (CSRD), was adopted by the European Parliament on November 10th, 2022, and by the European Council on November 28th ,2022. The new reporting obligation came into force at EU level on 5 January 2023 and must therefore be transposed into national law by July 2024 at the latest. France was the first country to take this step in December 2023. However, the legislative process is still in full swing in many European member states (including Germany).

The introduction will be gradual starting from fiscal year 2024. Initially, only those companies that were already subject to the NFRD, will be affected. Then the following year it will include other large companies. The CSRD will also apply for SMEs starting fiscal year 2026.

In the context of CSRD, some initial drafts for the most relevant cross-industry european reporting standards (ESRS = European Sustainability Reporting Standards) were defined and adopted. These standards contain two general disclosure as well as ten topic specific standards regarding the areas environment, social and governance. In the coming years, the ESRS will be successively supplemented , primarily by sector-specific requirements as well as standards for small and medium-sized enterprises (SMEs; as defined by EU staff <250).

By 2028 at the latest, the CSRD also applies to non-EU-companies with locations or substantial business in the EU (> 150 million revenue) with a slightly adapted catalogue of standards.

A first draft version of an appropriately limited reporting standard (LSME) for capital market-oriented SMEs has been under public review since January 2024. The voluntary SME standard (VSME), which allows many small and medium-sized companies to provide consistent sustainability data based on the information requirements within the value chains, regardless of their capital market orientation, is also in the consultation phase. These two SME reporting standards are intended to harmonise with the reporting obligations for large companies and banks in such a way that a complete overall picture can be created efficiently, particularly across supply chains and customer relationships.

In February 2024, both the draft XBRL taxonomy for ESRS disclosures and the draft XBRL taxonomy for disclosure requirements under Article 8 of the EU Taxonomy Regulation were also published as a requirement for the machine-readability of reports.

Expected impact on companies

All large companies with an annual average of >250 employees (if their balance sheet total exceeds €25 million, or their turnover exceeds €50 million) along with all capital market-oriented SMEs (with 50 or more employees and a balance sheet total of €5 million or €10 million turnover) are fully affected by the CSRD. In the case of corporate groups, the parent company may prepare sustainability reports at group level. These reports then simply have to be translated into the national language of the respective subsidiaries.

	Starting 2024	Starting 2025	Starting 2026
Criteria	Enterprises subject to **NFRD**	**Large enterprises** that meet (2/3) the following criteria	**Small- and medium-sized enterprises** that meet (2/3) the following criteria
Number of employees	> 500	> 250	> 50
Balance sheet total	> 25 Mio €	> 25 Mio €	> 5 Mio €
Turnover	> 50 Mio €	> 50 Mio €	> 10 Mio €

Table 1 Threshold values for CSRD reporting requirements

All information must be published in a separate section of the companies' annual management reports, i.e., as part of the annual report. The deadline its provision is three to five months after the end of the fiscal year, depending on the reporting entity.

The publication must occur in a machine-readable format, which aims to facilitate comparability and verifiability through the tagging of individual sustainability information. In the future, a central register for digitally prepared reports will simplify access.

The CSRD also stipulates an external audit of sustainability information (formal compliance with reporting standards, process of compiling reported information, and requirements for machine readability). It is to be expected that the initially moderate level of testing will gradually increase, and the examination by auditors will be based on stricter criteria. Similar to the area of traditional financial reporting, auditors of sustainability reports are not allowed to provide advisory services to the company simultaneously.

An important aspect of the reporting obligations is the so-called double materiality. It states that matters must be classified as material if they are material either to the success of the business or from a sustainability perspective. Therefore, the CSRD not only covers risks for the company (e.g. due to climate change), but also requires consideration of the impact of its own business activities on people, society and the environment. In Germany, for example, the rule has so far been that a matter is only relevant for reporting if it meets both conditions. A pure sustainability impact alone was not sufficient therefore leaving significant gaps in the non-financial reporting of companies. In the future, materiality in terms of ecological or social sustainability will be enough to justify a reporting obligation.

Requirements for report content

Many of the fundamental reporting requirements are now predictable with the political agreement. For example, companies must provide information on their business model and business strategy in their annual reports. In the future, they will also be required to disclose their sustainability strategy or the influence of sustainability aspects on their corporate strategy. Relevant questions include:

- How does the company prepare itself for the consequences of climate change, resource shortages, new environmental regulations, or other issues?
- Where does it see risks and opportunities in this environment?
- What goals and plans is the company pursuing with regard to sustainable business practices and the achievement of climate targets?
- What measures have been taken so far based on this strategy and what progress has already been made?
- What role do executive and supervisory bodies play in this?

Furthermore, existing sustainability policies within the company and the approach to due diligence must be described, which enables the evaluation of the sustainability impact of the organization, its business processes, products, and services. The actual or potential adverse effects and the measures taken to address, mitigate or avoid them, must be documented right down to their supply chains.

All information disclosed should be presented both in retrospective of the past and in perspective on short, medium, and long-term actions. The assessments must be qualitative but also substantiated quantitatively. Competition-relevant details do not have to be mentioned, unless otherwise specified in the national implementation.

CONCLUSION

With the CSRD and the accompanying ESRS standards, the scope and the number of affected entities of the NFRD will be significantly expanded. Many companies that had little to do with sustainability issues before are now forced to intensively engage with their own processes, business partners, and activities in the context of ESG aspects. While most large publicly traded companies have already laid a good foundation of data and processes through the implementation of the NFRD and therefore have a head start, the issue is a new territory for many medium-sized and non-listed companies. However, the new challenge is far more than just a reporting obligation. Many of the disclosures require a holistic understanding of the company and its environment, thus providing an ideal foundation for new business models and sustainable innovations.

Although it is not expected that every Saulus will suddenly become a Paulus with the introduction of the directive, and many companies will seek pragmatic ways to minimize the effort for these reporting obligations, it is likely that the compulsory engagement with sustainability issues in the company context alone will contribute to a gradual change in mindset and the implementation of obvious and cost-effective measures ("quick wins").

Author

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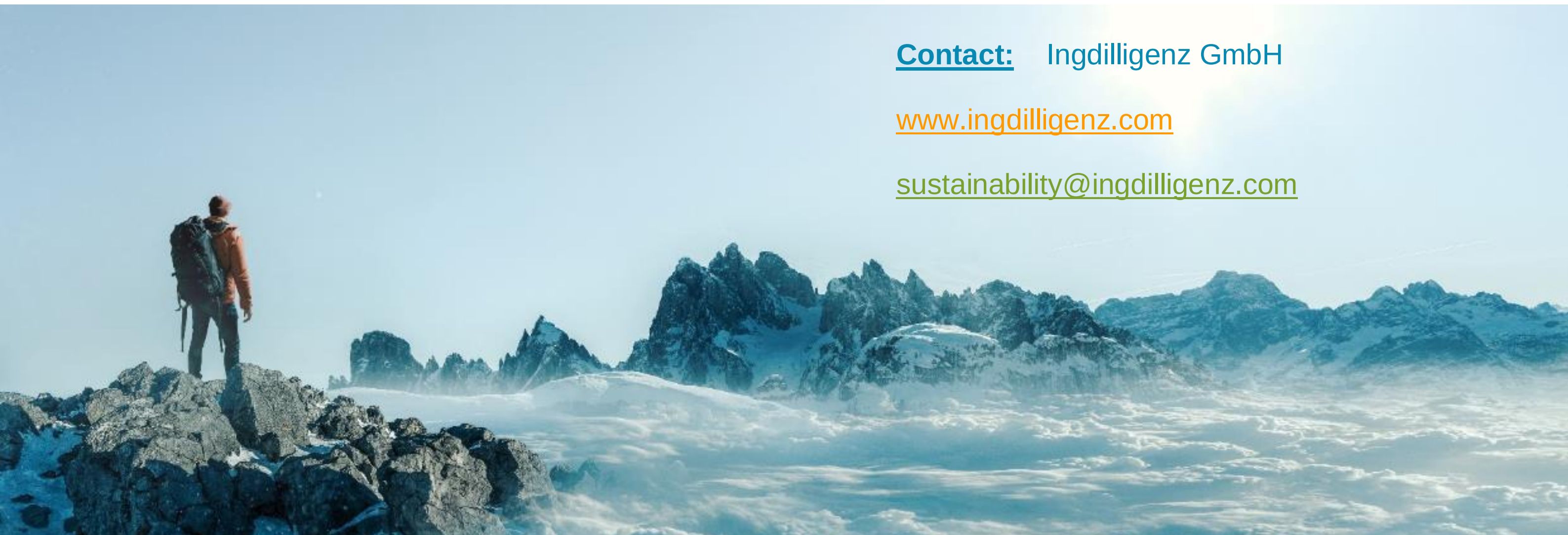

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