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Developments in the Corporate Sustainability Reporting Directive: Strategies Towards Net Zero

On 21 June 2022, the EU Council and Parliament reached a provisional agreement to amend the Corporate Sustainability Reporting Directive (CSRD). The directive replaces the existing Non-Financial Reporting Directive (2014/95/EU) (NFRD). The scope has been expanded to include more companies both inside and outside the EU. The regulation aims to address deficiencies in the current rules that hinder the transition to a sustainable economy and limit investors' proper use of non-financial information. By setting higher standards, it ensures the provision of consistent, comparable, and reliable non-financial information. This is a significant development for investors and all stakeholders, as it will enable transparent, simple, and easily accessible information, helping to prevent greenwashing. As consumers gain access to reliable information about the environmental and human rights impacts of businesses, their habits and preferences will shift, pushing companies towards more sustainable investments and products. The directive requires companies to submit their corporate sustainability reports for the 2024 financial year starting from 1 January 2025, and to have them independently audited and certified.

What is the Corporate Sustainability Reporting Directive (CSRD)?

On 21 April 2021, as part of the Green Deal, the EU Commission adopted a comprehensive Sustainable Finance Package to finance the transition. One of the objectives in this action plan is to redirect capital flows towards sustainable technological investments and businesses to achieve the goal of net zero carbon emissions by 2050. The directive is a new EU regulation requiring large companies to regularly publish reports so that investors, consumers, policymakers, and all other stakeholders can assess their environmental and social impact performance. The Commission is defining a common reporting framework for non-financial data. To ensure the reliability and quality of reports, the directive also mandates that reports prepared in accordance with EU sustainability standards must obtain external assurance. The main reasons for this expanded framework include the inadequacy of existing reporting data, understanding how sustainability will affect companies, identifying companies' impacts on people and the environment, the risk that unqualified data may negatively affect decision-making, extending a reliable and accountable reporting culture to non-PIEs and listed SMEs (excluding microenterprises), and preventing confusion between similar reports and avoiding duplicate reporting.

Which Companies Will be Covered by the CSRD?

While the NFRD required reporting from 'Public Interest Entities' with more than 500 employees, the CSRD extends the scope to large companies and all listed companies. If these companies have subsidiaries, they are also responsible for providing information at that level. SMEs are also included in the scope, with exemptions until 2028.

Accordingly, companies meeting at least two of the following three criteria are required to report on sustainability:

- 250 employees
- Total turnover exceeding €40 million
- Total assets exceeding €20 million

Once the legislation comes into force, it is estimated that around 50,000 companies—representing 75% of EU companies—will be subject to reporting obligations.

For non-EU countries, any company generating a net turnover of at least €150 million in the EU and having at least one subsidiary or branch in the EU will also be subject to these transparency obligations. Furthermore, non-listed SMEs, which constitute a large part of the economy (including those not traded on stock exchanges), will be encouraged to report voluntarily by the specified dates, in response to increasing sustainability demands from lenders and large companies to whom they supply.

Non-listed SMEs will be included in the scope with a suitable standard if they meet at least two of the following criteria:

- 50 employees
- Total turnover of €4 million
- Total assets of €8 million

What Information Are Companies Subject to the CSRD Required to Disclose?

Compared to the NFRD, the CSRD introduces more detailed reporting requirements. Companies are required to report on sustainability topics related to environmental, social, human rights, and governance (ESG) issues. Large companies must provide detailed information on how they address and mitigate possible negative impacts on people and the environment, and this should be considered across their entire value chain. The directive mandates that this report be published as a specific section of companies' management reports and that it must be easily accessible (digital and machine-readable—in XHTML format in accordance with the SEF regulation). Mandatory disclosure topics include:

- Environmental matters
- Respect for human rights
- Social matters and protection of employee rights
- Anti-corruption and anti-bribery efforts
- Diversity on company boards (in terms of age, gender, educational and professional backgrounds)

What is the Current Status of the Sustainability Disclosure Standards?

The development of the European Sustainability Reporting Standards (ESRS) is the responsibility of the European Financial Reporting Advisory Group (EFRAG). The Commission aims to adopt the first set of sustainability reporting standards developed by EFRAG by 30 June 2023, and the second sector-specific set by 30 June 2024. These reports are expected to complement financial reporting and may eventually be incorporated into annual financial reports.

How Will the Quality of the Reports be Ensured?

It is mandatory that reports be approved by an accredited independent auditor and certifier. Independent auditors and certifiers are required to ensure that companies' disclosed sustainability information complies with the certification standards accepted by the EU. Similarly, non-EU companies must have their reports certified by an auditor based either within or outside the EU.

When Will the CSRD Take Effect?

- Existing non-financial reports (NFR) will need to comply with the new rules as of 1 January 2024, and reporting will be required in 2025.
- Corporate sustainability reports (CSR) will commence from 1 January 2025, with reporting in 2026.
- For small and non-complex credit institutions, small insurance undertakings, and listed SMEs, reporting will start from 1 January 2026, with reporting due in 2027.

For non-EU countries falling under the scope, reporting will begin from 1 January 2028, with reports to be submitted in 2029.

The EU is introducing regulations to direct capital flows towards sustainable technological investments and businesses to ensure sustainable and inclusive growth in line with the Green Deal and the UN Sustainable Development Goals. Sustainability reporting, as part of the EU's sustainable finance package, is a driving force for transformation in the business world. As companies comply with reporting requirements for climate adaptation, they better understand and manage climate risks, access long-term funds under favorable conditions, increase their sustainable investments and create business opportunities, enhance their reputation and brand value through transparent data, and gain both internal and external benefits such as attracting investment, employee engagement, and motivation. Therefore, sustainability reporting will also serve as an important guide and opportunity for transformation for companies not yet covered by reporting obligations. The EU's expanded ESG strategy is an indication of its firm commitment to its net zero target.

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