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Client Alert
Commentary

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The EU Corporate Sustainability Reporting Directive — How Companies Need to Prepare

The EU's latest initiative to enhance ESG disclosures will expand the requirements of earlier initiatives and bring considerably more companies within its scope.

On 5 January 2023, the Corporate Sustainability Reporting Directive (CSRD)[1] entered into force in the EU. The CSRD is the EU's latest initiative to improve the quality and comparability of corporate ESG disclosures. The CSRD uses the term "sustainability" to refer to environmental, social (including human rights), and governance factors.[2] The CSRD will considerably increase both the number of companies that are within the scope of the EU's ESG reporting regime and the detail and extent of the ESG disclosures that must be published.

The CSRD significantly expands on the requirements of the Non-Financial Reporting Directive (NFRD), which was the EU's previous legislative initiative in this area. The CSRD revises sections of a number of EU statutes, including most notably the Accounting Directive,[3] to extend the ESG disclosures required of certain companies in the EU (and beyond, as discussed below).

While companies will not be subject to specific reporting requirements under the CSRD until at least 2024, the significant impact on ESG reporting for companies means that companies should identify the extent to which they will be subject to CSRD reporting well in advance of reporting requirements entering into effect. If they are subject to the CSRD, such companies will need to significantly build the processes, procedures and add internal controls, and develop the resources to manage their obligations.

This Client Alert discusses several key aspects of the CSRD: (i) the scope and timing of reporting (including the extent to which companies incorporated outside the EU may be subject to reporting requirements), (ii) underlying reporting standards (which remain in development), and (iii) the EU's "double materiality" reporting threshold (which may require certain in-scope companies to revisit how they approach materiality in the context of ESG issues). The Alert also sets out some high-level guidance on what potentially-impacted companies can do to prepare.

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Companies Subject to the CSRD

The CSRD will considerably expand the number of companies that will be required to report detailed ESG information in the EU[4], compared to those required to report under the NFRD. Three provisions of the CSRD, discussed below, introduce reporting requirements on different types of companies and groups.

Article 19a — Large or Listed EU Companies

Article 19a[5] introduces reporting requirements on what the EU describes as: (i) “large undertakings”; and (ii) “small and medium-sized undertakings[6] which are public interest undertakings”, terms that have been previously defined in the EU’s Accounting Directive.

A “large undertaking” is an EU company that exceeds at least two of the following three criteria on its balance sheet date:

- Balance sheet total: €20 million
- Net turnover: €40 million
- Average number of employees during the financial year: 250

The definition of “public interest undertaking” includes EU companies that are either: (i) listed on a regulated EU stock market; (ii) a specific form of financial services company (e.g., insurance company or credit institution, meaning that unlisted financial institutions may also be subject to the requirements of CSRD); or (iii) have been specifically designated a public interest entity by their country of incorporation. Such public interest undertakings (that are not micro-undertakings) will be within the scope of the CSRD even if they do not meet the size requirements to be considered a large company. Further, public interest undertakings that are not “large undertakings” will be subject to amended reporting standards under the CSRD that reflect the additional strains that data collection may put on such entities.

Companies that would otherwise be required to report pursuant to Article 19a may be exempted from such requirement if they are included in sustainability reporting conducted on a group level by a parent company (whether an EU parent company pursuant to Article 29a or a non-EU parent company) that is aligned with either the European Sustainability Reporting Standards (ESRS) (see below) or standards otherwise determined to be “equivalent” by the EU.

Article 29a — Parents of Large EU Groups

In addition to companies that meet the criteria to be considered “large” by themselves, the CSRD also includes reporting requirements for the EU parent companies of large groups. Large groups are defined in the Accounting Directive as groups of parent and subsidiary companies that meet the abovementioned size thresholds for large undertakings.

The CSRD introduces a requirement for the EU-incorporated parent companies of such large groups to file consolidated CSRD-aligned reports in relation to the whole EU group, including in relation to non-EU subsidiary companies that are included in such consolidated report. To the extent that the EU parent identifies significant differences between the risks for, or impacts of, one or more of the subsidiaries included in the CSRD-aligned report, it will also be required to include additional disclosure explaining the differences between such risks or impacts of the different subsidiaries. This requirement may be important for companies which are filing a consolidated report that includes subsidiaries in jurisdictions that are at a considerably different phase of the energy transition, or are in different industry or sectors.

As with individual companies that meet the threshold criteria, EU parent companies that would be required to report pursuant to Article 29a may be exempt from such requirements if they are included in the ESRS (or equivalent standards)-aligned sustainability reporting of their own parent company.

In addition, Article 48i permits, until 6 January 2030, one EU subsidiary of a non-EU parent company that has multiple EU subsidiaries required to report pursuant to Article 19a or 29a to report on behalf of all of such in-scope subsidiaries. This provision is expected to ease the administrative burden of reporting for a transitional period.

Article 40a – Global Groups With a Significant Presence in the EU

The introduction of reporting requirements in relation to non-EU companies is one of the most noteworthy aspects of the SCRD.

Pursuant to Article 40a, corporations with their ultimate parent companies outside the EU, but with a significant presence in the EU, may be required to issue CSRD-aligned reports in relation to the whole global group, including in relation to non-EU group companies that themselves have no business in the EU.

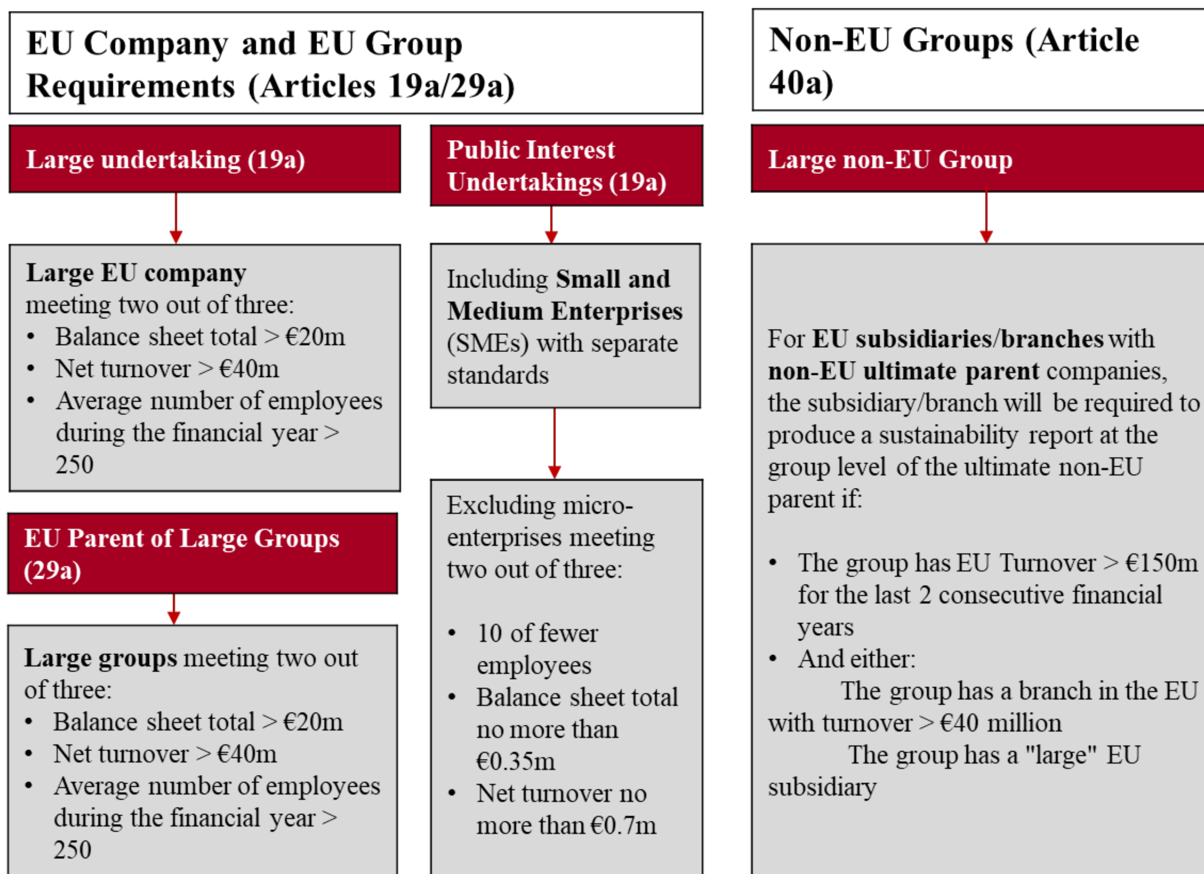
In order to be within the scope of Article 40a, the global corporate group of the non-EU undertaking must have generated a net turnover within the EU of €150 million for two consecutive financial years, and also either:

- have an EU subsidiary that meets the thresholds under Article 19a of the CSRD (e.g., is a large undertaking or public interest entity);[7] or
- have a branch in the EU that generated €40 million net turnover in the preceding financial year.

To the extent that the non-EU ultimate parent company of the group does not provide the necessary information for its EU subsidiary or branch to report on behalf of the global group, the subsidiary or branch is required to publish a report containing all of the information that it has access to, and issue a public statement indicating that its ultimate parent did not make the full extent of the necessary information available to them.

Even before the specific reporting requirements under Article 40a begin to apply, non-EU headquartered companies with a number of EU subsidiaries will be required to ensure that processes are in place for their subsidiaries such that they can meet their obligations under Articles 19a or Article 29a.

As discussed later in this Client Alert, different types[8] of in-scope entities will face different reporting requirements under the CSRD, with such reporting requirements phased in at different stages. Therefore, companies should not only identify whether they will be within the scope of the CSRD, but also which specific reporting requirements they will be subject to.



ESRS

While the CSRD itself sets out the high-level reporting requirements that applies to companies, the specific information that is to be reported will be described in a number of ESRS to be adopted by the European Commission over the coming years. The text of the CSRD[9] contains information that the ESRS must broadly cover and provides certain conditions that the Commission must abide by when adopting and developing the ESRS (e.g., take account of the work of the ISSB (see below for further information regarding the ISSB)). Otherwise, considerable discretion as to the content of the ESRS is left to the Commission. Different sets of ESRS have been proposed. The first core set is due to be finalised by 30 June 2023, with supplemental ESRS (including in relation to sector specific issues, SMEs, and global group reporting requirements) to be produced by 30 June 2024.

Structure of the First Set of Draft ESRS

The European Financial Reporting Advisory Group (EFRAG) has produced 12 ESRS in the first set of drafts. These ESRS consist of two “cross-cutting” ESRS, and 10 sector-agnostic “topical” ESRS, which themselves consist of five environmental ESRS, four social ESRS, and one governance ESRS. Please see below for a full list:

Cross cutting ESRS

ESRS 1
General principles

ESRS 2
General disclosures

Standards to be confirmed

Sector specific standards

SME proportionate standards

Non-EU Group standards

Sector-agnostic topical ESRS

Environmental	Social	Governance
ESRS E1 Climate Change	**ESRS S1** Own workforce	**ESRS G1** Business conduct
ESRS E2 Pollution	**ESRS S2** Workers in the value chain	
ESRS E3 Water and marine resources	**ESRS S3** Affected communities	
ESRS E4 Biodiversity and ecosystems	**ESRS S4** Consumers and end-users	
ESRS E5 Resource use and circular economy		

Cross-cutting standards set out general provisions applying to sustainability reporting and sustainability disclosure requirements that include: (i) how an entity complies with the ESRS; (ii) the way in which sustainability is embedded in an entity's business strategy and business model(s); and (iii) how an entity identifies and manages its principal sustainability impacts, risks, and opportunities.

Topical standards on the other hand set out disclosure requirements relating to sustainability impacts, risks, and opportunities that are deemed to be material for all undertakings, regardless of the sectors they operate in. Appendix 2 below contains a list of the high-level disclosure requirements in ESRS E1 (climate change) by way of example of the types of information that companies will be required to disclose. These requirements will be supplemented in future ESRS by sector-specific standards.

Key Aspects of the CSRD

While the CSRD has many aspects that separate it from other ESG reporting frameworks and requirements globally, the below discussion highlights certain aspects that we believe will be particularly relevant for companies considering how they will comply with their obligations that they may face.

Double Materiality

Article 19a requires in-scope entities to file, as part of their annual management report, the information "necessary to understand the [company's] impacts on sustainability matters, and information necessary to understand how sustainability matters affect the [company's] development, performance and position". Similar language is included with respect to the reporting requirements under Articles 29a and 40a.

This wording reflects one of the most notable aspects of the CSRD, namely the application of "double materiality". As per EFRAG's draft ESRS 1[10] (see below), double materiality has "two dimensions, namely: impact materiality and financial materiality". The concept of double materiality is therefore intended to extend the bounds of materiality past matters that will impact a company's bottom line in a material way (i.e., financial materiality), but also to include those matters in which the company is having a material impact on society in a manner that may not directly impact the company's bottom line. (However, ESRS 1

notes that each of the two strands of double materiality are inter-related and have many interdependencies).

Because of this broader understanding of materiality, companies that are within the scope of the CSRD and that may currently only consider ESG matters from a financial materiality perspective will need to revisit their conceptual approach and ensure that they are appropriately resourced for when reporting requirements begin to impact them. Notably, this will cause differences in risk assessment processes with other reporting requirements the company may adhere to, including requirements under the US, which do not apply this double materiality approach.

Value Chain Reporting Requirements

A further notable aspect of CSRD reporting is the requirement for companies not only to report with respect to their own operations, but also their broader value chain. Reporting companies will therefore be required to report information on the material impacts, risks, and opportunities connected to the in-scope entity through its direct and indirect business relationships in the upstream and/or downstream value chain.[11] According to ESRS 1 (see below for further information in relation to the ESRS), companies would not be required to report in relation to every single entity in the value chain, but only those that are considered "material" (on the basis of double materiality).

A key aspect of this extension of reporting requirements to include the broader value chain is the fact that it will likely lead to potentially significant ESG data requests of companies that are themselves not within the scope of the CSRD. A large number of such companies will be within the broader value chains of in-scope entities, and therefore such in-scope entities will require this ESG data in order to meet their own reporting requirements under the CSRD. This will likely extend to entities in the value chain of in-scope entities that have no business operations within the EU at all. The EU has recognised that procuring such information may prove challenging in the short term, and has included a three-year grace period within the CSRD for reporting on these issues. For the first three years of application, companies may explain their efforts in relation to obtaining value chain information and the reasons they have not been able to procure such information.

Assurance of CSRD Reporting

A final key aspect of CSRD reporting is the requirement that it be assured by an independent third party. From 2025, an independent third party must provide limited assurance[12] as to the compliance of an in-scope entity's reporting with the requirements of the CSRD (including the ESRS), the process carried out by the entity to identify the information reported according to the ESRS, and certain other issues.

The CSRD empowers the Commission to adopt, by means of delegated acts, specific assurance standards in relation to the CSRD. Moreover, until the EU adopts such standards, Member States may apply national assurance standards, procedures, or requirements.

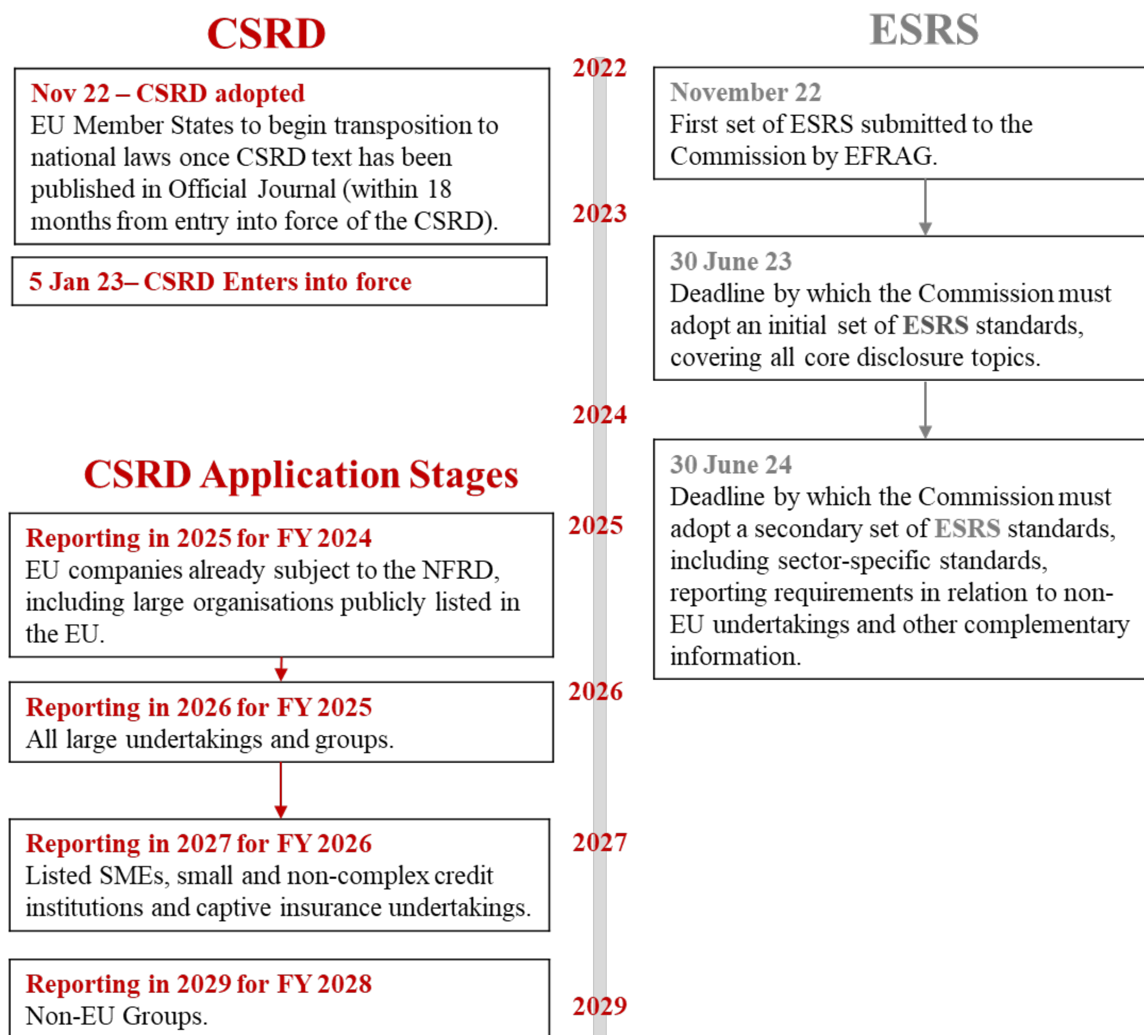
Implementation Timeline

Now that the CSRD has been enacted, the timeline for implementation has become clear. In relation to the CSRD, the next step is for EU Member States to enact the terms of the CSRD into national legislation. This enactment is required because, under EU law, a directive (such as the CSRD), does not automatically enter into effect in national law, and must be transposed into domestic legislation by national legislatures. This process will be crucial for companies with subsidiaries in multiple EU Member States to observe, as national governments have the ability to "gold plate" EU legislation when adopting it into their own legal system.

Gold plating refers to the act of a national government amending the requirements of the EU Directive to make them more "strict".[13] In the context of the CSRD, gold plating could involve initiatives such as bringing forward the timeline, or lowering the thresholds at which companies are considered to be in scope. Such actions could have significant impacts and will be a key area to monitor throughout 2023.

When companies will be required to report to the CSRD varies depending on the category of company. In summary, the relevant dates are as follows:

Type of Company	Reporting Requirements Begin	First CSRD-Aligned Reports to Be Issued
Company already required to report under the NFRD	1 January 2024	2025
Large EU companies and parents of large EU groups not subject to the NFRD	1 January 2025	2026
SME public interest entities	1 January 2026	2027
Global group reporting requirements	1 January 2028	2029



Moving Forward and Relationship to Other Global Standards

While the CSRD is one of the leading ESG reporting requirements globally in terms of the wide scope of the reporting requirements, the significant detail required to be reported, and implementation, nonetheless mandatory ESG reporting, particularly in relation to climate issues, is a key legislative trend that continues to proliferate in many parts of the globe. Some of the most notable examples are highlighted below.

Interaction With Other EU Measures

The CSRD is far from the only legislative initiative being developed by the EU in relation to ESG requirements. The EU Taxonomy, a classification system which seeks to define economic activities as “sustainable” or not, was enacted in 2020, and contains, among other things, a requirement for companies subject to the NFRD to report the Taxonomy-alignment of their activities beginning in 2023. This requirement will be extended to all EU companies that are subject to the CSRD once the reporting requirements of the CSRD come into effect. A dramatically increased number of entities will therefore need to become familiar with the calculations and criteria required to be met to be Taxonomy-aligned. Certain financial entities are also subject to reporting requirements (both at a product-level and entity-level) pursuant to the EU’s Sustainable Finance Disclosure Regulation (SFDR).

In addition, in February 2022, the Commission proposed the Corporate Sustainability Due Diligence Directive (CSDDD), which would introduce substantive ESG due diligence obligations on certain large companies operating in the EU. The CSDDD remains subject to negotiation by the EU's political institutions, but is likely to lead to significant obligations for companies in relation to their value or supply chains.

ISSB

The International Sustainability Standards Board (ISSB) was established by the IFRS Foundation (the entity responsible for the issuing of globally recognised accounting standards) at COP26 in November 2021, with the remit of developing a "global baseline" of ESG reporting standards. Subsequently, on 31 March 2022, the ISSB released exposure drafts of the first two IFRS Sustainability Disclosure Standards (ISSB Standards) for public consultation, with the standards focusing on (i) general disclosures; and (ii) climate issues.

Based on the feedback received during that consultation process, the ISSB has continued to refine the initial ISSB Standards throughout the latter half of 2022, and has issued public statements in relation to significant decisions it has made (e.g., defining the term "sustainability", and the inclusion of Scope 3 emissions as a reporting requirement). This process is continuing, and the ISSB has indicated that it hopes to be able to produce final versions of its initial two standards in early 2023.

While the ISSB Standards would be voluntary (on the basis they are being developed by a third party organisation and not a government or regulator), a number of governments, including the UK, have indicated that future mandatory ESG reporting regimes in their jurisdictions may be based on the ISSB Standards, and so they remain a key standard for multinational companies to be aware of.

SEC Proposed Climate Disclosure Rule

In March 2022, the US Securities and Exchange Commission (SEC) proposed a suite of climate-related disclosure requirements for companies with securities registered in the United States, Details on the proposed requirements are available here and here. A final rule is expected from the SEC in early 2023. Companies subject to both regimes will need to consider areas of partial overlap and certain divergent expectations. While there are various technical differences, some key considerations are:

- Materiality: the SEC proposal eschews the "double materiality" approach endorsed by the CSRD, maintaining a definition rooted in financial materiality.
- Financial Impacts: the SEC proposal would require extensive disclosure of climate-related financial impacts, including at the line-item level. These requirements have minimal overlap with the proposed disclosures on climate-related financial effects in draft ESRS E1.
- Regulatory Spillover: the SEC proposal includes various requirements that only apply to the extent the company has taken certain action. However, the CSRD might require companies to take such actions. For example, the SEC requires disclosure of a transition plan, and annual progress updates, to the extent a company has adopted such a plan. Given the definition in the SEC proposal, this could include aspects of the plans and policies contemplated under draft ESRS E1.

Potential Next Steps

Establishing the extent to which companies will be within the scope of the CSRD

The first step for companies to take, particularly multinational companies with operations and/or subsidiaries in the EU, is to establish the extent to which they and their subsidiaries will fall within the scope of the CSRD. In practice, this will likely require input from a number of stakeholders within the company and externally, including tax and accounting teams, internal and external legal teams, and others. Gaining this understanding of: (i) which subsidiary companies will be required to report pursuant to the CSRD; (ii) what reporting requirements apply to those companies; (iii) when those reporting requirements apply; and (iv) what exemptions to reporting are available, will be of critical importance when planning how the requirements will be met.

Monitoring the progress of the ESRS and Member State legislation including gold plating

While the CSRD has now entered into force at EU level, a number of aspects remain in flux. Most notable among these are the ESRS, which remain subject to consultation and adoption by the Commission[14] or to be developed by EFRAG,[15] and the transposition of the CSRD into the domestic law of EU Member States.

As noted above, the extent to which the CSRD is "gold plated" in certain EU Member States is a notable aspect to follow over the coming year. Such gold plating may bring more companies within the scope of the CSRD requirements in certain jurisdictions, or may lead to additional, more specific ESG reporting requirements that are not specifically mandated under the CSRD itself. Companies and their legal advisors should therefore monitor the development of such EU Member State legislation, particularly in jurisdictions where reporting is anticipated to be necessary.

Ensuring companies have the relevant data collection and publication resources

The CSRD will require in-scope companies to collect significant amounts of ESG-related data from their operations. For many companies, the specific reporting requirements of the ESRS will include the mandatory publication of data that may not, at present, be recorded internally. Being able to ensure accurate and verifiable data is being collected with respect to all relevant reporting categories is a necessary prerequisite for companies before they can start to look at how to improve their performance in these metrics, and therefore companies should be ensuring that they have adequate and reliable resources in place with respect to each of these categories. Such resources may include the development of new or revised processes and procedures, including the allocation of novel, specific responsibilities to individuals in relation to ESG data management.

Such resources will not be able to be limited to just data collection. The publication requirements of the CSRD will mean that in-scope organisations will be required to develop their internal controls and data collection systems to ensure that ESG data can be reported accurately, verifiably, and efficiently. As companies publicly disclose additional ESG data, the scope for such data to be challenged broadens (including in relation to greenwashing accusations), and as such, companies should look to treat their ESG disclosures akin to how they have traditionally treated financial disclosures.

Working with their value chain in relation to relevant data

As noted above, the CSRD will not just require companies to report data in relation to their own operations, but also in relation to the operations of their material value chain partners (including in relation to value chain partners who may not be required to report to CSRD themselves). Companies that will be in scope of CSRD should therefore look to begin engaging with such partners to seek to ensure that,

once such information is required, it can be procured, including the possibility of introducing contractual terms requiring the provision of such data. Securing and validating such data is likely for many companies to be among the more arduous requirements of CSRD.

Appendix 1 — Future Development Timeline

Date	Description
Additional reporting guidelines, transitional provisions, and review timescales	
On a yearly basis	The Commission shall consult the European Parliament, the Member State Expert Group on sustainable Finance, and the Accounting Regulatory Committee regarding EFRAG's work programme on the development of the ESRS.
Until 31 December 2025	The person carrying out quality assurance reviews of the assurance of sustainability reporting is exempted from requiring relevant experience in sustainability reporting and assurance.
At least every 3 years from date of application of delegated acts	The Commission should review (and amend if necessary) the delegated acts adopted pursuant to Article 29b, taking into consideration the technical advice of EFRAG
3 years from initial reporting period	Grace period for the value chain reporting requirements if transitional provisions may apply
By 31 December 2028	The Commission should review and report on the level of concentration of the sustainability assurance market.
Until 2030	Seven-year reporting flexibility under Article 48i, if non-EU groups with large EU or EU-listed subsidiaries can provide a consolidated report that covers only its EU subsidiaries rather than the consolidated global group.

Appendix 2 — Example of ESRS Disclosure Requirements

The topical ESRS include a varied list of disclosure requirements on the relevant subjects within Environmental, Social and Governance. These standards follow the requirements set out in ESRS 1 and ESRS 2, with the cross-cutting standards relevant to each of the topical disclosure standards.

ESRS 2 sets out disclosures required on the topics of Governance, Strategy, and Impact, and Risks and Opportunity Management, and these themes underpin the disclosures required throughout the topical ESRS.

As an example, the disclosures required in **ESRS E1 — Climate change** are as follows:

- **E1-1 —** Transition plan for climate change mitigation
- **E1-2 —** Policies related to climate change mitigation and adaption
- **E1-3 —** Actions and resource in relation to climate change policies
- **E1-4 —** Targets related to climate change mitigation and adaption
- **E1-5 —** Energy consumption and mix
- **E1-6 —** Gross Scopes 1, 2, 3 and Total greenhouse gas (GHG) emissions
- **E1-7 —** GHG removals and GHG mitigations projects finances through carbon credits
- **E1-8 —** Internal carbon pricing
- **E1-9 —** Potential financial effects from material physical and transition risks and potential climate-related opportunities

These disclosure requirements are enumerated in more detail in ESRS E1, with key disclosure factors including the following:

- The impact of the undertaking on climate change
- Mitigation efforts and details of the strategic business plan for climate change in line with the Paris Agreement and limiting global warming to 1.5°C
- Risks and opportunities arising from the businesses impact and dependency on climate change, and how these risks and opportunities are managed
- The financial impacts arising from climate change

The disclosure requirements take into account related EU legislation and regulation, including the SFDR and the EU Taxonomy.

A number of themes throughout the ESRS can be seen through the example of **ESRS E1**. For the environmental standards specifically, these include the following:

- Policies relevant to the environmental aspect
- Actions and resources allocated
- Related targets and metrics
- The potential financial effects from environmental related impacts, risks, and opportunities.

Further disclosure requirements are specific to the environmental topic in question, namely for climate change in relation to energy consumption, greenhouse gas emissions, and internal carbon pricing.

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Endnotes

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[1] Directive (EU) 2022/2464 of the European Parliament and of the Council of 14 December 2022 amending Regulation (EU) No 537/2014, Directive 2004/109/EC, Directive 2006/43/EC and Directive 2013/34/EU, as regards corporate sustainability reporting.

[2] In this Client Alert, we use the term sustainability in the context of the disclosures mandated by the EU pursuant to the CSRD or other initiatives (as this is the term used by the EU in such contexts). We use the term "ESG" when discussing the subject topics more broadly.

[3] Directive 2013/34/EU.

[4] The EU has anticipated that approximately 50,000 companies in total will have to report under CSRD, compared to approximately 11,700 under the NFRD.

[5] Article references in this Client Alert, unless otherwise stated, relate to the article number of the Accounting Directive, as revised by the CSRD.

[6] Excluding micro-undertakings, which are companies that meet at least two of the following three criteria: (i) 10 or fewer employees; (ii) balance sheet total of no more than €350,000; and/or (iii) net turnover of no more than €700,000.

[7] Note that this standard differs from the "significant subsidiary" definition for the purposes of 10-K filings in the US, meaning that significant subsidiary lists will not be adequate for determining whether a subsidiary brings a US entity within the scope of Article 40a.

[8] E.g., large EU companies will be subject to different (but similar) reporting requirements to listed SMEs and/or non-EU groups.

[9] In particular, Article 29b.

[10] Draft ESRS 1 - General Requirements

[11] Notably, the European Council's initial negotiating position in relation to the Corporate Sustainability Due Diligence Directive would require in-scope companies to conduct diligence in relation to their "chain of activities" (broadly defined as upstream suppliers) only. This may lead to inconsistency between the reporting requirements of the CSRD, and the substantive requirements of the Corporate Sustainability Due Diligence Directive.

[12] In the future, the requirement may be extended from a limited standard to a reasonable assurance standard.

[13] Member State governments are not typically allowed to weaken the requirements of an EU Directive in the transposition process.

[14] In the case of the initial core set of ESRS.

[15] In the case of the sector-specific, global group and other ESRS to be adopted in 2024.