

EU CO-LEGISLATORS REACHED POLITICAL AGREEMENT ON THE CORPORATE SUSTAINABILITY REPORTING DIRECTIVE

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Policy and Regulatory Alert

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INTRODUCTION

On 21 June 2022, the European Parliament (Parliament) and the Council of the European Union (Council) reached a provisional political agreement on the Corporate Sustainability Reporting Directive (CSRD).¹ As of 27 June 2022, the agreed text has not yet been made publicly available.

The proposal for the CSRD, first presented by the European Commission (Commission) on 21 April 2021, foresees the adoption of EU-wide sustainability reporting standards and aims to revise and strengthen the rules set out already in 2014 in the Non-Financial Reporting Directive (NFRD).² The new proposal came after the Parliament's call for an extension of the scope of the NFRD beyond public-interest entities. Furthermore, the evidence gathered by the Commission showed deficiencies in the current non-financial reporting framework, making it difficult for investors and other stakeholders to compare publicly available information, resulting in accountability gap of reporting companies.

With the new proposal, the European Union aims to achieve more complete and meaningful sustainability reporting that includes not only information on climate-related topics but also on other matters such as biodiversity, social rights, and human rights, taking the non-financial reporting to a new level.

SCOPE OF THE CSRD

The new reporting requirements will apply to all (listed and non-listed) large companies, i.e., companies with over 250 employees and €40 million turnover, as defined in the Accounting Directive.³

The new rules will also apply to listed Small and Medium Enterprises (SMEs). Following Parliament's proposal, an opt-out clause was introduced in the proposed text making it possible for in-scope SMEs not to apply CSRD requirements until 2028.

Non-European companies will also be in the scope of the CSRD. In particular, non-European companies with at least one subsidiary or branch and generating an annual net turnover of €150 million will be subject to the new EU reporting requirements. Non-European companies will also benefit from a transitional period before the rules would fully enter into force.

When it comes to company groups, while parent companies will have the responsibility to report the relevant information and to assess the information of their subsidiaries and branches, the company group will be obliged to present only one consolidated report.

SUSTAINABILITY REPORTING AUDIT

The CSRD provides that the sustainability information to be reported by in-scope companies will need to be independently audited and certified by an accredited independent auditor or certifier, just like financial information. This obligation effectively results in matching the level of importance amongst both types of reporting, ensuring companies will comply with reporting standards adopted at EU level and provide reliable, transparent, and comparable data. The non-financial reporting will be included in the so-called managing report, which will contain all the information subject to audit.

In the initial proposal, the Commission proposed for the sustainability assurance to be performed by the statutory auditor or audit firm, arguing that it would help with the consistency between financial and non-financial auditing. However, under the provisional agreement, non-financial reporting audit will be open also to other auditors and assurance providers, provided they will obtain a certification for non-financial auditing.

The process of accreditation for non-financial auditors and assurance providers will be carried out at national level. Furthermore, Member States will also set the requirements to ensure the quality of the assurance engagement carried out by independent assurance services providers; the requirement should also ensure consistent outcomes in the assurance of sustainability reporting.

The European Financial Reporting Group (EFRAG) will be the authority in charge of setting up the European sustainability reporting standards. The standards will be built as much as possible on already existing international standardisation initiatives and relevant EU policies. EFRAG is set to publish some initial general standards in early summer 2023 and the standards for companies in specific sectors are expected to be published in June 2024.

CONCLUSION

The CSRD sets a precedent in sustainability reporting, broadening the scope by not only including environmental topics but also social and human rights, biodiversity, and work ethics. Furthermore, for the first time, financial and non-financial reporting are considered equally important.

The reporting will have to be performed in accordance with the new EU sustainability reporting standards set up by EFRAG. The information provided by companies will then be audited by independent and certified auditors.

In terms of timeline, the application of the new requirements will take place in three different phases. The reporting will enter into force as of 1 January 2024 for companies already in scope of the NFRD. For companies not previously subject to the NFRD, the new reporting requirements will enter into force as of 1 January 2025. Finally, for listed SMEs the requirements will enter into force as of 1 January 2026.

Next Steps:

Both the Parliament and the Council need to formally approve the provisional agreement, after which the CSRD will be published in the EU Official Journal. It will enter into force 20 days after publication and its provisions will have to be transposed into Member States' national legislation within 18 months.

FOOTNOTES

¹ Proposal for a Directive of the European Parliament and of the Council amending Directive 2013/34/EU, Directive 2004/109/EC, Directive 2006/43/EC and Regulation (EU) No 537/2014, as regards corporate sustainability reporting.

² Directive 2014/95/EU of the European Parliament and of the Council of 22 October 2014 amending Directive 2013/34/EU as regards disclosure of non-financial and diversity information by certain large undertakings and groups.

³ Directive 2013/34/EU of the European Parliament and of the Council of 26 June 2013 on the annual financial statements, consolidated financial statements and related reports of certain types of undertakings, amending Directive 2006/43/EC of the European Parliament and of the Council and repealing Council Directives 78/660/EEC and 83/349/EEC.

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