



ESG Briefing Series

ESG Reporting for EU and non-EU companies: Entry into force of the Corporate Sustainability Reporting Directive

(5 January 2023)

On 5 January 2023, the long awaited Corporate Sustainability Reporting Directive (**CSRD**) has come into force throughout the European Union. The CSRD establishes sustainability reporting obligations for a large number of companies both within and outside of the European Union (**EU**). For some companies, the first sustainability reporting under the CSRD will have to be submitted already in 2025 for the financial year 2024. The majority of companies within the scope of the CSRD will have to begin reporting in 2026 for the financial year 2025.

Along with the EU Taxonomy Regulation (**Taxonomy**) and the EU Sustainable Finance Disclosure Regulation (**SFDR**), the CSRD forms part of the EU's Sustainable Finance Agenda. The CSRD builds on the framework of the already existing EU Non-Financial Reporting Directive (**NFRD**), which has been in force since 2017 and established a minimum level of sustainability reporting obligations for certain companies. However, the CSRD significantly widens the scope of sustainability reporting, both with regard to covered companies and subject matters.

The central theme of the CSRD is that it no longer refers to ESG matters as being simply "non-financial". Instead, the CSRD coins the term *sustainability reporting*, which underlines its significance and financial importance for profit-oriented companies. What's more, the CSRD aligns corporate sustainability reporting with corporate financial reporting (technically, the CSRD is an amendment to the European Accounting Directive), a development evident from the fact that going forward, sustainability related information will have to be published as part of a company's management report and may no longer be made available in a separate report.

The CSRD has yet to be transposed into the laws of each EU Member State. And the technical reporting standards on how to report still have to be adopted by the European Commission. There is therefore some uncertainty as to how sustainability reporting under the CSRD will actually play out. In this client briefing, we analyse this new legislative framework.



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1. Background

Sustainability reporting is not entirely new for EU companies. Some of them have already been subject to reporting obligations under the NFRD since 2017. However, the NFRD had a very limited scope of application (it only applied to listed companies, credit institutions and insurance companies meeting certain thresholds), very few substantive reporting requirements, and no mandatory reporting format.

The aim of the CSRD is to improve the flow of sustainability information in the corporate and financial world by making corporate sustainability reporting more consistent and verifiable so that financial companies and investors, as well as the wider public, can use comparable and reliable sustainability information. This includes the requirement to make sustainability data reported under the CSRD available in machine-readable form.

2. Scope of application

Under the CSRD, sustainability reporting is mandatory for EU companies that are (i) currently subject to the NFRD, (ii) “large undertakings¹”, or (iii) “small² and medium sized undertakings³” (except for “micro undertakings”) if considered a “public interest entity”. In addition, the CSRD also requires the provision of sustainability information on non-EU companies (so-called third-country undertakings; see below under 7.). It is estimated that the CSRD will apply to approx. 50,000 companies (compared to approx. 11,700 companies which are subject to the NFRD).

The applicability of the CSRD will be stretched over four stages depending on the size and statutory seat of the company:

- First reporting in 2025 on financial year 2024 for companies already subject to the NFRD;
- First reporting in 2026 on financial year 2025 for “large” companies and “large groups” of companies not already subject to the NFRD;
- First reporting in 2027 on financial year 2026 for listed SMEs (except micro undertakings), small and non-complex credit institutions, and captive insurance companies;

- First reporting in 2029 on financial year 2028 for non-EU companies with net turnover above 150 million in the EU if they have at least one subsidiary or branch in the EU exceeding certain thresholds.

3. Reporting format

The CSRD provides for a change from the previous option of publishing sustainability information via a separate sustainability report. In the future, the sustainability reporting will have to be included in a dedicated section of the management report and will need to be submitted electronically and in a machine-readable format. Sustainability reporting under the CSRD will – like financial reporting – be subject to an external audit requirement. The CSRD provides for a gradual approach on the level of assurance: First, limited assurance⁴ on sustainability information is introduced, for which the European Commission is expected to adopt standards by 1 October 2026. The level of assurance may later be enhanced to reasonable assurance⁵ if it is determined that this is feasible for auditors and companies. In such case, standards for reasonable assurance will have to be adopted by the European Commission by 1 October 2028. As long as the adoption of European assurance standards is pending, national assurance standards are applicable. As part of the management report, the sustainability reporting together with the assurance opinion must be published in accordance with Art. 30 Accounting Directive.

4. General reporting themes

The CSRD – as the NFRD – applies the concept of double materiality. This means that companies have to report both on the impact of their activities on people and the environment, and on how sustainability matters affect the company itself.

In essence, companies have to provide sustainability information on the following topics:

- Plans to ensure compatibility with transition to sustainable economy,
- Consideration of stakeholders’ interests and sustainability in strategy,
- Implementation of strategy considering sustainability,

¹ To be considered as a *large company* under the CSRD two out of the three following criteria need to be exceeded: (i) balance sheet total of 20m EUR, (ii) net turnover of 40m EUR and (iii) 250 employees on average during financial year.

² A *small undertaking* is one that does not exceed two out of the three following criteria: (i) balance sheet total of 4m EUR, (ii) net turnover of 8m EUR and (iii) 50 employees on average during financial year.

³ A *medium sized undertaking* is defined as one not exceeding two out of the three following criteria: (i) balance sheet total of EUR 20 million, (ii) net turnover of EUR 40 million and (iii) 250 employees on average during the financial year.

Small and medium sized undertakings are of *public interest* if they are listed undertakings (governed by law of an EU Member State and whose transferable securities are admitted to trading on a regulated market of any Member State) or credit institutions or insurance undertakings. The latter two not being relevant for the case at hand.

⁴ Negative form of expression stating that no matter has been identified to conclude that subject matter is materially misstated.

⁵ Positive form of expression resulting in providing an opinion on the measurement of the subject matter against previously defined criteria.

- Time bound targets related to sustainability,
- Role of managing bodies with regard to sustainability,
- Policies in relation to sustainability,
- Incentive schemes offered to members of managing bodies with regard to sustainability,
- Due diligence process implemented regarding sustainability,
- Information about own operations, value chain, business relationships and supply chain including their adverse impacts,
- Actions taken to mitigate adverse impacts,
- Indicators relevant to disclosures above,
- Resilience to risks related to sustainability,
- Opportunities related to sustainability,
- Risks and dependencies related to sustainability,
- Process identifying reported information,
- Short, medium and long-term time horizons.

To be clear: There are no binding sustainability targets in the CSRD which companies are required to meet. But companies need to report information in a complete and accurate manner and EU Member States are obliged to provide for effective, proportionate and dissuasive penalties in case of non-compliance.

However, once sustainability data becomes available in standardized and machine-readable formats, it can be expected – and this is what the EU aims at – that investors, stakeholders, and consumers will use this data much like they already use financial data to benchmark companies against each other and to base investment decisions on this data.

5. Applicable reporting standards

One of the obvious deficits under the NFRD are the different ways and forms of sustainability reporting by companies; they are free to choose from several reporting standards, such as GRI (Global Reporting Initiative), SASB (Sustainability Standards Board), UNGC (United Nations Global Compact) or TCFD (Task Force on Climate-related Financial Disclosure). This “alphabet soup” of standards did not allow to transparently compare one company’s sustainability performance, its agendas, and measures taken with that of a competitor.

Therefore, EU legislators have tasked the European Financial Reporting Advisory Group (*EFRAG*) with preparing technical European Sustainability Reporting Standards (*ESRS*) for companies to report under the CSRD. The first set of draft ESRS has by now been submitted to the European Commission, which has yet to adopt them into law by 30 June 2023.

This first set draft ESRS covers twelve reporting areas:

1. Cross-cutting standards:
 - Draft ESRS 1 General requirements
 - Draft ESRS 2 General disclosures
2. Topical standards:
 - Environment (in line with taxonomy’s five objectives)
 - Draft ESRS E1 Climate change
 - Draft ESRS E2 Pollution
 - Draft ESRS E3 Water and marine resources
 - Draft ESRS E4 Biodiversity and ecosystems
 - Draft ESRS E5 Resources and circular economy
 - Social
 - Draft ESRS S1 Own workforce
 - Draft ESRS S2 Workers in the value chain
 - Draft ESRS S3 Affected communities
 - Draft ESRS S4 Customers and end-users
 - Governance
 - Draft ESRS G1 Business conduct

But that is only the beginning. EFRAG is set to publish more than 50 ESRS as the CSRD provides for the Commission to adopt sector-specific, third-country-specific, as well as SME-specific standards by 30 June 2024. However, EFRAG has already expressed concerns regarding the timeline for developing the 41 sector-specific standards and proposed to extend the process until June 2026.

As next steps EFRAG will prepare draft ESRS which will be sector-specific and focus on:

- Five sectors covered by GRI standards: agriculture, coal mining, mining, oil & gas (upstream), oil & gas (mid- to downstream);
- Five high-impact sectors: energy production, road transport, motor vehicle production, food/beverages, textiles.
- It will also include specific standards for SMEs.

6. Consolidated reporting

Consolidated reporting

Sustainability reporting is mandatory on consolidated EU level if the company is a parent company of a large group. Large groups are groups consisting of parent and subsidiary companies to be included in a consolidation and which, on a consolidated basis, exceed the limits of at least two of the three following criteria on the balance sheet date of the parent company: (i) balance sheet total of EUR 20 million; (ii) net turnover of EUR 40 million and (iii) average number of 250 employees during the financial year.

A parent company that is also a subsidiary company (i.e., an *intermediate holding company*) is exempt from separate

reporting obligations if included in its ultimate parent's reporting and if the parent reporting is in accordance with (i) EU reporting standards or (ii) non-EU standards that are determined to be equivalent by a European Commission's decision. This also holds true for ultimate parent companies located outside of the EU. I.e., EU parent companies can be included in a non-EU parent management report and will then be exempt from their own reporting obligations provided that the non-EU parent reports are in line with CSRD requirements.⁶ As the European Commission has not yet accepted any non-EU reporting standard as equivalent to the CSRD, non-EU ultimate parent companies would have to report in line with the CSRD standards in order to make use of the consolidated reporting exemption.

Furthermore, if the ultimate parent company is established in a third country, the consolidated sustainability reporting needs to be accompanied by an assurance opinion expressed by one or more person(s) or firm(s) authorised to give an opinion on the assurance of sustainability reporting under the national law of the non-EU company or of an EU member state.

Transitional period: consolidated report at the level of the EU subsidiary with the greatest turnover in the EU

During a transitional period until 6 January 2030, a consolidated report at the level of the EU subsidiary with the greatest turnover within the EU is possible *in lieu* of the non-EU parent company. The consolidated report is to be published at the level of one of the EU subsidiaries that generated the largest turnover in the EU in at least one of the preceding five financial years. It must include all EU subsidiaries of the non-EU parent company.

7. Reporting obligations for non-EU companies

Beginning with financial year 2028, non-EU companies may also be subject to CSRD reporting requirements. Generally, there are two types of scenarios where this becomes relevant:

- Non-EU issuers with securities listed on an EU exchange
- Non-EU parent companies of EU subsidiaries or branches

Non-EU issuers with securities listed on an EU exchange

The rationale is to treat all securities listed on an EU exchange in the same way, so even non-EU issuers listed on an EU exchange would have to report under the CSRD.

The only exception to this requirement would be if the European Commission were to grant equivalence recognition to a specific jurisdiction. However, this would require that the third country standards cover all sustainability matters covered by the CSRD and apply the double-materiality perspective. For the foreseeable future, it is unlikely that any equivalence will be granted.

Non-EU parent companies of EU subsidiaries

In this case, the CSRD would only apply if the non-EU parent company has a branch or a subsidiary in the EU exceeding the following thresholds:

- The non-EU parent company exceeds the threshold of a net turnover of at least EUR 150 million in the EU at consolidated level in two consecutive financial years *AND*
- The EU subsidiary
 - Meets two out of the three following criteria: (i) balance sheet total exceeds EUR 20 million, (ii) net turnover above EUR 40 million, (iii) average of more than 250 employees during the financial year *OR*
 - Has listed securities on an EU market *OR*
- The EU branch had a net turnover of more than EUR 40 million in the EU in the preceding year.

The CSRD regulates on the one hand that the reporting perspective would be that of the non-EU parent company, on the other hand it states that the actual sustainability report will need to be published by the EU subsidiary as part of its management report.

This ambiguity is still pending clarification by the European Commission. However, it is likely that the actual reporting obligation will sit with the non-EU undertaking, but with the EU subsidiary being required to make the sustainability reporting available in accordance with EU reporting standards (incl. publication in the management report) as well. Therefore, non-EU parent companies, such as US-listed companies, would not have to include sustainability reporting (in accordance with the CSRD) in their Form 10-K filed with the SEC.

8. Aligning with other reporting requirements

International companies may be subject to several different sustainability reporting requirements. The CSRD is only one of these standards and, so far, there is not yet one globally recognized sustainability reporting standard that companies

⁶ This exemption is subject to the following restrictions:
 (1) The exempted parent company must not be a large company that is also a public-interest entity, i.e., such companies cannot be exempted from their consolidated reporting obligation at the EU level.
 (2) The management report of the exempted company contains (however):

(i) Name and registered office of the ultimate non-EU parent company that reports the information, (ii) Weblinks to the consolidated management report or if applicable to the consolidated sustainability reporting and to the assurance opinion, (iii) The information that the company is exempted from reporting obligations.

could use to meet all of the increasingly complex disclosure requirements that may apply.

This means that for the time being, companies need to be prepared to gather sustainability data in accordance with different standards and to prepare sustainability reports based on different legal requirements.

Interestingly, EFRAG, when submitting its first set of draft ESRS to the European Commission, noted in its cover letter its strong intention on making the ESRS standards interoperable with those being currently developed by the ISSB. In particular, EFRAG underlined that “the draft ESRS now follow the same structure as the ISSB (Governance—Strategy—Risk Management—Metrics and Targets) as first proposed by the TCFD” while they encompass the “necessary adaptations to account for the double materiality principle and to secure an efficient interaction between the general disclosures and the various topics that the ESRS have to cover according to the CSRD”. EFRAG concludes that “from a general standpoint the goal is that the undertakings which comply with ESRS are also considered as complying with the ISSB standards to avoid unnecessary multiple reporting.” While this is a step in the right direction, it remains to be seen whether and how this will work in practice.

9. What to do next

The CSRD’s considerably broader scope of application compared to the NFRD alone should prompt EU and non-EU companies with EU business to familiarize themselves with the CSRD and to clarify on which level of a group of companies sustainability information will need to be made available in the future. This may also require establishing means to collect the necessary data to meet the sustainability reporting requirements.

Overall, it is the declared aim of the EU that the new CSRD and the ESRS standards will have an impact on sustainability reporting regimes in other parts of the world, to promote the global dissemination of sustainability reporting, and – ideally – its unification towards the EU standards. Switzerland, for example, has already announced that it will decide towards the end of 2023 whether (and if so, how) it will align its national ESG reporting regime (which is currently closer to the NFRD) to the CSRD.

In addition, it should be kept in mind that apart from the strand of general corporate reporting under the CSRD, there is a second strand of ESG reporting in numerous other ESG regulations – be it sector-specific or with a thematic focus – imposing reporting obligations on companies. Almost all regulations currently being drafted in the EU, such as the Deforestation Regulation or the Corporate Sustainability Due Diligence Directive comprise of specific reporting duties, e.g., on due diligence efforts in supply chains.

Sustainability reporting under the CSRD will indirectly but powerfully trigger a thorough readjustment of the company's management towards a “sustainability transformation”. It will have impact, amongst others, on investment targets, M&A deal parameters, executive board remuneration, KPI guidance vis-à-vis the financial markets and general stakeholder communication.

We will of course keep you up to date on further developments and will be happy to answer any questions you may have.

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