The EU's Corporate Sustainability Reporting Directive: What Do Companies Need to Know Now That Reporting Standards Are Finalized?

November 16, 2023

Environmental, Social, and Governance (ESG)

In this alert, we provide an overview of the Corporate Sustainability Reporting Directive ("CSRD") and the European Sustainability Reporting Standards ("ESRS"). The ESRS, developed by the European Financial Reporting Advisory Group ("EFRAG"), specify the substance of the CSRD disclosures that in-scope companies will have to make in their annual sustainability statements starting in 2025. We also offer practical tips on what companies can do to prepare for compliance, distilled from recent CSRD counseling we have been providing to a broad range of clients across industry sectors and with differing European footprints.

1. What is the current status of CSRD and how are companies preparing?

The CSRD has entered into force and the EU Member States, as well as the European Economic Area countries (Norway, Iceland, and Lichtenstein), now have until July 6, 2024, to transpose the CSRD into their national laws. The ESRS have passed the scrutiny period for EU delegated acts and will soon be published in the EU Official Journal, and therefore applicable to companies' data gathering and reporting as of January 1, 2024.

At this stage, we are seeing companies take a range of steps to prepare for CSRD compliance, including:

- Conducting **applicability assessments** to determine whether and when their corporate entities will trigger application thresholds for CSRD.
- Deciding the **level** at which the company will prepare its CSRD sustainability statement (e.g., at the parent company level or entity-by-entity), as the CSRD provides companies with options on this key issue.
- Implementing processes for and conducting **double materiality assessments,** and related impact assessments in areas such as climate and human rights.
- Establishing **oversight procedures**, including drawing together cross-functional teams to coordinate a reporting process that can withstand assurance (as required by CSRD).
- **Collecting and evaluating the availability and quality of data** to inform the company's first year of reporting (or a trial run if not yet in scope).

- **Mapping CSRD requirements** against other rapidly evolving reporting regimes to develop an efficient and consistent **global ESG reporting strategy**.

2. Who is required to report under the CSRD?

The CSRD is significantly broader in scope than its predecessor, the EU's Non-Financial Reporting Directive ("NFRD"). Whilst the NFRD covered approximately 11,700 companies/groups across the EU, the CSRD is expected to ultimately apply to approximately 50,000.

The CSRD will be phased in and will start to apply to the first tranche of companies from January 1, 2024 (with reporting in 2025), with staggered application dates depending on the entity type, as shown in the below table. The CSRD will ultimately create reporting obligations for many non-EU-headquartered entities either because they have in-scope EU subsidiaries or branches that meet certain thresholds.

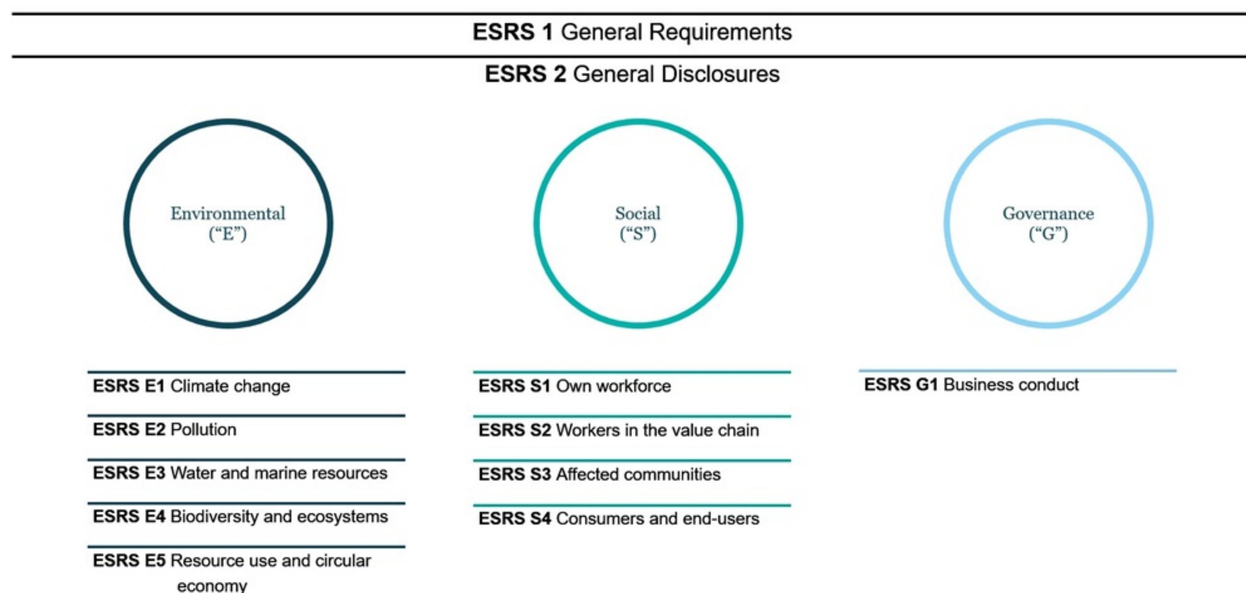
Table 1: Applicability Thresholds for CSRD (simplified excerpt)

Type of Company	Application Date	First Sustainability Report Due
Large EU/EEA Public Interest Entity ("PIE") with more than 500 employees* **These companies were also required to report under the NFRD*	FY beginning in 2024	2025 / 2026
Large EU/EEA Company *or* EU/EEA Parent Company of a Large Group *Large Company: Is incorporated under law of EU/EEA Member State and meets at least two of the following conditions:* *i. More than 250 employees (annual average);* *ii. More than EUR 40 million in net turnover; and/or* *iii. More than EUR 20 million in total assets* *Large Group: Consisting of an EU/EEA parent company and its subsidiary companies (whether in the EU or ex-EU) that on a consolidated basis meet the definition of a "Large Company," above.*	FY beginning in 2025	2026 / 2027
EU-Listed Small- and Medium EU/EEA Enterprise ("SME")	FY beginning in 2026 (option to delay until FY beginning in 2028)	2027 / 2028 (if opted to delay 2029 / 2030)
Non-EU Parent Company With Significant Business in the EU/EEA	FY beginning in 2028	2029 / 2030

On October 17, 2023, the European Commission adopted a delegated act to amend the Accounting Directive (which contains the entity thresholds for CSRD reporting) by adjusting the thresholds used to determine the size category of a company. This is to account for the impact of inflation, and—if brought into effect—it will impact the number of companies potentially coming into scope of the CSRD by altering the thresholds listed in the above table. Specifically, for Large Companies and Parent Companies of Large Groups, the net turnover threshold would change from EUR 40M to EUR 50M and the total assets threshold from EUR 20M to EUR 25M. The delegated act will now be subject to a two-month (extendable to four-month) scrutiny period by the European Parliament and the Council of the EU.

3. What are companies required to report?

Broadly, the CSRD requires each in-scope company to report on the **material sustainability impacts** associated with its business operations and value chain, and on the company's sustainability related policies and targets. The reports must be made according to the disclosure requirements set forth in the ESRS. The ESRS include twelve standards: two cross-cutting standards, covering General Requirements and General Disclosures; and ten topical standards, as depicted in the diagram below.



Under the ESRS framework, ESRS 1 sets out general requirements for CSRD-compliant sustainability reporting (e.g., rules on double materiality and disaggregation), whereas the cross-cutting General Disclosures in ESRS 2 (and related topic-specific process disclosures about the materiality assessment) require in-scope companies to always report certain policies and processes they have adopted, irrespective of the outcome of the materiality assessment. All other ESRS disclosure requirements in the ten topical standards are subject to a materiality assessment, and companies must only report what they deem to be material.

The topical ESRS cover a very broad range of sustainability issues, with environment-focused disclosures for not only Scope 1-3 greenhouse gas emissions, but also regarding pollution, water, biodiversity, and waste and circularity. The social standards encompass impacts on own workforce as well as up- and downstream value chain workers, affected communities, and the consumers and end-users of a company's products and services. The governance-related disclosures include issues such as anti-corruption and lobbying. Companies will require significant time and often new organizational processes to collect, compile, and ultimately disclose their sustainability impacts with the rigor required by the CSRD.

4. How do companies determine what is "material" for reporting?

To determine what matters to report, companies must undertake a materiality assessment. A key aspect of the ESRS is the "double materiality" principle, under which a sustainability matter is "material" if it meets the criteria for impact materiality, financial materiality, or both. The ESRS

note that the starting point for an assessment is impact materiality, which relates to the potential or actual impacts, whether positive or negative, of the company's activities on people and the planet (sometimes described as "inside-out" impact). Financial materiality relates to the financial effects (i.e., risks and opportunities) that a sustainability matter has on the company, including influences on a company's development, financial position, performance, current and future cash flows, access to finance, and cost of capital (sometimes described as "outside in" impact). Financial materiality is the disclosure concept more familiar from existing disclosure rules (e.g., those under the rules of the U.S. Securities and Exchange Commission).

5. Does the CSRD require due diligence?

The CSRD does not impose any conduct requirements in relation to a company's due diligence on sustainability issues in its operations and value chain (this is stated expressly in ESRS 1). However, while not mandating due diligence, the requirement to report on due diligence is designed to drive further focus by companies. The ESRS suggest that a company's due diligence process—based on international due diligence frameworks, such as the UN Guiding Principles on Business and Human Rights ("UNGPs") and the OECD Guidelines for Multinational Enterprises ("OECD Guidelines") — should inform its assessment of its material impacts, risks, and opportunities, and that companies must explain how and where their due diligence efforts are reflected in their sustainability statements. Many of the disclosure requirements set out in the ESRS also reflect core elements of due diligence. For example, the "social" ESRS require companies to disclose their processes for engaging with various stakeholders about actual or potential human rights impacts. This concept of stakeholder engagement is based on the UNGPs, which recommend that companies consult with affected groups and stakeholders to identify any actual or potential adverse human rights impacts connected to their operations and value chains.

Of course, regulations in some jurisdictions already require or will require companies to conduct due diligence on sustainability issues. For example, the EU has adopted supply chain due diligence obligations on fair and equitable benefit-sharing from the use of genetic resources under the Nagoya Protocol to the Convention on Biological Diversity, which will inform the substance of ESRS E4. Further, there are a range of broad, mandatory environmental and human rights due diligence regulations already in force (e.g., the German Supply Chain Due Diligence Act) and on the horizon (e.g., the EU's proposed Corporate Sustainability Due Diligence Directive ("CSDDD")).

6. What else should companies be looking out for?

In addition to the **sector-agnostic** ESRS, we anticipate that EFRAG will develop further binding standards and non-binding guidance, including:

- **Sector-specific** reporting standards. These are stated to initially cover certain "higher risk" sectors: agriculture, farming, and fishing; food and beverage services; mining, coal, and quarrying; motor vehicles; oil and gas; power production and energy utilities; road transport; textiles, accessories, footwear, and jewelry. To facilitate an initial focus on the implementation of the sector-agnostic ESRS, on October 17, 2023, the Commission proposed extending the deadline to adopt sector-specific reporting standards from June 2024 to June 2026. Other sector-specific standards may be developed at a later date, including for the pharma, biotechnology, and information technology industries. The

Commission has also committed to publishing sector-specific reporting standards for financial institutions.

- Less demanding reporting/disclosure standards for listed SMEs and voluntary standards for non-listed SMEs.
- Optional alternative reporting standards for non-EU parent companies coming into scope for financial years starting on or after January 1, 2028. On October 17, 2023, the Commission proposed extending the deadline to adopt these reporting standards from June 2024 to June 2026.
- Non-binding Implementation Guidance from EFRAG on key areas. EFRAG recently published draft Value Chain Implementation Guidance and Materiality Assessment Implementation Guidance, and a public consultation on both is expected in November 2023.
- An online ESRS Q&A platform (recently launched by EFRAG).

7. How does the CSRD intersect with sustainability disclosure requirements in other jurisdictions?

We are seeing a global proliferation of sustainability reporting obligations. In addition to the reporting requirements of the CSRD, we have seen an increased tempo of other reporting obligations on human rights and environmental issues. Some of the most recent developments include:

- **California**: On October 7, 2023, California governor Gavin Newsom signed into law important climate-related legislation, Senate Bill 253 ("SB 253"), Senate Bill 261 ("SB 261"), and Assembly Bill 1305 (covered in previous alerts here, here, and here). The bills will phase in requirements for companies of certain sizes operating in California to report on GHG emissions (including, ultimately, Scope 3 emissions), climate-related financial risk, and their use and quality of carbon offsets. *This reporting intersects with one of the ten topical ESRS under the CSRD regime (E1)*.
- **Singapore**: Singapore's Sustainability Reporting Advisory Committee, established by the Accounting and Corporate Regulatory Authority and Singapore Exchange Regulation in 2022, recently proposed to expand the scope of existing climate-related disclosures to certain non-listed companies from the fiscal year beginning in 2027. *The proposal currently includes a limited exemption for companies reporting under "equivalent" regimes, which might include reporting under the CSRD*.
- **UK**: By July 2024, the UK government is expected to endorse UK Sustainability Disclosure Standards ("SDS") based on the IFRS Sustainability Disclosure Standards S1 and S2, issued by the International Sustainability Standards Board ("ISSB"). The UK's Financial Conduct Authority ("FCA") also plans to update its TCFD-aligned disclosure rules, and to introduce new requirements for listed companies for accounting periods beginning on or after January 1, 2025. The UK government (and, separately, the FCA) will also consult on making disclosure of climate transition plans mandatory for large public and private UK companies, following the publication of detailed transition plan disclosure guidance. *UK sustainability reporting requirements so far align with global reporting standards including the ISSB's standards and the relevant standards in the ESRS*.
- **Australia**: In September 2023, the Taskforce on Nature-related Financial Disclosures ("TNFD") published its final disclosure recommendations for organizations to make

nature-related disclosures which include climate-related issues as well as biodiversity and engagement with stakeholders such as Indigenous Peoples and Local Communities. The TNFD recommendations will remain voluntary until codified under domestic law. *The TNFD recommendations state that the TNFD has sought to align its language and structure with international standards and the CSRD*.

Companies that have previously reported against voluntary reporting standards, such as the Carbon Disclosure Project ("CDP"), Global Reporting Initiative ("GRI"), Sustainable Accounting Standards Board ("SASB"), or the ISSB, will benefit from close attention to the evolving interplay between such voluntary regimes and mandatory reporting under CSRD and other laws. For example, ISSB has been collaborating with EFRAG to ensure interoperability between IFRS S1 and S2 and the ESRS, and CDP has recently announced trainings on ESRS compliance. Any companies that continue to report under voluntary regimes while also being subject to mandatory reporting laws should track these developments and implement disclosure processes focused on consistency and completeness across disclosures.

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