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IN SUMMARY: 1 minute read

A detailed look at the Corporate Sustainability Reporting Directive

The EU's Corporate Sustainability Reporting Directive (CSRD) requires sustainability information to be reported alongside financial performance. We explore the decisions boards should be making, the questions that need to be asked and the actions companies must take now.

Although a large number of risks and value drivers are categorised under ESG, they underpin long-term business success. So, transparency and accountability are essential. However, the sustainability reporting landscape is becoming increasingly complex to navigate.

The CSRD is one of the five regulatory texts supporting the European Sustainable Finance Action Plan, a key part of the European Green Deal and the EU strategy to reach carbon neutrality by 2050. It sits alongside the Sustainable Finance Disclosure Regulation, the EU Green Bond Standard, the EU Taxonomy and the Corporate Sustainability Due Diligence Directive.

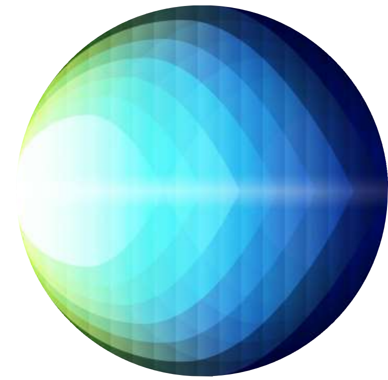
The CSRD requirements include a double materiality assessment plus reporting against European Sustainability Reporting Standards (ESRSs) – the first set issued includes two cross-cutting standards and 10 topical standards. CSRD also requires application of the EU Taxonomy, digital tagging of the sustainability disclosures and mandatory assurance. The first entities came into scope on 1 January 2024.

The reach of the CSRD is extensive and applies to UK companies with a listing on an EU-regulated market, and EU subsidiaries of UK groups. There is a requirement, from 2028, for large EU subsidiaries or branches of non-EU headed groups to publish information on group-wide sustainability impacts. This applies if specific revenue targets or thresholds are exceeded.

There is a number of exemptions and transitional provisions that companies should be aware of. Each EU Member State must transpose the CSRD into local legislation, so there may be variations in requirements from one country to another.

Who reports and when?

	2024	2025	2026	2028
Which entities are in scope (first-time application)?	• **Large undertakings that are public interest entities, with employees > 500** • **Non-EU large groups listed on EU-regulated market, with employees > 500**	**All large undertakings:** • **Based in EU; or** • **Listed on EU-regulated market**	**EU and non-EU SMEs listed on EU-regulated market (not micro-undertakings)** Entities can defer reporting until 2028.	**EU subsidiaries and EU branches of certain non-EU groups present consolidated reporting of ultimate non-EU parent**, if non-EU ultimate group: • Revenue > €150M in EU for last two years; and • At least one large subsidiary/branch in EU has turnover > €40M in previous year.
	Large undertakings meet at least two criteria: • Balance sheet total (total assets) > €25M • Net turnover (revenue) > €50M • Average number of employees > 250		SMEs meet at least two criteria: • Total assets >€450K but <€25M • Revenue >€900K but <€45M • Employees > 10 but <250	
	EU Member States may decide to extend scope of application to more entities.			
What standards apply?	**ESRS:** EU entities **ESRS or standards deemed equivalent by EC:** Certain non-EU entities within scope of CSRD		**ESRS or SME standards:** SMEs	**ESRS, or standards deemed equivalent, or specific standard for non-EU entities:** Non-EU entities not listed on EU-regulated market



In collaboration with Chapter Zero

Based on a webinar discussion on 11 June 2024

Host:
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Speaker:
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Speaker:
Linda Riedel,
IFRS and Corporate Reporting Technical Partner, Deloitte

"Clients who are impacted are in discussion with entities in their value chain around how they can obtain accurate, quality, reliable information on a timely basis, because this has to be prepared ready for disclosure with the annual report."

Charlotte Drain

Take a deeper dive into the conversation

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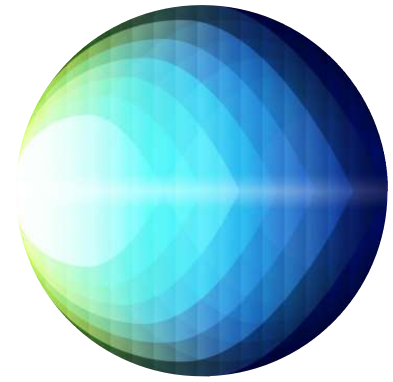
DEEP DIVE: 5 minute read



In conversation with the Deloitte Academy panel

Veronica: How should UK companies start to consider the CSRD's scope and transitional relief exemptions?

Linda: Begin at the very basic level. Understand the legal structure of the group, including which entities have subsidiaries, because you need to assess size criteria at the sub-group and company level. For each EU subsidiary, you must know the country of incorporation so you can monitor the Member State transposition.

Whether an entity is within the scope of the CSRD depends on the size criteria (based on two out of three size thresholds), classification as an EU Public Interest Entity or existence of instruments traded on an EU regulated market. Traded instruments include both shares and debt, and if it is debt, it is important to look at the denomination because different rules apply. If the ultimate parent is a non-EU entity, the net turnover generated in the EU determines whether further reporting on group-wide impacts applies from 2028.

Developing an understanding of requirements in each relevant Member State is important, both in terms of the application of the EU Accounting Directive and the size criteria.

Based on this information, you can start to assess which entities or sub-groups fall into scope and when. The next step will be to assess which exemptions or transitional reliefs are available.

Veronica: From 2028, obligations will start to include reporting on broader information related to the group. Could you expand on this?

Linda: The CSRD makes it clear that reporting on group-wide sustainability information should be done in accordance with the ESRS for non-EU undertakings, which we are not expecting to be developed until 2026; it is also clear that the ESRS for non-EU undertakings will focus on impacts rather than risks and opportunities, so it is likely to be less extensive than applying full ESRS. While the reporting must cover the required information at the overall group level, the responsibility for publishing it and making it accessible lies with the EU subsidiary or branch.

Information on the group-wide sustainability impacts needs to be published within 12 months of the balance sheet date, which is a longer period than if this information were to be reported by the ultimate parent company in its consolidated annual report. The location of that reporting is not specified in the regulations, but it needs to be public and freely available. As stated earlier, this reporting on the group-wide sustainability impacts is an additional reporting obligation, so the EU subsidiary will already be in scope itself and will still need to prepare and publish its own sustainability report.

Veronica: Can you explain the double materiality assessment?

Charlotte: The CSRD requires companies to provide information that is necessary to understand both the company's impact on sustainability matters, and how sustainability matters affect the company's prospects, performance and position. That is the CSRD uses the concept of double materiality - an important distinction from other sustainability frameworks that use a financial materiality lens.

When assessing impacts, the point of reference is the effect on the stakeholder, which is based on an assessment of severity, including whether the impact can be remediated. So, a breach of human rights at a key supplier or a fatality in the workforce at a subsidiary level would not reduce in severity of the impact and would likely remain material at the group level.

The CSRD requires companies to explain any significant differences between the impacts, risks and opportunities identified for the group as a whole and those identified at the level of one or more subsidiaries. Another critical point is around value chain information. Identifying impacts, risks and opportunities across the entire value chain should not be underestimated in terms of both complexity and effort.

Veronica: What questions should boards be asking their management teams?

Charlotte: There is no specific approach or process that needs to be used for the double materiality assessment, so it is up to each organisation to design it themselves. The European Financial Reporting Advisory Group (EFRAG) has issued helpful guidance.

In determining the double materiality assessment process, focus might be on challenging the organisation's approach as a whole. Is this a compliance exercise or a strategic one and which direction is the organisation taking? Is it a standalone double materiality process, or can it be

> **"It is clear that in the first few years we are going to end up with a lot of data gaps, proxy data, estimation and uncertainty. So, transparency and accountability will be key. It is in the interests of all concerned, including those charged with governance, to ensure data is not misunderstood, is not factored into valuations inappropriately and does not result in a greenwash."** Veronica Poole

"Thinking on the CSRD keeps evolving, many EU member states are still in the process of transposing it into their local laws, and the European Commission continues to issue further guidance. It is important to check in regularly with your legal and reporting advisors to make sure you have a comprehensive understanding of the information available before you make your decisions." Linda Riedel

integrated into existing enterprise risk management processes?

Value chain mapping is also really important and within that there are some decisions that have to be taken by management around disaggregation and granularity. Then there is stakeholder engagement. How is that being designed and implemented?

We know organisations are grappling with how key decisions and judgements are being made, strong governance is needed in this regard. Also, as the double materiality assessment process is subject to assurance, it is important to have appropriate internal challenge.

Veronica: What assurance is required?

Charlotte: The CSRD includes mandatory assurance from year one. The scope of the required assurance covers four areas – sustainability reporting in compliance with the ESRS standards, the double materiality assessment process, the digital tagging and reporting in accordance with Article 8, the EU Taxonomy disclosures. For the vast majority of companies, it represents a significant step up in terms of their sustainability assurance. CSRD assurance covers metrics and qualitative reporting on a broad range of topics – across the 10 ESRSs, there are about 1,000 metrics. It also requires information about the entity's own operations and value chain, which may contain many hundreds if not thousands of other entities.

In terms of who should perform the assurance work, the directive places an obligation on the statutory auditor or audit firm to express an opinion regarding the compliance of sustainability disclosures. However, in their transposition of the CSRD, Member States can allow an independent auditor or assurance services provider to do it.

Veronica: What do you suggest in terms of navigating the different options that companies have with the CSRD, for example considerations that apply with a non-EU parent or EU subsidiaries?

Linda: In terms of the EU subsidiary of a UK parent, there are exemptions and reliefs available. EU subsidiaries could take exemption from preparing their own sustainability reporting if they are included in a consolidated sustainability report higher up the group. There is certain criteria that need to be met, a key one being that the consolidated sustainability report is prepared in accordance with either full ESRS, or if the parent is a non-EU entity, it can be prepared in accordance with standards or requirements that are 'deemed equivalent'. Equivalence decisions are yet to be made by the European Commission.

This is an area where we see increasing discussion, with UK parents considering whether to report on a voluntary basis at the UK consolidated level to enable its EU subsidiaries to take that exemption. There is a number of considerations around what that report needs to include and the location of the reporting. There is an important distinction here around whether the UK parent is required to report because, for example, it has a listing in the EU, or whether it is purely voluntary reporting to enable subsidiaries to benefit from the available exemptions. If the UK parent is already required under the CSRD to report, the reported sustainability information must be included in the management report within the parent's annual report. If the reporting is voluntary to enable subsidiaries to benefit from the available exemptions, the guidance is not as clear. We are expecting FAQs from the European Commission to address this.

Veronica: How will value chain considerations impact SMEs?

Charlotte: SMEs themselves may indeed not be in scope of the CSRD but they may still be impacted. And that is as early as this year, because the ESRS require the in-scope entity to identify and assess material impacts, risks and opportunities across the value chain, so the requests for information to SMEs will come from companies higher up and down the value chain that are having to comply with the requirements of the CSRD.

Veronica: Does the same apply to UK groups with UK subsidiaries?

Linda: Absolutely. If it is a pure UK group listed in the UK with no EU listing or operations, the entity and the group itself will not be caught directly by the CSRD. However, that group will most likely be in the value chain of organisations that are in scope.

In respect of the value chain disclosures, the CSRD and ESRS recognise that this is a difficult exercise that will take time and therefore provide transitional reliefs. However, companies still have to disclose what information gaps remain, the efforts already made to obtain the required information, and the plans for closing information gaps in the future.

Veronica: There is a question around interoperability between IFRS S2, the International Sustainability Standards Board (ISSB) requirements on climate and the EU equivalent. If an entity complies with one, can it claim compliance with the others?

Linda: The short answer is no.

Interoperability and equivalence are not the same thing. Equivalence enables companies reporting under their jurisdictional requirements to claim compliance with another framework automatically if those jurisdictional requirements are formally determined by legislators to be equivalent. Interoperability, by contrast, is a reconciling exercise that shows similarities and differences between different frameworks. So, while it helps increase reporting efficiency and reduce duplication, it does not automatically lead to compliance with both frameworks.

The Interoperability Guidance published by EFRAG and the ISSB helps to identify commonality in disclosures and additional disclosures required in order to claim compliance with both the ISSB's S2 and ESRS depending on which is the primary reporting framework.

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