

Q&A: The EU Corporate Sustainability Reporting Directive: Who Does It Apply To and What Should EU and Non-EU Companies Consider

Skadden

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If you have any questions regarding the matters discussed in this memorandum, please contact the following attorneys or call your regular Skadden contact.

Greg Norman

Partner / London
44.20.7519.7192
greg.p.norman@skadden.com

Simon Toms

Partner / London
44.20.7519.7085
simon.toms@skadden.com

Kathryn Gamble

Associate / London
44.20.7519.7219
kathryn.gamble@skadden.com

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One Manhattan West
New York, NY 10001
212.735.3000

40 Bank St., Canary Wharf
London, E14 5DS, UK
44.20.7519.7000

As part of the European Commission's (EC's) commitment to strengthen sustainability disclosure in its 2018 Sustainable Finance Action Plan, the EC, together with the European Financial Reporting Advisory Group (EFRAG), has conducted a number of reviews and consultations over the last few years with the aim to improve existing European legislation in this area, including the [Non-Financial Reporting Directive \(2014/95/EU\)](#) (the NFRD). On 21 April 2021, the EC adopted a proposal for a Corporate Sustainability Reporting Directive (the CSRD) and on 10 November 2022, the European Parliament (EP) resolved to adopt, with amendments, the EC's proposal for the CSRD. According to the EC, this will expand the scope of the reporting requirements from approximately 11,000 entities under the NFRD to approximately 49,000 entities under the CSRD. The CSRD amends and updates the NFRD not only by expanding the scope of covered companies, but also by broadening the reporting requirements to include environmental considerations.

The EP [officially adopted the CSRD](#) on 28 November 2022 and the directive came into force on 18 December 2022.

Unlike the NFRD, the CSRD specifies the format of disclosure and standards that companies must use for their reports. The CSRD also emphasises “double materiality” — meaning companies will need to detail both their impacts on the environment and the climate-related risks they face. Below we summarise further details about these obligations and reporting standards.

1. Which companies will the CSRD affect?

The CSRD will apply to:

- i. all **large companies incorporated in an EU member state**, including EU subsidiaries of non-EU companies. The directive defines a large company as an entity that meets two of the following three criteria:
 - a. a net turnover of more than €40 million;¹
 - b. balance sheet total assets greater than €20 million; and/or
 - c. more than 250 employees;
- ii. parent companies incorporated in an EU member state, where the group of companies collectively meet the large company criteria;
- iii. **non-EU incorporated companies** if they meet the following criteria:
 - a. the company carries on substantial activity in the EU, meaning the company's net turnover in the EU in two consecutive financial years was over €150 million per annum; and
 - b. the company has at least one:
 - x. branch in the EU that has a net turnover of at least €40 million; or
 - y. subsidiary in the EU that meets at least two of the large company requirements;

¹ Net turnover means the amounts derived from the sale of products and the provision of services after deducting sales rebates and value added tax and other taxes directly linked to turnover (Article 2(5) Directive 2013/24/EU).

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- iv. **companies listed on an EU-regulated market**, including small and medium-sized companies (SMEs)² but excluding micro companies;³ and
- v. captive insurance⁴ and reinsurance undertakings,⁵ as well as small and noncomplex institutions,⁶ provided they also qualify as large companies or SMEs.

2. When will the CSRD come into force?

Currently, the NFRD applies to companies incorporated in the EU that are (i) traded on an EU-regulated market, (ii) banking companies or (iii) authorised insurance companies and that satisfy at least two of the following three criteria:

- i. a net turnover of more than €40 million;
- ii. balance sheet total assets greater than €20 million; and/or
- iii. more than 500 employees.

EU member states will phase in the CSRD, applying the directive first to companies most likely to be able to comply:

- **Starting 1 January 2024:** The CSRD applies to any company already subject to the NFRD for FY 2024 with reports due in 2025.
- **Starting 1 January 2025:** The CSRD applies to categories (i), (ii) and (iii) listed in [Question 1 above](#), which includes large listed companies referenced in category (iv) of [Question 1 above](#), for FY 2025 with reports due in 2026.

² SMEs are companies that on their balance sheet dates do not exceed the limits of at least two of the following three criteria: (i) an annual balance sheet total not exceeding €20 million; (ii) net turnover not exceeding €40 million; and/or (iii) an average number of employees for the financial year not exceeding 250 (Article 3(3) Directive 2013/24/EU).

³ A micro company is a company that on its balance sheet date does not exceed at least two of the following three criteria: (i) an annual balance sheet total not exceeding €350 000; (ii) net turnover not exceeding €700 000; and/or (iii) an average number of employees for the financial year not exceeding 10 (Article 3(3) Directive 2013/24/EU).

⁴ A captive insurance undertaking is an insurance undertaking that exclusively provides insurance coverage for the risks of the company or group of companies to which it belongs (Article 13(2) Directive 2009/138/EC).

⁵ A reinsurance undertaking is an undertaking that has received authorisation to carry on reinsurance activities (Article 13(4) Directive 2009/138/EC).

⁶ A small and noncomplex financial institution is an institution: (i) that is not a large institution; (ii) that can report the total value of its assets is on average equal to or less than €5 billion over the four-year period immediately preceding the current annual reporting period; (iii) that is not subject to any obligations in relation to recovery and resolution planning; (iv) that has a trading book business classified as small; (v) for which the total value of derivative positions held with trading intent does not exceed 2% of the total assets both on and off the balance sheet and the total value of its overall derivative positions does not exceed 5%; (vi) for which more than 75% of both the institution's consolidated total assets and liabilities relate to activities with counterparties located in the EU; (vii) that does not use internal models to meet the prudential requirements; (viii) that has not communicated to the competent authority an objection to being classified as a small and noncomplex institution; and (ix) that the competent authority has not decided cannot be considered a small and noncomplex institution (Article 4(1) (145) Regulation (EU) No 575/2013).

- **Starting 1 January 2026:** The CSRD applies to SMEs covered by categories (iv) and (v) of [Question 1 above](#) for FY 2026; however, listed SMEs may opt out of the CSRD until 2028.

3. What obligations will the CSRD impose?

Under the CSRD, a company will need to include in a dedicated section of its management report the information necessary to understand the company's impacts on sustainability matters as well as how sustainability matters affect the company's own development, performance and position. This reflects the "double materiality" principle emphasised during the development of the CSRD.

The information that a company is required to provide under the CSRD must include information about the company's own operations and about its value chain.

However, the EC has acknowledged the likely difficulties of gathering this data, so for the first three years of the application of the CSRD, regulators will implement this requirement on more of a "comply or explain" basis. Where a company cannot provide the information, the company should explain the efforts it has made to obtain the information, state the reasons why the information could not be provided and note how the company intends to obtain this information in the future.

4. What will the reporting standards be?

On 23 November 2022, EFRAG submitted to the EC the first set of 12 draft European Sustainability Reporting Standards (ESRS) outlining the reporting requirements for the CSRD. The standards are divided into two "cross-cutting standards" and 10 "topical standards". The cross-cutting standards set out general requirements that will apply across all of the topics covered by the CSRD, while the topical standards are further divided to apply separately to environmental, social and governance issues. Sector-specific standards will later supplement these draft standards.

To implement the ESRS, the EC plans to adopt delegated acts that will specify what information companies need to report and how to present that information. These acts are due to be finalized by June 2023. Following adoption of these delegated acts, the EC will review the reporting standards at least every three years, considering technical advice from EFRAG and the development of other international standards.

5. Where should companies include the new information?

In contrast to reporting protocols under the NFRD, companies that are under the scope of the CSRD will need to report sustainability information in a clearly identifiable section of their management

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reports (not in separate sustainability reports). The EC believes this will make the link between financial and sustainability information clearer and improve the accessibility of data for those interested in the interplay of financial and sustainability information.

6. Will the CSRD require audits?

Though the NFRD did not require auditing, the terms of the CSRD require sustainability reporting to be checked externally when the CSRD takes effect. Companies will need to seek “limited” assurance of the sustainability information. This requirement is less extensive than what is required for the financial audit statement but will nonetheless require external scrutiny. Where a non-EU company is subject to the CSRD, the company should certify its reporting either by a European auditor or an independent auditor from a third country.

“Limited” assurance usually means that the auditor performs fewer tests than it would in a reasonable assurance engagement and usually provides the conclusion of the engagement in a negative form of expression, with the auditor stating that it has identified no matter to conclude that the subject matter is materially misstated.

Member states will apply their national assurance standards and procedures until the EC adopts equivalent assurance standards, which it expects to adopt before 1 October 2026.

7. Are there any exemptions?

An entity will be exempt from the CSRD reporting requirements at an individual level if the consolidated management report of a parent company has included the results of the company and its subsidiaries. The exemption will be available if a group’s consolidated management report has been drawn up in a manner that may be considered equivalent with the CSRD, based on an equivalency mechanism to be adopted by the EU. The subject of this mechanism is likely to generate debate as further legislative measures are proposed over the next few years.

For U.S. companies, whether the SEC’s climate rules, once adopted, would be deemed equivalent remains to be seen.

An exempted EU-based subsidiary will still need to (i) publish the consolidated management report of its parent company in accordance with local law requirements, (ii) include a reference in its own individual management report to its exemption from reporting sustainability information under the CSRD and (iii) include clear instructions on how to access the consolidated management report.

As mentioned in [Question 2 above](#), for financial years starting before 1 January 2028, listed SMEs may choose not to report in accordance with the CSRD provided that they include a statement in their management report as to why they have chosen not to comply.

Listed SMEs and companies listed in category (v) of [Question 1 above](#) will also be entitled to rely on a derogation under the CSRD to only comply with proportionate obligations using proportionate reporting requirements.

8. How will the CSRD apply alongside the EU Taxonomy Regulation?

Companies that are within the scope of the CSRD will also have to comply with Regulation (EU) 2020/862 (the EU Taxonomy Regulation).

a. What are the disclosure obligations under the EU Taxonomy Regulation?

Under Article 8 of the EU Taxonomy Regulation, a company subject to the CSRD must disclose:

- i. how and to what extent its activities are associated with environmentally sustainable economic activities; and
- ii. information on the proportion of its turnover, capital expenditure and operating expenditure (together, its KPIs) derived from products or services associated with environmentally sustainable economic activities.

b. What qualifies as “environmentally sustainable economic activities”?

The EU Taxonomy Regulation defines “environmentally sustainable economic activities” as activities that satisfy all of the following:

- i. the activity contributes to the environmental objectives of the EU Taxonomy Regulation;
- ii. the activity does not significantly harm any of the environmental objectives of the EU Taxonomy Regulation;
- iii. a company carries out the activity in compliance with the minimum safeguards set out in the EU Taxonomy Regulation; and
- iv. the activity complies with the technical screening criteria established by the EC in accordance with the EU Taxonomy Regulation.

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c. **What are the environmental objectives of the EU Taxonomy Regulation?**

The EU Taxonomy Regulation sets out six environmental objectives:

- i. climate change mitigation;
- ii. climate change adaptation;
- iii. the sustainable use and protection of water and marine resources;
- iv. the transition to a circular economy;
- v. pollution prevention and control; and
- vi. the protection and restoration of biodiversity and ecosystems.

d. **Are there any exemptions?**

If a company is exempt from reporting under the CSRD as set out in [Question 7 above](#), the company will also be exempt from reporting under the EU Taxonomy Regulation. The EU Taxonomy Regulation does not provide for any other exemptions.

9. **Is there similar legislation in the United Kingdom?**

On 6 April 2022, The Companies (Strategic Report) (Climate-Related Financial Disclosure) Regulations 2021 (the Regulations) came into force, amending the Companies Act 2006. The Regulations make sustainability reporting in accordance with the Task Force on Climate-Related Financial Disclosures (TCFD) compulsory for a number of U.K. companies as part of their strategic reporting. For more information, please see our 19 April 2022 client alert "[Q&A: New Climate-Related Disclosure Regulations for Companies and LLPs](#)".

10. **Next steps — what can companies do to prepare?**

Companies, whether or not they have subsidiaries incorporated in the EU, should review the CSRD and seek legal advice on whether the directive will apply to them and, if so, when they will need to begin reporting. Given the potential reach of the new rules, companies may wish to consider at what level within their corporate structure they should report internally.

The EC's adoption of reporting standards in 2023 should help companies determine how to report under the CSRD and each company's required level of detail.