



Multinationals Need To Revisit Their Reporting as New EU Sustainability Disclosure Rules Bite

- New EU-mandated environmental disclosures will apply to many multinationals based outside the EU if they have EU operations.
- Third-party audits of environmental information will be required, but the EU may not release detailed standards for those until 2026.
- Companies will need to decide whether to limit disclosures to their EU affiliates or make enterprise-wide disclosures.
- With no uniform, global set of ESG standards, multinationals may face diverging reporting obligations.

At the end of 2022, the European Union adopted a law mandating detailed environmental disclosures and, for the first time, extending its non-financial disclosure requirements to many companies incorporated outside the EU. Companies will need to detail both their impacts on the environment and the climate-related risks they face.

Some companies will have the option to report for just their EU businesses, but some will be required to make enterprise-wide disclosures. Even those that are not required to provide global information will have to decide whether to do so for consistency.

In March 2022, the U.S. Securities and Exchange Commission proposed climate-related disclosure rules, and in April 2022 the United Kingdom introduced new legislation requiring disclosure of this kind of information. It is not yet clear how much the requirements will differ between

jurisdictions, or whether the EU will accept disclosures that meet the standards set by the U.S., U.K. or other countries.

EU companies that are already subject to EU non-financial disclosure obligations will have to comply beginning in 2025 for the 2024 fiscal year. Large companies that will become subject to the rules for the first time, including non-EU companies, will need to disclose the information in 2026 for their 2025 fiscal years. Small and medium-sized enterprises will have another year.

More companies are affected. The law, the Corporate Sustainability Reporting Directive (CSRD) applies to many more companies than the 2014 EU law that currently governs non-financial disclosures. It will now apply to all EU-incorporated companies that satisfy two of the three “large company” criteria, as well as EU-incorporated parents where the

corporate group collectively meets those. The criteria are:

- net turnover of more than €40 million;
- total balance sheet assets of more than €20 million; and/or
- more than 250 employees;

It is notable that these are rather low thresholds.

Companies incorporated outside the EU may be subject to the law if they have net annual turnover in the EU of more than €150 million in two consecutive financial years and have at least one EU subsidiary that meets two of the three large company requirements above, or an EU branch has a net turnover of more than €40 million.

Management teams and boards will need to consider whether they will be required to report enterprise-wide or jurisdiction by jurisdiction.

The law imposes “double materiality” obligations. Under the new law, a company will need to include information necessary to understand both (a) the company’s impacts on sustainability matters and (b) how sustainability matters affect the company’s own development, performance and position. That will include information about the company’s own operations and its value chain.

The European Commission acknowledges that it may be difficult to gather this data, so for the first three years, the law will be applied on a “comply or explain” basis: Where a company cannot provide the information, it should explain the efforts it has made to obtain the information and why it could not be provided.

“Limited” assurance audits will be required. Sustainability information must be checked by third parties. These “audits” will be less extensive than those for financial statements, but the European Commission has not yet adopted detailed standards. It expects to do so by October 1, 2026. In the meantime, companies will need to consider the standards and procedures of the member states in which they are incorporated when arranging their audits.

The reporting standards are still being developed. In November 2022, the private European Financial Reporting Advisory Group submitted 12 draft sustainability reporting standards under the new law, and the European Commission plans to finalize requirements by June 2023. At present, there is limited information about the proposed standards, but the picture should become clearer later in the year.

Exemptions remain for global corporations. An entity will be exempt from the reporting requirements at an individual level if the consolidated management report of its parent company includes the results of the

company and its subsidiaries. The exemption will be available if a group's consolidated management report is in a form considered equivalent to EU standards, based on an equivalency mechanism that will be outlined by the EU at a future date.

Will there be a divergence or convergence in sustainability disclosures?

It is unclear whether the U.S. Securities and Exchange's proposed climate disclosure requirements or parallel U.K. rules will be considered equivalent. If the EU does not accept compliance with the U.S. or U.K. regimes, companies will need to consider how best to meet the competing jurisdictional demands. That will entail weighing the risks of providing different levels of detail for subsidiaries in different countries or choosing to report according to one regime for all subsidiaries and affiliates with particular supplemental information as required.

The immediate task for companies is to gear up for the new mandates.

While the EU formulates more detailed rules and other jurisdictions frame their own environmental disclosure standards, multinationals need to begin preparing for the new demands, which may involve adding resources.

Management teams and boards will also need to consider whether they will be required to report enterprise-wide or jurisdiction by jurisdiction, and, if the latter is an option, whether that is the best approach.

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