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

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***Editor's note:* This article has been updated to reflect the EC's amendment to the thresholds for determining the size category of a company.**

As part of its commitment to strengthen sustainability disclosure in its 2018 Sustainable Finance Action Plan, the European Commission (EC), together with the European Financial Reporting Advisory Group (EFRAG), has conducted a number of reviews and consultations over the last few years in an aim to improve existing European legislation in this area, including the so-called Non-Financial Reporting Directive (2014/95/EU) (NFRD).

On 28 November 2022, the European Parliament adopted, with amendments, the EC's April 2021 proposal for a Corporate Sustainability Reporting Directive (CSRD), and it came into force on 18 December 2022. 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, but also by broadening the reporting requirements to include environmental considerations.

Unlike the NFRD, the CSRD specifies the format of disclosure and standards that companies will have to meet 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. Further details on these obligations and reporting standards are summarised below.

## 1. Which companies will be affected and when?

The CSRD will be phased in as follows:

| | |
|---|---|
| **From 1 January 2024 for full year (FY) 2024 with reports due in 2025:** | Any EU-incorporated company already subject to the NFRD. |
| **From 1 January 2025 for FY 2025 with reports due in 2026:** | All **large companies** incorporated in an EU member state and EU-incorporated parents of **large groups** (which will include any non-EU subsidiaries of the parent), including captive insurance[1] and reinsurance undertakings[2] as well as **small and non-complex institutions** that meet the large company requirements. |
| **From 1 January 2026 for FY 2026 with reports due in 2027:** | **Small and medium-sized entities** (SMEs) that are listed on an EU regulated market. |
| **From 1 January 2028 for FY 2028 with reports due in 2029:** | Companies whose ultimate parent company is outside the EU but that have a **significant presence** in the EU must report on the whole global group, including non-EU group companies. |

[1] **Captive insurance undertaking** means an insurance undertaking that exclusively provides insurance cover for the risks of the company or companies to which it belongs (Article 13(2) Directive 2009/138/EC).

[2] **Reinsurance undertaking** means an undertaking that has received authorisation to carry on reinsurance activities (Article 13(4) Directive 2009/138/EC).


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A **large company** or **large group** means an entity or group that meets two of the following three criteria:

i. a net turnover of more than €50 million[3];

ii. balance sheet total assets greater than €25 million; and/or

iii. more than 250 employees.

**Small and non-complex institution** means an institution that:

i. not a large institution as defined in Article 4(1)(146) Regulation (EU) No 575/2013;

ii. 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. is not subject to any obligations in relation to recovery and resolution planning;

iv. has a trading book business that is classified as small;

v. the total value of derivative positions held with trading intent does not exceed 2% of its total on- and off-balance sheet assets and the total value of its overall derivative positions does not exceed 5%;

vi. more than 75% of both the institution's consolidated total assets and liabilities relate to activities with counterparties located in the EU;

vii. does not use internal models to meet the prudential requirements;

viii. has not communicated to the competent authority an objection to being classified as a small and non-complex institution; and

ix. the competent authority has not decided is not to be considered a small and non-complex institution (Article 4(1)(145) Regulation (EU) No 575/2013).

A company or group has a **significant presence** in the EU if it:

i. carries on substantial activity in the EU, meaning the company's net turnover in Europe in two consecutive financial years was over €150 million per annum; and

ii. the company has at least one:

   a. branch in the EU that has a net turnover of at least €40 million; or

   b. subsidiary in the EU that meets at least two of the large company requirements.

[3] **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).

### 2. 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 required to be provided under the CSRD must also include information on a company's own operations as well as its value chain.

However, the likely difficulties in gathering this data have been acknowledged by the EU and, for the first three years of the application of the CSRD, this requirement will be implemented on more of a "comply or explain" basis. Where the information cannot be provided, a company should explain the efforts it has made to obtain the information and state the reasons why the information could not be provided as well as how the company intends to obtain this information in the future.

### 3. What are the reporting standards under the CSRD?

On 23 November 2022, EFRAG submitted to the EC the first set of 12 draft European Sustainability Reporting Standards (ESRS) alongside its recommendations on how these should be implemented. The EC subsequently released a draft delegated act implementing the ESRS in June that incorporated some but not all of the EFRAG recommendations. On 31 July 2023, the EC officially adopted the ESRS.

#### a. What are the ESRS?

The first draft ESRS set out sector-agnostic standards and outlined the reporting requirements for the CSRD. These 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.

Within each standard, there are a number of datapoints on which companies are either required to or may choose to report if they meet the materiality threshold for the standard.

It is intended that sector-specific standards will later supplement these standards.

The EC will review the reporting standards at least every three years, considering technical advice from EFRAG and the development of other international standards.

**b. Which standards are mandatory?**

Following receipt of stakeholder feedback, only ESRS 2– General Disclosures, will be mandatory for all companies that qualify under the CSRD. This is a cross-cutting standard that covers both general characteristics of the company and its business but also incorporates specific disclosures on compliance.

As a result, companies will need to determine for themselves whether the impacts, risks and opportunities under the other standards are material, using the "double materiality" principle.

**c. What is the "materiality assessment"?**

When assessing whether the ESRS are material to a company, the "double materiality" principle set out in the CSRD applies. Companies must therefore assess materiality from the perspective of:

i. value creation for the company; and

ii. the wider impact the company has on the economy, environment, nature and communities.

A standard is "material" if either of the two limbs above is satisfied.

The EFRAG recommended that companies be required to provide an explanation where they determine that a standard is not material to their business, but the EC's draft has amended this to say that companies "may" explain their conclusions.

Given the importance of the materiality assessment, the EC has requested that EFRAG provide additional guidance for companies on how to assess which standards they are required to report against.

**d. Are there any exemptions?**

**Phasing-in of standards**

Alongside the phase-in for value chain reporting provided for in the CSRD, in the first year of applying the ESRS, companies need not report on expected financial effects related to non-climate environmental issues and particular datapoints within ESRS S1 (Own Workforce).

Companies with fewer than 750 employees (Small Companies) will also have more time to comply with the standards. In their first year of reporting, Small Companies need not include data on their scope 3 greenhouse gas emissions and ESRS S1, and for the first two years, Small Companies may disregard the standards on biodiversity (ESRS E4) and all of the social standards other than ESRS S1.

**Voluntary standards**

The EC has amended a number of specific datapoints within the standards to be voluntary, regardless of whether a company determines that the standard is material to their business.

**e. How do the ESRS align with other sustainability standards?**

As part of its recommendations, EFRAG had encouraged the EC to make ESRS E1 mandatory. This would have resulted in the disclosure under the CSRD aligning with the principle adverse indicators under the Sustainable Finance Disclosure Regulations. However, the EC has chosen not to follow this recommendation and, rather than being mandatory, companies will only need to report against ESRS E1 if they meet the materiality threshold.

Despite this deviation, the EC has made changes to the ESRS to try and ensure the compatibility of the ESRS with the Global Reporting Initiative's standards and the International Sustainability Standards Board standards. Whether this will work in practice remains to be seen as companies begin to report against the CSRD.

The ESRS have been drafted in a manner that ensures that companies that comply with the ESRS will also comply with the Taskforce for Climate-related Financial Disclosure (TCFD). As the TCFD only relates to climate disclosure, reporting against ESRS 1 and ESRS 2 (the general standards) as well as the environmental standards ESRS E1-E4 will satisfy the TCFD requirements.

**4. Where should the information be included?**

In comparison to the NFRD, companies which are in-scope of the CSRD will need to report sustainability information in a clearly identifiable section of their management reports, and not in separate sustainability reports. The EC believes that this will make the link between financial and sustainability information clearer as well as improve the findability and accessibility of information for those who are interested in the interplay of financial and sustainability information.

**5. Will the CSRD require external review?**

Though the NFRD did not require auditing, the terms of 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 falls short of what is required for the financial audit statement but nonetheless will require external scrutiny. Where a non-EU company is subject to the CSRD, its reporting should also be certified, either by a European or a third-country independent auditor.

"Limited" assurance usually means that the auditor performs fewer tests than in a reasonable assurance engagement and the conclusion of the engagement is usually provided in a negative form of expression, with the auditor stating that no matter has been identified by them 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. These are expected to be adopted before 1 October 2026.

**6. Are there any exemptions?**

An entity will be exempt from the CSRD reporting requirements at an individual level if it and its subsidiaries are included in the consolidated management report of a parent company. 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. This mechanism is likely to be the subject of debate as further legislative measures are proposed over the next few years.

It is not yet clear whether the current UK non-financial reporting requirements as further described in question 9 below or any new climate rules adopted by the US Securities and Exchange Commission would be deemed equivalent.

Exempted EU-based subsidiaries will still need to (i) publish the consolidated management report of their parent company in accordance with local law requirements; (ii) include a reference in their own individual management report to the fact that they are exempted from reporting sustainability information under the CSRD; and (iii) include clear information and instructions on how to access the consolidated management report.

For financial years starting before 1 January 2028, listed SMEs may choose not to report in line with the CSRD, provided that they include a statement in their management report as to why they have chosen not to comply.

Listed SMEs, as well as captive insurance and reinsurance undertakings and small and non-complex institutions, will also be entitled to rely on a derogation under the CSRD to only comply with proportionate obligations using proportionate reporting requirements.

**7. What are the penalties for non-compliance with the CSRD?**

As yet, the penalties for non-compliance with the CSRD are unclear. Each member state will, when transposing the CSRD into national law, be able to introduce its own penalties for non-compliance. It is believed that the penalties to be introduced will be based on the current penalties that were implemented when member states transposed the NFRD.

Under the NFRD, penalties currently range from fines of €25,000 or imprisonment for individual directors or fines being imposed on the company that could equal the higher of €10 million or 5% of the company's global annual turnover.

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

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

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

Under Article 8 of the EU Taxonomy Regulation, companies in-scope of the CSRD must disclose:

i. how and to what extent their activities are associated with environmentally sustainable economic activities; and

ii. information on the proportion of their turnover, capital expenditure and operating expenditure (together KPIs) derived from products or services associated with environmentally sustainable economic activities.

**b. What qualify as "environmentally sustainable economic activities"?**

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

i. contributes to the environmental objectives of the EU Taxonomy Regulation;

ii. does not significantly harm any of the environmental objectives of the EU Taxonomy Regulation;

iii. is carried out in compliance with the minimum safeguards set out in the EU Taxonomy Regulation; and

iv. complies with the technical screening criteria established by the EC in accordance with the EU Taxonomy Regulation.

**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 6, it 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 UK?**

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 TCFD compulsory for a number of UK 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 they have subsidiaries incorporated in the EU or not, 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 these rules, companies may wish to consider at what level in their corporate structure they should report.

In particular, non-EU companies that may be held to have a significant presence in the EU need to consider the interplay between the CSRD and liability provisions in their jurisdictions of incorporation. This will include 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 supplemental information as required.