CSRD ESSENTIALS

THE DEFINITIVE GUIDE TO THE EU CORPORATE SUSTAINABILITY REPORTING DIRECTIVE

WITH THE SUPPORT OF PASCAL DURAND, MEMBER OF THE EUROPEAN PARLIAMENT, CSRD RAPPORTEUR

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Foreword

by Pascal Durand, MEP and CSRD rapporteur

Over the last decade, the way consumers and market operators look at sustainability issues and corporate business accountability has evolved significantly. As a consequence, the European Union had to adapt the legislation on corporate disclosure, in accordance with its values and principles. With the final adoption of the *Corporate Sustainability Reporting Directive* (CSRD) in December 2022 and the subsequent *European Sustainability Reporting Standards* (ESRS), the European Union now finds itself at a decisive moment – a moment where the application of reporting rules by market operators supervised by authorities can be transformational for the economy and society. This new framework is not about undermining the business world, but about ending the overly arbitrary and disparate nature of sustainability information so far, creating real and lasting value, away from short-term logics that focuses solely on profit maximization.

Based on the CSRD, companies will need to report on the impact of their activities on the environment and society, as well as the related (financial) risks and opportunities using ESRS; they will also be required to provide assurance of reported information through standardized reporting and transparency. The EU sends a strong signal to drive progress towards a more sustainable society and conveys a message of hope and humanity regarding the fight against daily abuses in global supply chains.

Organizations will now have to assess how their operations affect the wider world and will do so by conducting a double materiality assessment process, known as 'impact materiality.' They will also have to gauge how sustainability issues, in turn, affect their bottom-line or 'sustainability-related financial materiality.' This will help make economic activity more ethical and clean up the market. By declaring actions against deforestation and social right abuses, companies will find themselves in a clearer and more transparent competitive situation compared with those that continue to import timber illegally or use child labor. In a nutshell, this marks the end of declarations made by companies purely for public-relation reasons: having an impeccable human rights record will be just as important as having a flawless balance sheet.

The EU is not alone in this journey. Globally, sustainability reporting has grown from a niche activity, adopted by a handful of companies, to a common and increasingly required practice for thousands of organizations worldwide. Today, more than 130 countries all over the world mandate voluntary or mandatory sustainability reporting. Since reporting obligations will also apply to a significant number of companies headquartered outside the EU, European decision-makers and the delegated EU standard-setter (EFRAG) should maximize the development of financial and impact-related standards compatible with those already in use globally (such as GRI, the Task Force on Climate-related Financial Disclosures or the Carbon Project Disclosure).

The CSRD can appear as a complex mandatory regulation at first. The present work, carried out by various stakeholders in a collaborative and transparent way, shows that its rules are, in fact, quite easy to understand and apply. I would like to thank warmly all of those who contributed to these briefings, which continues and sheds light on the legislator's work.

Pascal Durand

NFRD vs CSRD: What's new?

The CSRD (EU 2022/2464) did not emerge ex nihilo; its development is deeply embedded in recent history, starting from 2014 when the *Non-Financial Reporting Directive* (NFRD) came into force.

The NFRD was a regulatory framework within the European Union (EU) designed to enhance transparency and disclosure of non-financial information by certain large companies and groups within the EU. It was adopted by the European Parliament and the Council of the European Union on November 22, 2014.

The NFRD encouraged businesses to consider environmental, social, and governance factors in their business strategies and operations, and required companies to disclose certain non-financial information. It affected about 11,000 companies and directly referred to the GRI Standards and to other frameworks.

The directive applied to large public-interest entities (PIEs) with over 500 employees, including listed companies, credit institutions, and insurance companies, as well as some other large companies brought within the scope of application by decision of EU Member States. Companies falling under the scope of the directive were required to disclose non-financial information either in their management report or in a separate report published alongside their management report. This statement covered information on environmental, social and employee matters, respect for human rights, anti-corruption and bribery issues. To that purpose, the European Commission issued non-binding guidelines to help companies disclose relevant information in a more consistent and more comparable manner. If a company decided not to disclose certain information, it was required to provide a clear and reasoned explanation for this omission.

The NFRD did not require assurance of the sustainability information disclosed, although EU Member States were free to set up their own assurance requirements. Although it marked a milestone in the comparability of sustainability disclosure, it had a rather limited scope both when it came to reporting requirements and to the type of companies affected.

With the CSRD, many more companies will have to provide standardized qualitative and quantitative information, both forward-looking and retrospective.

FIGURE 1

	Affect	When ?	Disclosure requirements	Assessment requirement	Audit requirement	Reporting format	Located reporting	Standards
NFRD Non-Financial Reporting Directive	Approx. 11 700 companies including: • Large public interest entities (> 500 employees) such as : - Listed companies - Banks and insurance companies, etc. If they exceed some thresholds	2018: first report	Disclose information on: 1. Environmental 2. Social and employee matters 3. Respect for human rights 4. Bribery and corruption + to present general disclosures (business model, due diligence process, etc.)	Double materiality in the NFRD's guidelines (soft law)	On a voluntary basis by Member States	Online reporting / PDF format	In the management report or in a separate non-financial statement	Voluntary disclosure based on International, European or national guidelines
CSRD Corporate Sustainability Reporting Directive	Approx. 42 500 companies including: • Small, medium and large Public interest entities (PIE) • Large companies • Third-countries companies If they exceed some thresholds Example: Large companies should exceed at least two of the following three criteria: - €25m (balance sheet total); - € 50m net turnover; - 250 employees during the financial year	2025: first report from Large listed companies 2026: first report from Large companies 2027: first report from SMEs which are PIE (with option to opt out to 2029) 2029: first report from third-country companies	Disclose information on 10 topics in line with EU standards (ESRS): 1. Climate change 2. Pollution 3. Water and marine resources 4. Biodiversity and ecosystems 5. Resource use and circular economy 6. Own workforce 7. Workers in the value chain 8. Affected communities 9. Consumers and end-users 10. Business conduct (business model, value chain, views of stakeholders, due diligence, etc.) + to present general disclosures	Double materiality in the directive (hard law)	From limited assurance of the reporting (for the first report) to reasonable assurance of the reporting (after the adoption of a standard on it no later than 1 October 2028)	Human-readable format of reporting with structured machine-readable data (compliant with European Single Electronic Format (ESEF) based on inline XBRL)	Specific section of the management report	Mandatory disclosure based on European Sustainability Reporting Standards (ESRS) (including sector-agnostic and secto-specific standards) and a robust materiality assessment

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Scope

The CSRD makes a big leap in scope compared to the NFRD it replaces. From the 11,000 companies included in the NFRD Scope, the CSRD will directly apply to about 42,500 companies with their headquarters in the EU.

While no official figure has been communicated by the EU, a few thousand companies with headquarters outside the EU will also be covered by these new rules.

The type of companies covered by the directive in each Member State are listed in Annex I of the Accounting Directive (2013/34/EU). In most cases, it concerns public and private companies limited by shares or by guarantee. For companies which are not governed by the law of an EU Member State, obligations are defined by the legal form which is comparable with the types of companies listed in this specific annex.

Several types of companies fall under the scope of the CSRD, depending on specific size criteria. This is the case for large, small and medium public-interest entities (PIEs), meaning:

- Listed companies on regulated markets. These markets, such as certain stock exchanges, are recognized by national authorities and function in accordance with the provisions of EU rules on “markets in financial Instruments”[1].
- Credit institutions, insurance companies, mutual or other, including cooperatives.
  - Member States may choose to exclude central banks and particular public credit institutions.
- Member States may choose to include some companies in the list of PIEs at national level.

Furthermore, certain financial products, such as pension schemes or companies dedicated to cross-border investments (UITPs), are excluded from the scope of this directive.

On top of the above-mentioned entities, all the companies with their headquarters in the EU exceeding at least two of the three thresholds listed below fall within the scope of the CSRD[2]. The following thresholds also apply on a consolidated basis. They define “large companies” as per EU law:

- average net turnover of EUR 50 million;
- average balance sheet of EUR 25 million;
- at least 250 employees.

Any company with a lower turnover, balance sheet and/or number of employees is defined as a micro, small and medium enterprise. The following thresholds also apply on a consolidated basis.

- Micro-companies that do not exceed two of the following criteria are not within the scope of the directive:
- a net turnover of EUR 900,000;
- a balance sheet of EUR 450,000;
- 10 employees.

What is a branch?

In EU law a branch is a place of business other than the head office which is a part of an investment firm, has no legal personality, provides activities or investment services, and which may also perform reception and transmission of orders in relation to one or more financial instruments for which the firm has been authorised.

1 Directive 2014/65/EU (MIFID).
2 Based on the latest adjustments of the Commission as per the EU delegated act of 17.10.2023.

Companies with their headquarter outside the EU and with either a large, small or medium listed subsidiary, or a branch in the EU, fall under the scope of the CSRD if:

- the large, small or medium, subsidiary, is a public-interest entity and listed on an EU-regulated market;
- the branch generates more than EUR 40 million of net turnover a year;
- The company that owns the branch or controls the subsidiary generates more than EUR 150 million in the EU during at least during two consecutive years.

Review clause of the directive

By April 2029, the Commission should provide an assessment of whether and how the scope should be further extended, especially in relation to small and medium-sized companies and to third-country companies. It should also provide an assessment of the number of SMEs which have used the dedicated non-binding European Sustainability Reporting Standards (ESRS) for SMEs.

FIGURE 2 CSRD: Who and When?

2025 on the 2024 data | **2026** on the 2025 data | **2027** on the 2026 data | **2028** on the 2027 data | **2029** on the 2028 data

Entity	Thresholds (m = million)
Large listed companies	• with balance sheet (total) in excess of €25m; • and/or net turnover in excess of €50m; • with more than 500 employees during the financial year.
Large companies and groups	Exceeding at least two of the following three criteria: • €25m (balance sheet total); • €50m net turnover; • 250 employees during the financial year.
Public interest entities (PIEs) other than **large listed companies, credit institution and insurances**	Pending Member State's applicable rules.
Listed parent companies of a large group	• with balance sheet (total) in excess of €25m; • and/or net turnover in excess of €50m; • with more than 500 employees (consolidated basis) during the financial year.
Parent companies of a large group	Exceeding at least two of the following three criteria on a consolidated basis: • €25m (balance sheet total); • €50m net turnover; • 250 employees (consolidated basis) during the financial year.
Possibility of an opt-out for 2 years Listed Small and Medium Enterprises (SMEs)	Do not exceed two of the following three criteria: • €25m (balance sheet total); • €50m net turnover; • 250 employees during the financial year.
Small, non-complex credit institutions that are listed SMEs or large corporates	Thresholds of [listed SMEs] or [large companies]
Captive insurance or reinsurance companies if they are listed SMEs or large companies	Thresholds of [listed SMEs] or [large companies]
IMPACT REPORTING ONLY Third-country companies	• with net consolidated turnover of more than €150m in the EU; • and has either a large or listed subsidiary or a European branch with net turnover in excess of €40m.
EXCLUDED FROM THE SCOPE Micro-undertaking	Do not exceed two of the following three criteria: • €450 000 (balance sheet total); • €900 000 net turnover; • 10 employees during the financial year.

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Timing

FIGURE 3 What's the timeline?

2023 2024 2025 2026 2027 2028 2029 2030

Legislatives acts and Proposals

- **05/01** Entry into force of the CSRD
- **06/07** End of transposition period for the Member States
- First report (based on limited assurance)
- Evaluation report on the directive
- EU Commission assessment of possible legal measures to ensure sufficient diversification of the sustainability assurance market

For which companies?

- Public interest entities (PIEs) subject to a regulated market + Bank + Insurance companies if > 500 employees
- Large companies
- Listed SMEs (but possible to opt out during 2 years)
- Non EU-companies if net consolidated turnover > 150 millions euros
- End of exemption for Listed SMEs

Under which standards?

- **31/07** Sector-agnostic standards
- **By June** Standards for SMEs
- **By June** Sectorals standards and for Non-EU companies
- **By October** Standards on limited assurance
- First revision of the standards
- **By October** Standards on reasonable assurance
- End of the artificial EU consolidation for subsidiaries with parents' HQ outside the EU

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LEFEBVRE SARRUT

European Sustainability Reporting Standards (ESRS)

What are the European Sustainability Reporting Standards – ESRS?

The ESRS outline the disclosure requirements that companies need to meet to comply with the CSRD. The directive mandates companies falling within its scope to adopt the ESRS when reporting on their sustainability information. The ESRS align with the goals and requirements set forth by the CSRD and provide a standardized approach to sustainability reporting (environmental, social and governance) across the EU. In short, they impose obligations in terms of transparency, but they do not prescribe any obligations in terms of behavior. Like a detailed recipe book, they provide step-by-step instructions to comply with the directive.

What does the CSRD require for ESRS standards setting?

Article 1 of the CSRD introduces new articles (19a and 29a) in the *Accounting Directive*, prescribing with various levels of granularity what information shall be disclosed on environmental, social and governance matters. More specifically, they require companies to disclose information on five reporting areas:

1. Business model
2. Policies, including the due-diligence processes implemented;
3. The outcome of these policies;
4. Risks and risk management;
5. Key performance indicators relevant to the business.

How are the ESRS structured?

There are different sets of ESRS to be used by the different companies in the CSRD's scope: the full ESRS (to be used by listed and large companies), the standard for listed SMEs, and the standard for third-country companies.

The full ESRS are made up of three categories: cross-cutting standards (sector agnostic), topical standards (sector agnostic), and sector-specific standards.

Cross-cutting standards (ESRS 1 and ESRS 2): Standards that define the general principles when

The role of the EFRAG in developing the ESRS

ESRS are based on technical advice from EFRAG, an independent, multistakeholder advisory body, primarily funded from the European budget. As part of its mandate granted by the CSRD to provide technical advice to the European Commission on ESRS, EFRAG is in charge of developing sector-agnostic standards, sector-specific standards, mandatory standards for listed SMEs. The development of the initial sets of ESRS will be a multi-year exercise. Although this was not part of the CSRD mandate as such, EFRAG has undertaken to draft voluntary standards for SMEs, as well as standards for companies operating in the European market with headquarters outside the EU. The CSRD requires a regular review of each standard no more than three years after its entry into force.

EFRAG has also issued implementation guidance documents, releasing three 'ESRS implementation guidance' resources to aid in adhering to reporting standards. These non-authoritative materials serve as educational tools and can be found in the REFERENCES section.

reporting according to the ESRS (ESRS1). They specify the "general disclosures", which outline the essential information to be disclosed irrespective of the sustainability topics (ESRS 2) and can apply across sectors. These include: whether a company has opted to omit a specific piece of information pertaining to intellectual property, know-how or the results of innovation, or to what extent the sustainability statement covers the company's upstream and downstream value chain.

ESRS 1 and ESRS 2 apply to sustainability matters described in the topical standards and sector-specific standards. The information requested by ESRS 2 is mandatory for all companies. All other standards are subject to a materiality assessment.

Topical standards (10 of them) reflect the three dimensions of sustainable development (ESG). Each dimension is indicated by a letter and a number (for instance, ESRS S1 focuses on the social dimension, specifically on the organization and its workforce). Each topical standard is itself structured into sustainability topics, sub-topics and sub-sub-topics, collectively called "sustainability matters".

Sectoral standards: as of 2027 and upon the adoption of the sectoral standards by the EU, companies should report on specific disclosures, depending on their sector of activity. They will be applicable to all companies within a specific sector (e.g. textile industry, including footwear and garment production activities). By addressing sector-specific impacts, risks and opportunities, the ESRS should ensure that organizations report information that are specific to that sector, and that are not already

Terminology of the standards

Disclosure Requirements (DR): all the information that shall be or could be disclosed in the various categories of ESRS.

Datapoint (DP): are the smallest, most specific reporting element of the of all disclosure requierements. It can be produced as a narrative (e.g. how the organization seeks to ensure meaningful engagement with stakeholders) or as quantitative data (e.g. the percentage of total employees covered by collective bargaining agreements). ESRS 2 and topical standards represent more than 1,000 datapoints in total, but not all of them will be reported by a company – only those that are deemed material.

Impacts, Risks and Opportunities (IROs): they relate to environmental, social and governance matters that are to be reported in the company's own operations and its value chain. Only material IROs are to be reported.

Entity-specific disclosure: when specific Impacts, Risks, or Opportunities (IROs) are not addressed in the ESRS, whether at the topical or sectoral level, but the company deems them material for reporting, it can offer supplementary entity-specific disclosures. This allows users to understand the impact of these IROs. In the absence of sector-specific standards, companies must report each material IRO, potentially resulting in a plethora of disaggregated data, specific to the entity rather than the sector. When defining its entity-specific disclosures for the first three sustainability reporting years, the company may use other frameworks or reporting standards, such as IFRS industry-based guidance or GRI Sector Standards, to complement disclosures which are not yet available in the ESRS.

Materiality assessment: ESRS 1 requires all companies to conduct a materiality assessment that applies the principle of double materiality (identification of relevant impact and financial materiality). The identification of the material matters is the starting point to determine the material information to be disclosed in the sustainability statement, and to identify which related **IROs** need to be reported on, using the relevant standard. This assessment requires the exercise of judgement by the company, which needs to define itself what is material/relevant to its activities and throughout its value chain.

TO LEARN MORE ABOUT MATERIALITY ASSESSMENT, PLEASE READ OUR BRIEFING ON MATERIALITY AND INTERNAL SUPERVISION, AND OUR GLOSSARY.

covered, or not sufficiently covered, by the 10 topical standards. Until sector-specific standards are adopted by the EU, companies will also need to determine sector-specific material information on their own (using rules for entity-specific disclosures). Companies or groups operating in more than one sector are likely to report against more than one sectoral standard. However, there may be some overlap in data points.

Standards for listed SMEs: the CSRD requests these standards to be simpler than the full ESRS set for large companies and proportionate to SMEs' capacity to report, as well as to the scale and complexity of their activities. They should at least include requirements on sustainability matters, including a set of targeted metrics to assess how companies measure their performance and how they identify, manage, and engage on the impact and risks of their activities. Reporting standards for listed SMEs are under development: they should be adopted by June 2024, and apply as of fiscal year 2026, with a possibility to ask for a 2 year "opt-out" option (a delay). They will apply to listed SMEs on regulated markets, including small listed non-complex credit institutions, and captive insurance or reinsurance companies.

TO LEARN MORE ABOUT THE DIFFERENT TYPES OF SMEs READ OUR GLOSSARY.

Voluntary standard (for SMEs): this standard can be used on a voluntary basis for SMEs which are not listed on regulated markets. Non-listed SMEs are outside the scope of CSRD – the CSRD does not require them to disclose any sustainability information. This standard will therefore have no legal authority. Its structure differs from the other ESRS, and no assurance of the data is required. A materiality assessment is nonetheless incorporated. Voluntary standards should be more basic, focusing on specific narratives on the company's own policies, actions and targets, as well as information on lenders, investors and clients.

Standards for third-country companies: they specify the information to be included in the sustainability report of third-country companies, generating an annual net turnover of EUR 150 million in the EU and that have at least one subsidiary or branch in the EU. These standards should be adopted by June 2026 and applied as of fiscal year 2028. They will only address the sustainability performance of companies, focusing on their impacts.

In addition, the CSRD provides the European Commission with the possibility to allow third-country companies within the scope of the CSRD, or non-EU parent companies of EU subsidiaries (such as those based in the U.S. or the UK), to use sustainability standards equivalent to the ESRS. In that case, the European Commission will need to grant an equivalence status to those jurisdictions first.

FIGURE 4 **Sustainability matters covered in topical ESRS – 1/2**

ESRS E1
CLIMATE CHANGE
- Climate change adaptation
- Climate change mitigation
- Energy

ESRS E2
POLLUTION
- Pollution of air
- Pollution of water
- Pollution of soil
- Pollution of living organisms and food resources
- Substances of concern
- Substances of very high concern
- Microplastics

ESRS E3
WATER AND MARINE RESOURCES
- Water
  - Water consumption
  - Water withdrawals
  - Water discharges
  - Water discharges in the oceans
- Marine resources
  - Extraction and use of marine resources

ESRS E4
BIODIVERSITY AND ECOSYSTEMS
- Direct impact drivers of biodiversity loss
  - Climate Change
  - Land-use change, fresh water-use change and sea-use change
  - Direct exploitation
  - Invasive alien species
  - Pollution
  - Others
- Impacts on the state of species
  - Examples: Species population size, Species global extinction risk
- Impacts on the extent and condition of ecosystems
  - Examples: Land degradation, Desertification, Soil sealing
- Impacts and dependencies on ecosystem services

ESRS E5
CIRCULAR ECONOMY
- Resources inflows, including resource use
- Resource outflows related to products and services
- Waste

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FIGURE 4 Sustainability matters covered in topical ESRS – 2/2

ESRS S1 OWN WORKFORCE

ESRS S2 WORKERS IN THE VALUE CHAIN

- Working conditions
  - Secure employment
  - Working time
  - Adequate wages
  - Social dialogue
  - Freedom of association, the existence of works councils and the information, consultation and participation rights of workers
  - Collective bargaining, including rate of workers covered by collective agreements
  - Work-life balance
  - Health and safety
- Equal treatment and opportunities for all
  - Gender equality and equal pay for work of equal value
  - Training and skills development
  - Employment and inclusion of persons with disabilities
  - Measures against violence and harassment in the workplace
  - Diversity
- Other work-related rights
  - Child labour
  - Forced labour
  - Adequate housing
  - Privacy

ESRS S3 AFFECTED COMMUNITIES

- Communities' economic, social and cultural rights
  - Adequate housing
  - Adequate food
  - Water and sanitation
  - Land-related impacts
  - Security-related impacts
- Communities' civil and political rights
  - Freedom of expression
  - Freedom of assembly
  - Impacts on human rights defenders
- Rights of indigenous peoples
  - Free, prior and informed consent
  - Self-determination
  - Cultural rights

ESRS S4 CONSUMERS AND END-USERS

- Information-related impacts for consumers and/or end-users
  - Privacy
  - Freedom of expression
  - Access to (quality) information
- Personal safety of consumers and/or end-users
  - Health and safety
  - Security of a person
  - Protection of children
- Social inclusion of consumers and/or end-users
  - Non-discrimination
  - Access to products and services
  - Responsible marketing practices

ESRS G1 BUSINESS CONDUCT

- Corporate culture
- Protection of whistle-blowers
- Animal welfare
- Political engagement and lobbying activities
- Management of relationships with suppliers including payment practices
- Corruption and bribery
  - Prevention and detection including training
  - Incidents

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Legal interconnections

Legal reporting obligations on corporate sustainability are often scattered across various legal frameworks. Despite the inclusion of over 40 legal cross-references in the CSRD, their primary objective is to establish consistency in disclosure requirements. By doing so, the CSRD not only adds significant value, but also simplifies the reporting process for both preparers and users. The following briefing presents concise definitions of the essential cross-references. It also aims to improve the understanding of the structure of mandatory measures outlined in the directive, and to clarify the implications for companies engaged in the preparation of their management reports.

The CSRD (Directive 2022/2464/EU) amends four structural European legislative acts in the field of company law:

1. **The Accounting Directive (Directive 2013/34/EU)** establishes rules and standards for the preparation and presentation of financial and sustainability statements by companies.

This directive harmonizes accounting rules and regulations across EU Member States. It aims to ensure the consistency and comparability of financial statements and sustainability information provided by companies.

Mandatory measures include:

- preparation of (consolidated) financial statements;
- specification of the content of the management report, including additional information on their performance, position, and future developments;
- audit and assurance requirements on financial statements and sustainability reporting;
- definitions, size criteria and thresholds for companies and groups, to determine the level of disclosure and reporting requirements for companies.

What is amended by the CSRD:
The CSRD extends the existing rules governing the disclosure of financial information to encompass specific details on to the disclosure of sustainability-related information – including environmental, social, human rights, and governance topics. It also introduces a single electronic format for the preparation of the management report.

2. **The Transparency Directive (Directive 2004/109/EC)** aims to improve the transparency of financial markets by establishing disclosure requirements for issuers of securities listed on regulated markets.

It focuses on enhancing transparency in financial and sustainability reporting by companies which are listed on regulated markets within the EU.

Key mandatory measures prescribed by the directive:

- periodicity of companies' reporting;
- obligations for shareholders when their voting rights exceed or meet certain thresholds;
- disclosure of information about companies' corporate governance practices in a Corporate Governance Statement;
- language of the report;
- designation of a "home Member State" – where the company has its registered office.

What is amended by the CSRD:
To ensure that companies listed on a EU regulated market adhere to the same sustainability reporting requirements as non-listed companies falling under the scope of the Accounting Directive, the CSRD amends the Transparency Directive accordingly. Additionally, it establishes criteria for the European Commission to assess the equivalence of sustainability reporting standards used by third-country issuers.

3. **The Audit Directive (Directive 2006/43/EC)** establishes rules for the statutory audit of annual and consolidated financial and sustainability statements in the EU.

It aims at improving the quality and transparency of audit services within the EU. This directive sets outs rules for the appointment of statutory auditors, the conduct of statutory auditors and the oversight of audit firms.

Key elements of the directive:

- a framework for quality assurance systems for audit firms to ensure consistent high-quality audits;
- provisions for an audit committee composed of non-executive members of the administrative or supervisory body;
- measures on auditors' independence, to avoid conflicts of interests;
- measures for auditors and their firms to prevent them from engaging in financial, business, employment, and other relationships that could compromise their independence;
- transparency requirements on ownership and governance of audit firms, including disclosure of the legal structure, ownership, and governance arrangements;
- requirements for education, training and competences for statutory auditors.

Finally, the directive describes the content and format of auditors' reports and requirements for the public oversight of statutory auditors and audit firms to ensure compliance with professional standards.

What is amended by the CSRD:
The CSRD introduces a mandatory assurance (audit) of sustainability information by an independent third party. This can either be the statutory auditor, who already audits the financial information, or a second auditor or an Independence Assurance Service Provider (IASP), if allowed by national public authorities. Notably, the directive introduces a limited assurance review in the European Single Market, with a planned transition to reasonable assurance over time. By referring to the *Audit Regulation*'s list of prohibited services, it also introduces provisions on prohibited non-audit services for statutory auditors carrying out sustainability assurance services, such as consultancy services on sustainability matters (e.g. preparation of a materiality assessment).

The CSRD also amends the Audit Directive, by adding specific requirements to the necessary educational competencies. These requirements are for statutory auditors to qualify for the conducting of sustainability assurance engagements.

In a bid to promote diversity in the audit market, the directive provides companies' shareholders with more than 5% voting rights or 5% capital the option to request the involvement of an accredited third party, to prepare a report on some elements of the sustainability reported. This accredited third party cannot be affiliated with the same audit firm or network as the auditor conducting the statutory audit.

4. **The Audit Regulation (Regulation (EU) No 537/2014)** sets out specific requirements and rules governing the conduct and oversight of the statutory audits of public-interest entities.

It complements the Audit Directive to establish rules and standards for the audit profession within the EU and provides additional requirements for the content of the audit report.

This Regulation introduces:

- the mandatory rotation of audit firms for certain categories of companies (the public-interest entities – see Glossary for more details);
- a list of non-audit services (e.g. consultancy services) that audit firms are prohibited from providing to the clients they audit.

What is amended by the CSRD:
- extends the prohibition of the provision of non-audit services to cover sustainability assurance;
- It extends the limits of certain audit fees to include sustainability assurance services.

While defining which information should be disclosed by companies, the CSRD also refers to key legal acts:

The EU Taxonomy Regulation on Sustainable Investment (Regulation (EU) 2020/852)

The CSRD proposes to integrate the disclosure requirements related to the EU Environmental Taxonomy into the larger framework of sustainability reporting. This means that companies falling within the scope of the CSRD would need to disclose information on the extent to which their activities are associated with environmentally sustainable economic activities, as defined by the *EU Taxonomy Regulation*.

The EU Taxonomy Regulation sets specific criteria for economic activities to be classified as environmentally sustainable. It focuses on economic activities that substantially contribute to one or more of the environmental objectives, without significantly harming (being detrimental) to other goals.

The environmental objectives covered by the regulation include:

- **Climate Change Mitigation:** activities that contribute to the reduction of greenhouse gas emissions and the transition to a low-carbon economy;
- **Climate Change Adaptation:** activities that enhance resilience to the impacts of climate change, helping society and ecosystems adapt to changing climate conditions;
- **Sustainable Use and Protection of Water and Marine Resources:** activities promoting the responsible and efficient use of water resources, as well as the protection and restoration of marine ecosystems;
- **Transition to a Circular Economy:** activities that contribute to the sustainable use of resources, waste prevention, and the promotion of circular business models:
- **Pollution Prevention and Control:** activities aimed at preventing pollution, reducing the release of hazardous substances, and promoting the sustainable use of resources;
- **Protection and Restoration of Biodiversity and Ecosystems:** activities that support the preservation, restoration, and sustainable use of ecosystems, biodiversity, and natural habitats.

These objectives are complemented with criteria for sustainable activities in each of the environmental goals mentioned above. Activities meeting these criteria can be considered as environmentally sustainable.

Article 8 of this Regulation specifically deals with the obligations of large companies and financial institutions to disclose information regarding the environmental sustainability of their economic activities, a requirement fully integrated into the CSRD. Consequently, non-financial companies concerned by the CSRD are required to disclose the three ratios, namely the turnover, CapEx and OpEx in relation to economic activities which are Taxonomy-aligned. Reporting related to the Taxonomy should be incorporated into a specific section within the management report, alongside the sustainability statement.

The Sustainable Finance Disclosure Regulation (SFDR) (Regulation 2019/2088/EU)

The SFDR aims to enhance the transparency and sustainability of disclosures in the financial sector by establishing a framework for how financial market participants and financial advisers integrate ESG considerations into their investment processes and decision-making. It sets disclosure obligations for financial market participants, including investment firms, asset managers and insurance companies, as well as financial advisers, and for specific financial products.

To meet these obligations, financial market participants need sustainability information from companies, not only to understand the broader sustainability performance of companies covered by the CSRD, but also to better assess the sustainable nature of their investment portfolio.

The directive introduces the notion of Principal Adverse Impact (PAI). PAIs refer to the adverse effects or negative impacts that the investment decisions of financial market participants may have on sustainability matters. However, the directive does not set any metrics to assess those. The ESRS should help financial institutions build relevant metrics for PAIs disclosure.

The European Climate Law (Regulation 2021/1119/EU)

Companies in the scope of the CSRD should disclose their climate transition plan – if they have one – showing how their business model and strategy are compatible with:

- the transition to a sustainable economy;
- the limiting of global warming to 1,5 °C, in line with the Paris Agreement adopted as part of the *United Nations Framework Convention on Climate Change*; and
- the objective of carbon-neutrality (the sum between positive and negative Greenhouse Gas Emissions – GHG is net zero) of the European Climate Law.

This regulation establishes a legal framework in the EU to address climate change and to set the stage for achieving climate neutrality by 2050. The key elements and mandatory measures of the European Climate Law include:

- an overarching goal for the EU to become climate-neutral by 2050, with intermediate targets to reduce those by 55% by 2030 compared to 1990 levels;
- carbon budget trajectories, which allocate the total allowable emissions over a specific period for Member States;
- a governance mechanism to monitor progress, ensure accountability, and facilitate adjustments through National Energy and Climate Plans (NECPs) outlining the contributions of Member States to the EU's climate goals;
- provisions for the regular review of Member States' progress toward climate goals including an intermediate target in 2040.

EU Climate Transition Benchmarks and EU Paris-aligned Benchmarks (Delegated Regulation (EU) 2020/1816 – 1817 – 1818)

The EU Climate Transition Benchmarks and EU Paris-aligned Benchmarks are among the key legislative vehicles used by EFRAG in the development of the ESRS on climate reporting.

These benchmarks are designed to help investors identify environmentally sustainable economic activities, and investments aligned with the objectives of the Paris Agreement on climate change. They strongly connect with the EU Taxonomy Regulation: to qualify and comply with an EU Climate Transition Benchmark, companies' activities and revenues to be considered as sustainable must meet certain requirements, such as minimum carbon reduction and maximum carbon content.

Corporate Sustainability Due Diligence Directive (CSDDD)

The Due Diligence Directive lays down obligations for large companies regarding actual and potential adverse impacts on the environment and human rights for their business chain of activities. This includes coverage of the upstream business partners of the company. Additionally, it partially encompasses downstream partners' activities. These activities involve distribution, transport, and storage. The directive requires companies to adopt a plan ensuring that their business model and strategy are compatible with the Paris agreement on climate change. It also lays down rules on penalties and civil liability for infringing these obligations.

While the CSRD sets mandatory disclosure requirements for companies on their due diligence processes (obligation to tell), the CSDDD requires about 5,500 companies to identify, prevent, mitigate, communicate and remedy adverse impacts in their value chain (obligation to act). This means that companies within its scope have to describe how they act on due diligence in their management report, using the ESRS. That includes defining a climate transition plan in line with the Paris agreement on climate change, and consistent with the objective of meeting carbon neutrality by 2050.

The directive should be formally adopted by European policymakers in April 2024. Starting with EU and non-EU companies with over 5,000 employees and EUR400 million turnover, it should progressively enter into force three years after its adoption.

Companies falling within the CSDDD scope but not covered by the CSRD, including certain sizable third-country companies operating in Europe without branches or subsidiaries, will have to communicate their due diligence obligations in line with the CSRD requirements. This communication will be guided by dedicated reporting criteria, to be established at a later stage by the European Commission.

FIGURE 5 Legal interconnections

Linked to the CSRD

Modified by the CSRD

Graph legend
- Reporting requirements
- Obligation to act
- Audit
- Financial Sector
- Benchmarks

EU Taxonomy Regulation

Obligations regarding the content of the management report: disclosure requirements (turnover, capex, opex) on the activities of the companies that can be classified as environmentally sustainable.

Part of the sustainability reporting

European Climate Law

Disclosure of a climate mitigation plan that shows how the business model and strategy of the companies are compatible with the transition to a sustainable economy and with the limiting of global warming of 1,5 °C and the objective of carbon-neutrality (reduction of 55 % by 2030 compared to 1990 levels).

Part of the sustainability reporting (climate transition plan)

Corporate Sustainability Due Diligence Directive

Requires companies to identify, prevent, mitigate, communicate and remedy adverse impacts on the environment and human rights for their direct business chain of activities, etc.

Use the ESRS on due diligence processes

EU Climate Transition and EU Paris-Aligned Benchmarks

Defines the minimum standards for EU climate transition and EU Paris-aligned Benchmarks, etc.

Linked to the CSRD standards on climate reporting

Sustainable Finance Disclose Regulation

Disclosure obligations on how sustainability matters are including in investment processes and decision-making.

ESRS will serve financial institutions to monitor information to be disclosed on Principal Adverse Impacts (PAIs)

European Single Access Point

Digital platform for the centralized access to financial and sustainability information in the EU (by July 2027).

Access to sustainability reporting (by january 2028)

CSRD

CSRD

Accounting directive

Obligations regarding the content of the management report (reporting requirements on financial and sustainability reporting) + audit requirements, etc.

Transparency directive

Obligations regarding the content of a corporate governance statement, etc.

Audit directive

Audit process of sustainability information (from limited to reasonable assurance) + measures on independance of the auditor, etc.

Audit regulation

List of forbidden non-audit services for auditors + rotation rules.

Lefebvre Sarrut's infographic in association with GRI (Global Reporting Initiative) and MEP Pascal Durand, CSRD rapporteur

Reporting format

Unlike the NFRD, the CSRD specifies the format of disclosure and standards that companies will have to meet to draft their reports.

Location

The CSRD requires sustainability information to be located in a particular section of the annual management report, instead of a separate sustainability report. A more detailed structure is set out by the ESRS in its Appendices D and F. It is made up of four parts: general, environmental, social and governance information. Therefore, financial and sustainability information will be disclosed all at once. Companies should publish their management report on their website or make a hard copy available upon request. Their management report must be submitted to the appropriate authority in accordance with national regulations.

Language

The language of the management report should be the one of the Member State where the company is based, or another language that said Member State's authorities accept. To avoid unnecessary costs, EU regulators decided to lift the obligation to have the necessary translations certified, if the absence of certification is clearly stated.

Electronic format

Since 2020, companies listed on European regulated markets should use the European Single Electronic Format (ESEF) to prepare their annual financial reports for filing with the competent authority. The CSRD extends this obligation to sustainability information and to non-listed companies under the scope of the directive.

Companies targeted by the CSRD will be required to prepare their management report in the electronic format and tag their sustainability information based on the digital taxonomy.

EFRAG was tasked to develop the XBRL digital

The European Single Access Point (ESAP)

The ESAP is designed to provide a single digital point of access to public financial and non-financial information about EU companies and investment products. It is built as a digital platform for the centralized access to information already published in accordance with existing European legislation, as well as future European directives and regulations. This includes financial regulations and ESG-related disclosure regulations, such as the Sustainable Finance Disclosure Regulation (SFDR) and CSRD. The information will be accessible for free, and the system will be user-friendly and located in one central place.

One of its objectives is to give companies more visibility towards investors and open more financing opportunities, especially for small companies in small capital markets. It also makes the information easily accessible for other stakeholders.

Companies not covered by the scope of EU regulations (such as most of the EU SMEs) will also be able to voluntarily transmit information on the platform.

In practice, companies will file their reports to national "collection bodies" (e.g. a public authority specifically appointed for that role) and Officially Appointed Mechanisms (e.g. appointed national stock exchanges) that will check, approve, and make the data available via the ESAP. Verifications shall be limited to assess that all the necessary documents have been handed in the correct reporting format.

The ESAP platform should be available from summer 2027 and gradually phased in. Information required by the CSRD shall be available from the first year on.

taxonomy for sustainability reporting, including the mark-up of the datapoints related the EU Taxonomy for sustainable activities. The XBRL tagging is important to ensure that the same sustainability-related data are labeled consistently across organizations and geographies. This computer-based language also enables the electronic communication of structured business data by providing machine-readable information, which helps to delete the language barrier to access the information. For instance, XBRL tagging will enable the users to assemble data from documents written in Finnish or Welsh. This consistency is crucial for accurate benchmarking and comparative analysis of sustainability practices and reporting, allowing investors and other stakeholders to make more informed decisions.

FOR MORE INFORMATION ELECTRONIC FORMAT, CONSULT THE GLOSSARY.

Based on EFRAG's XBRL taxonomy, the European Securities and Markets Authority (ESMA) will develop regulatory technical standards to define the tagging rules to be applied in digital reporting. The European Commission will adopt these regulatory standards via delegated acts.

Review clause of the directive

By April 2029, the Commission should assess whether and how to ensure that sustainability reports published by companies covered by the CSRD are accessible to people with disabilities.

Consolidation of subsidiaries

What is a subsidiary?

A subsidiary is a company controlled by another company, known as the parent, or holding company. In the accounting rules, a parent company, together will all its subsidiary companies, form a group. A parent company can also be controlled by another, higher-up company (still defined as parent). In that case that parent company included in the group is considered also as a subsidiary. In this context, the parent company has the power to govern the financial and operating policies of the subsidiary to obtain benefits from its activities. For instance, different accounting standards, like the IFRS or the US GAAP, may define control differently. In general, owning more than 50% of the voting rights in the subsidiary, should enable control

What is consolidation?

Consolidating the financial and sustainability information of a EU subsidiary at the parent-company level, whether based in or outside of the EU, refers to the process of combining the individual financial and sustainability statements of the parent company, and its subsidiary or subsidiaries into a single set of consolidated statements. These statements will become the formal record of the activities and position of a group, and will be audited or assured.

The purpose of consolidation is to present a comprehensive and aggregated view of the group controlled by the parent company, rather than looking at each entity in isolation.

It should be emphasized that thresholds for the application of financial and sustainability reporting obligations, under the EU Accounting Directive, are determined on a consolidated basis. Therefore, a subsidiary not listed or considered as large as per the CSRD thresholds may still be included in the consolidation by the parent company of a group, – which exceeds the CSRD thresholds on a consolidated basis. The group's report, including the data for that subsidiary, will be subject to mandatory reporting and audit requierements. This underscores the importance of considering the consolidated financial position when deciding on consolidation practices, as it directly affects the obligation to report and audit the information voluntarily included in the consolidation. The specific case of subsidiaries with parent companies based outside the EU is described in a following section.

What does the CSRD change for consolidation?

The CSRD broadens the existing rules that govern the disclosure and consolidation of sustainability information, incorporating environmental, social, human rights, and governance topics. Both financial and sustainability information shall now be in the same consolidated management report, although the sustainability statement shall be presented in a dedicated section.

The CSRD further specifies that subsidiary undertakings are exempted from the obligation to include a full individual sustainability statement in their own management report, if they are included in the consolidated management report of another (parent) company drawn up in accordance with the CSRD and the ESRS.

In practice, this means that parent companies must include subsidiaries in their consolidated sustainability statement, and that such consolidated subsidiaries may use the exemption or may issue an individual sustainability statement in their own management report, in addition to being consolidated.

Therefore, a subsidiary within the scope of the CSRD needs to provide a sustainability statement and issue an individual report, or have this information consolidated at parent-company level – such as with an EU holding company. In this case, the subsidiary is exempted from publishing a stand-alone report. This exemption does not apply to PIEs that are large, listed companies on an EU regulated market. For those, whether they are consolidated by their parent company or not, a sustainability statement in their own management report is still required.

The CSRD explicitly states that the exemption regime for consolidated sustainability reporting operates independently from the exemption to prepare consolidated financial statements and a consolidated management report. This, for instance, means that a holding based in the EU and that consolidates

financial reports for its subsidiaries may not consolidate sustainability reports.

If there are significant differences between the sustainability risks or impacts of the group and those of its subsidiaries, the parent company should provide, in the consolidated sustainability statement, an adequate understanding of the risks or impacts of its subsidiaries – including information on their due diligence processes (where appropriate).

During the CSRD transposition process by Member States, national authorities have the discretion to restrict the use of reporting exemptions or to mandate distinct disclosures at entity or country level. This might involve obligating companies within the country to submit standalone reports.

What is required from exempted subsidiaries which are individual companies or groups?

Exempted EU-based subsidiaries are subsidiaries that will be consolidated; their sustainability information will be incorporated in the report of their parent company. In this case, they will still need to:

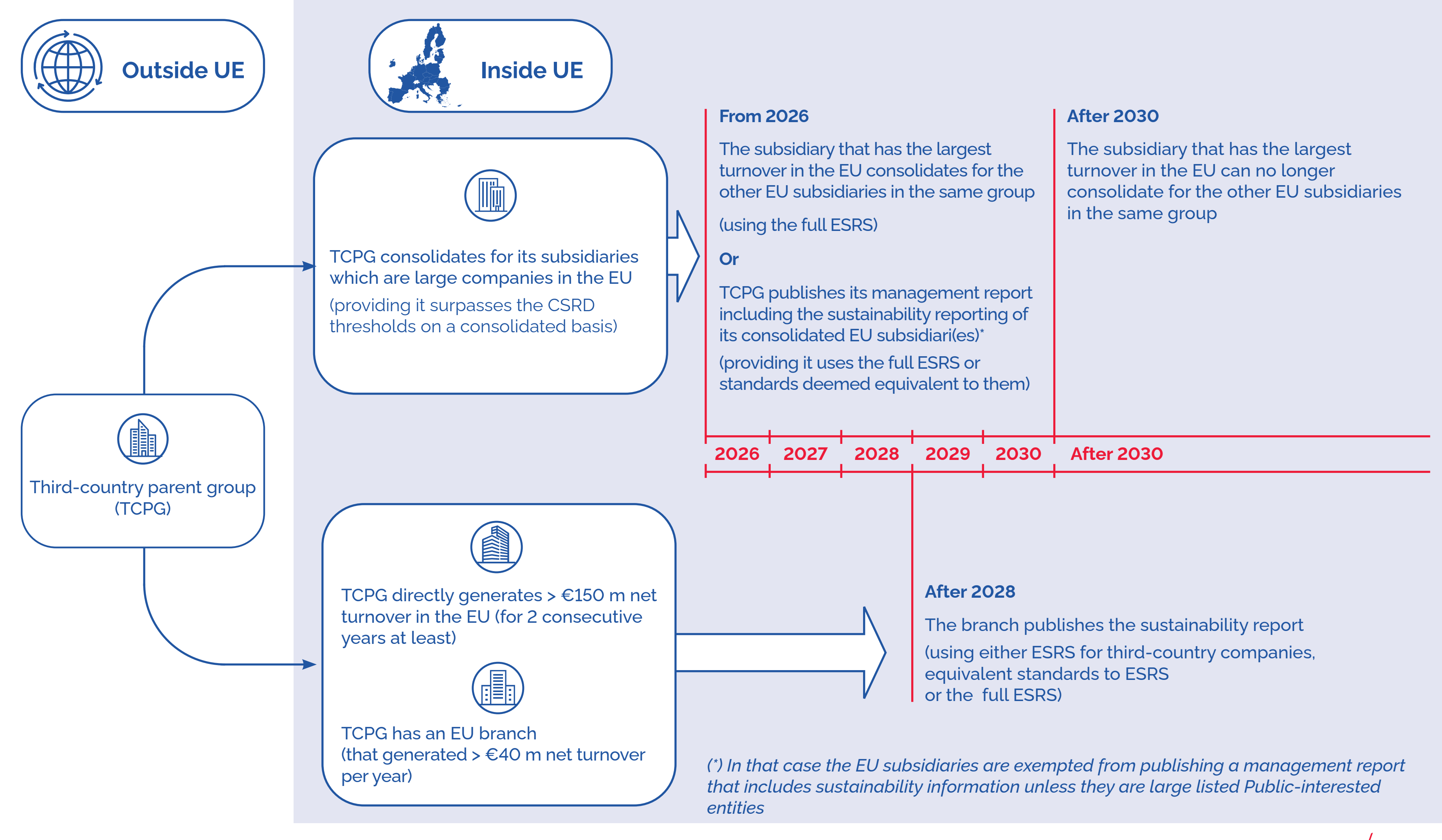
a) report the name and registered office of the parent company that is reporting on the sustainability information at group level;
b) publish the weblinks to the consolidated management report of their parent company, with clear information and instructions on how to access the consolidated management report, especially if it is not available online;
c) clearly state that they are exempted from sustainability reporting, in their management report.

The specific case of subsidiaries with parent companies based outside the EU

A distinctive form of the subsidiary exemption is currently applicable (on a temporary basis) to EU subsidiaries or subgroups, with a parent company headquartered outside the EU. Until 2030, these companies may be exempted from individual reporting requirements if they are incorporated into a report using ESRS and "artificial consolidation," meaning that the EU subsidiaries and subgroups are consolidated. The entity responsible for consolidating other EU-based subsidiaries is the one with the highest turnover within the EU. The purpose of this transitional provision is to reduce the burden for the non-EU groups that do not have a single EU-based holding entity that controls the group's EU entities.

The ultimate parent companies that are not based in the EU may also consolidate their EU subsidiaries in a global sustainability statement. However, such consolidation exempts the EU subsidiaries from the obligation to produce their own sustainability statements only if the global consolidated statement is drawn up in accordance with the ESRS, or in an equivalent manner.

FIGURE 6 **Consolidation of a third-country parent group with subsidiaries or branches in the EU**



Lefebvre Sarrut's infographic in association with GRI (Global Reporting Initiative) and MEP Pascal Durand, CSRD rapporteur

LEFEBVRE SARRUT

FIGURE 7 Consolidation of a third-country parent company that has listed subsidiaries in the EU

Outside UE

Inside UE

Third-country parent group (TCPG)

TCPG has a small, medium or large subsidiary with securities admitted to trading on an EU regulated market
(By consolidating it surpasses the CSRD thresholds)

Progressive application as of 2025

Those listed subsidiaries publish a stand-alone management report.
(It can use:
- full ESRS
- ESRS for listed SMEs if it is a listed SME)

TCPG can also publish a consolidated report that includes its listed subsidiaries in the EU
(it can use either:
- full ESRS
- equivalent standards to ESRS

2025 | 2026 | 2027 | 2028 | 2029 | 2030 | After 2030

TCPG directly generates > 150m net turnover in the EU that are independent of the activites of its subsidiaries (for 2 consecutive years at least)

TCPG has a small, medium or large subsidiary with securities admitted to trading on an EU regulated market

After 2028

The listed subsdiary publishes the sustainability reporting of the third-country parent group (using ESRS for third-country companies),
TCPG can also publish a consolidated report that includes its listed subsidiaries in the EU and information at group level.
(it can use either:
- full ESRS
- equivalent standards to ESRS)

Lefebvre Sarrut's infographic in association with GRI (Global Reporting Initiative) and MEP Pascal Durand, CSRD rapporteur

FIGURE 8 **Consolidation of a parent company in the EU that has subsidiaries listed or not**

Inside UE

Parent company (PC)

PC has subsidiaries which are either large or listed SMEs in the EU

Progressive application as of 2026

PC publishes a consolidated report that includes its subsidiaries in the EU*
(it uses the full ESRS)

2026 2027 2028 2029 2030 After 2030

(*) In that case the EU subsidiaries are exempted from publishing a management report that includes sustainability information unless they are large listed Public-interested entities

Lefebvre Sarrut's infographic in association with GRI (Global Reporting Initiative) and MEP Pascal Durand, CSRD rapporteur

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Reporting by third-country companies

The CSRD extends the scope of the reporting obligations to include international companies. It applies to:

- third-country companies with securities listed on an EU regulated market (about 100 companies as per the European Commission's estimate);
- non-EU companies that directly generate a net turnover of over EUR150 million in the EU and have a subsidiary or a branch, with no legal personality, with a net turnover of at least EUR40 million in the EU, or a listed subsidiary in the EU which is an SME or a large company.

While no official figure on the number of third-country companies with substantial EU business have been released, the global provider of financial market data Refinitiv estimated that 11,000 companies with their headquarters outside the EU could be impacted by the reporting obligations, including about 1,000 in the UK and more than 3,000 in the U.S[3].

The directive states that branches or subsidiaries are responsible for publishing the sustainability report of their controlling company and, if they do so, that sustainability report should be published in a language accepted by the Member State where they are registered.

Third-country companies meeting the above-mentioned conditions have the following options for reporting their sustainability information, from 2028 onwards:

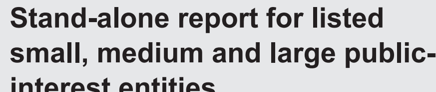
- use the standards for third-country companies;
- use the full sets of ESRS available to date;
- use their own domestic reporting rules (for them, exclusively on impact materiality), provided that applicable standards set by those rules for third-country companies are deemed equivalent to the ESRS by the European Commission. The same applies to parent companies outside the EU that want to consolidate the reporting of their EU subsidiaries. The European Commission assesses the equivalence on a country-by-country basis, following a request by a country to do so.

The European Commission, based on the information received by EU Member States, should make publicly available on its website a list of the third-country companies that have published a sustainability report applying the ESRS.

FOR MORE INFORMATION ON CONSOLIDATION OF PARENT COMPANIES, PLEASE READ OUR BRIEFING ON CONSOLIDATION OF SUBSIDIARIES.

Which criteria guide the determination of equivalence with domestic standards?

While the CSRD provides the European Commission with the possibility to allow in-scope third-country companies to use sustainability standards equivalent to the ESRS, it has not yet decided which standards would be deemed equivalent. Note that equivalent standards



Stand-alone report for listed small, medium and large public-interest entities

EU companies exceeding the CSRD thresholds and that have their parent companies outside the EU cannot be exempted from producing their sustainability statement on the account of being consolidated by their parent company. The exemption only applies if their parent company issues a sustainability statement drawn up in accordance with the ESRS, or standards for which an equivalence status has been granted by the European Commission through an implementing act. However, until 2030, the EU subsidiary of a non-EU group with the highest turnover within the EU can prepare a consolidated sustainability statement that includes all other EU subsidiaries in this group and which are subject to the CSRD. Such consolidated subsidiaries can then benefit from the exemption unless they are listed.

3 https://www.wsj.com/articles/at-least-10-000-foreign-companies-to-be-hit-by-eu-sustainability-rules-307a1406

will only be available for reporting at the third-country parent-company level; any reporting done at an EU-company level must use the ESRS.

The criteria that the Commission will use, when assessing the equivalence of sustainability reporting standards used by third-country issuers, shall ensure that those standards require:

- disclosing information on environmental, social and governance factors; and
- reporting the impacts the company has on sustainability matters, as well how these sustainability matters affect the development, performance, and position of the company.

In other words, the second equivalence criterion shall consider standards that incorporate double materiality.

Until equivalences are set, policymakers around the world, responsible for their own national reporting standards, can benefit from ensuring future equivalence to the ESRS. They can also support their companies by building on globally widely adopted standards, such as those from the GRI and ISSB.

TO LEARN MORE ABOUT THE IMPLEMENTING DECISIONS PROCEDURES, PLEASE READ OUR BRIEFING ON THE IMPLEMENTING & DELEGATED ACTS.

Review clause of the directive

By April 2029, the Commission should provide an assessment of the implementation of the reporting requirements on subsidiaries and branches of third-country, including an assessment of the number of third-country companies.

Global standard-setting landscape

The last few years have seen significant developments in the regulatory landscape, due to the recognition of the human-rights impacts of climate change, and environmental degradation at the international and national level. The increasing demand for transparent information on companies' tax payments and ensued practices has led governments wanting to drive a positive agenda towards a more just and sustainable society, and to use legislative tools to change corporate behavior and market conditions. As a consequence, this has driven a broader increase in corporate sustainability initiatives globally. But while stock exchanges play a particularly active role in Asia-Pacific and the Middle East, governments remain the most active issuers of ESG & sustainability policies[4].

Many companies around the world already report on their sustainability impacts, using globally accepted standards such as those developed by the GRI, which provides the world's most widely used sustainability reporting standards. 73% of the world's 250 largest companies by revenue use GRI guidelines or standards and 67% of the top 100 companies by revenue in 52 countries and jurisdictions use GRI guidelines or standards. The GRI offers the only reporting standards used by most surveyed companies in all regions (75% in the Americas, 68% in Asia-Pacific and Europe, 62% in the Middle East & Africa). 99% of Singapore-registered companies use GRI standards. Organizations already using GRI standards in their reporting will maximize their chances of compliance with the ESRS based on the high level of commonality and technical cooperation on non-EU Standards.

The IFRS-ISSB governance framework has recently consolidated other frameworks and risk-related standards, such as the SASB metrics and the Climate Disclosure Standards Board (CDSB). Australia is at the forefront, incorporating ISSB into their national standards. Several countries instead, including Brazil, Canada, Nigeria, and Japan, have expressed their intention to reference or mandate ISSB, formal adoption has not yet occurred.

The EFRAG serves as the technical advisor to develop the ESRS for the EU. Under the EU mandatory regime, approximately 42,500 user companies, along with several thousand non-EU large companies with significant operations in the EU, are affected.

Regional and globally recognized standard-setters actively engage in close collaboration with the Taskforce on Climate Disclosure (TCFD), now integrated into the ISSB, the Taskforce on Nature-related Financial Disclosure (TNFD). This collaborative effort aims to establish a shared methodological foundation for reporting on impacts and risks related to climate and nature.

ISSB, ESRS and GRI form the triangle of sustainability reporting. While it would be ideal to have a single international standard, having full compatibility would already be a huge step forward.

4 Carrots & Sticks Database, GRI, Kings College London, the University of Edinburg, Stellenbosch Business School. The database covers 2,463 policies from 132 countries, 76 international and regional organizations, in 38 languages, from 1897 to 2023; with 36% ESG mandatory policies and 63% voluntary worldwide. https://www.carrotsandsticks.net/#:~:text=Welcome%20to%20the%20Carrots%20%26%20Sticks,ESG)%20impact%20of%20businesses%20worldwide

Audit & assurance

Both amended by the CSRD, the Audit Directive (Directive 2006/43/EC) and the Audit Regulation (Regulation EU No 537/2014) establish laws and regulation for the statutory audit of annual and consolidated financial and sustainability statements in the EU. In addition, the Audit Regulation sets out specific requirements and rules governing the conduct and oversight of statutory audits of public-interest entities.

The CSRD introduces a mandatory assurance (audit) of sustainability information by an independent third party. This can either be the statutory auditor, who already audits financial information, or another auditor than the statutory auditor or an Independence Assurance Service Provider (IASP), if allowed by national public authorities. Notably, the directive introduces a limited assurance review in the European Single Market, with a planned transition to reasonable assurance over time.

In a bid to promote diversity in the audit market, the directive gives companies' shareholders with more than 5% voting rights or 5% capital the option to request the involvement of an accredited third party, to prepare a report on some of the sustainability information. This cannot be affiliated with the same audit firm or network as the auditor conducting the statutory audit.

The CSRD introduces:

- the level of assurance engagements (limited and reasonable);
- the assurance requirements for companies in and outside the EU; and
- the organization of the audit market in Europe, especially for the sustainability assurance services.

The CSRD mandates the European Commission to develop assurance standards that will outline technical aspects of the assurance engagement of sustainability information, by auditors and independence assurance service providers. These standards will be adopted by means of delegated acts. In that context, the Committee of European Auditing Oversight Bodies (CEAOB) has been tasked by the European Commission to work on the adoption of non-binding assurance guidelines, to help independent assurance providers in the absence of EU standards. It should deliver technical advice for the drafting of the Delegated Act adopting limited assurance before May 2025.

TO LEARN MORE ABOUT THE ADOPTION PROCEDURE OF DELEGATED ACTS, PLEASE READ OUR BRIEFING ON IMPLEMENTING AND DELEGATED ACTS.

Audit: What does the CSRD say about the audit of sustainability information?

The CSRD introduces a general EU-wide audit (assurance) requirement for reported sustainability information, addressing investors' and other stakeholders' concerns about the reliability of the sustainability information reported by companies. Although the objective is to have a similar level of assurance for financial and sustainability reporting, a progressive approach has been undertaken. The CSRD stages the introduction of mandatory auditing starting with a "limited" assurance requirement and aiming to introduce EU-wide standards for limited assurance by October 1, 2026. This represents a significant advance considering only France, Italy and Spain previously opted for mandatory independent assurance, based on limited requirements for reported sustainability information.

A "reasonable" assurance requirement is requested only as of October 1, 2028, pending a favorable assessment of the Commission on the introduction of this stricter assurance level. This marks the latest date the Commission can adopt standards for reasonable assurance.

Once the Commission has adopted EU-wide standards for this level of assurance, the legal audit requirement in the CSRD will automatically become a requirement for reasonable assurance instead of limited assurance. Until the adoption by the Commission of EU-wide assurance standards, Member States may apply national assurance schemes, rules, and procedures.

TO LEARN MORE ABOUT LIMITED AND REASONABLE ASSURANCE DEFINITIONS, PLEASE READ OUR GLOSSARY.

Sustainability assurance market

The directive allows Member States to open the market of sustainability assurance services to so-called "independent assurance services providers" (IASP). This means that a Member State can choose to allow firms other than the usual auditors of financial information to assure sustainability information. While this leaves the option for Member States to provide fairer access to the audit market for non-statutory auditors, it can also result in a less consistent approach throughout the EU market. In practice, accreditation of independent assurance providers operates in the public interest across all market sectors. It provides an attestation that accredited bodies offering assurance services have the technical competence and impartiality to check the conformity of products and services, based on the relevant standards and regulations.

Member States willing to open their market to IASPs shall appoint a public authority or any other body to undertake the accreditation process of IASPs. This process should conform with the applicable requirements of the EU Regulation on accreditation and market surveillance, such as proper monitoring, as well as objectivity and impartiality of the rules and processes in place. The national accreditation body may be either the same as or different from the entity issuing operating licenses for statutory auditors.

The creation of the IASP status is a positive step forward in terms of opening the market and the quality of assurance services. It should be noted that in case two assurance providers work together, it is the group auditor in charge of auditing the consolidated reports who provides the final engagement.

Passporting system

The CSRD also sets a so-called "passporting system" for IASPs. This allows accredited service providers in one Member State to operate freely in another Member State that has opted to accredit IASPs, without having to seek accreditation from each of the national competent authorities. So far, only France has granted this opportunity, while several other Member States have announced their intention to grant authorizations. In practice, it is the Member State that has provided the accreditation (the "home") that will keep supervising the independent assurance services providers operating in another Member State (the "host"), unless the latter indicates otherwise.

Organization of the assurance profession

Member States that chose to authorize IASPs should set out requirements equivalent to those applying to the statutory auditors under the Audit Directive, to be allowed to carry out assurance engagements of sustainability reporting. Especially in terms of professional ethics, independence, objectivity, confidentiality, and professional secrecy regarding the assurance of sustainability reporting, existing rules applying to statutory auditors shall apply *mutatis mutandis* to IASPs.

Moreover, statutory auditors are subject to specific educational qualification requirements to be allowed to carry out assurance engagements of sustainability reporting. IASPs should also meet specific requirements on educational competences, training and examination. Equivalent requirements should also be set out on quality assurance systems, requirements on irregularities, investigation and sanctions. Nevertheless, at the implementation stage, the continuous evaluation criteria may differ between IASPs and statutory auditors.

Review clause of the directive

By December 31, 2028, the Commission shall review and report on the level of concentration of the sustainability assurance market and assess possible legal measures to ensure sufficient diversification of the sustainability assurance market and sustainability reporting quality.

Equivalence with third-country audit companies

The directive provides a mechanism for the recognition of third-country auditors if their regulatory framework is deemed equivalent to the EU's, for statutory audits. Third-country auditors seeking to provide audit services for entities based in the EU are required to register with the competent authority of the Member State where they intend to carry out the audit. In case they do not, their assurance report shall have no legal effect in that Member State.

Materiality and internal supervision

The importance of the materiality assessment

The CSRD recognizes the wide range of users and uses of reported information, and therefore states that the company's evaluation of materiality must consider both the impact and financial aspects of a company's activities, while also acknowledging their interconnections. However, it doesn't require separate and independent procedures. Typically, identifying material impacts is the starting point, as the financial evaluation benefits from this assessment. This is because material impacts often lead to significant risks, opportunities, and financial consequences.

The ESRS do not prescribe a specific method for conducting the materiality assessment, as one approach may not suit all businesses due to variations in economic activities, organizational structures, operational locations, and supply chains. Therefore, each company should develop a tailored process that fits its unique circumstances, including the depth of the assessment. Professional associations that represent a specific profession in a particular sector of activities can also play an important role in helping companies determine the full range of impacts, risks and opportunities which are recurring for the entire sector. These are particularly relevant in the absence of sector-specific standards in the EU.

TO LEARN MORE ABOUT THE CONCEPT OF MATERIALITY, CONSULT OUR GLOSSARY.

Steps to get there

Companies seeking guidance on conducting a materiality assessment can use the guidance provided by EFRAG and GRI to inform their process.

A materiality assessment in sustainability reporting starts with understanding the context of the company. This means the company develops an overview of its activities and business relationships as well as the context in which these take place; it would then try to understand which stakeholders are primarily affected. Subsequently, the company usually determines which environmental, social, and governance matters are significant enough to influence decision-making and impact the perceptions of stakeholders. It should aim to identify the issues that are most relevant to its business

Materiality thresholds

In the context of double materiality reporting, a materiality threshold refers to the criteria (qualitative and/or quantitative), used both internally to the company's operations and externally to broader societal and environmental concerns. Setting a threshold on sustainability matters is usually necessary to determine which topics are material to the company. It helps to establish the boundary beyond which sustainability impacts, risks and opportunities (IROs) are considered material and provide grounds for their inclusion in the sustainability statement.

The ESRS (in particular, ESRS 1) prescribe rules for the application of double materiality with respect to the evaluation of materiality of IROs. Materiality thresholds on sustainability impacts shall therefore be determined by severity for actual negative impacts, and severity and likelihood for potential negative impacts. "Severity is based on factors that are scale, scope and irremediable character for negative impacts, and scale and scope for positive impacts. These factors should be the basis for determining the thresholds. Also, when defining the threshold, the undertaking may consider the overall number of potential impacts across environmental, social and governance."[5] In this regard, the ESRS are aligned with the GRI standards. For risks and opportunities, criteria shall be based on the magnitude and likelihood of financial effects for risks and opportunities.

5 EFRAG, Implementation guidance 1: materiality assessment

operations and stakeholders, focusing on those that could affect financial performance and have a significant impact on society or the environment.

Key steps for stakeholder engagement in the materiality assessment:

- identifying relevant stakeholders;
- conducting stakeholder engagement to understand their concerns and expectations;
- mapping out potential sustainability issues based on industry standards, regulations and best practices;
- assessing the significance and potential impacts of these issues on the company's operations and its stakeholders;
- prioritizing them based on their importance to the business and its stakeholders.

Identifying and assessing stakeholders' expectations is crucial in materiality assessment, particularly in terms of determining the materiality of impacts, risks and opportunities for sustainability reporting. Stakeholders may include investors, customers, employees, suppliers, local communities, non-governmental organizations (NGOs), regulators, and other parties affected by or interested in the company's activities. Companies should therefore understand how stakeholders (workers, nature, etc.) are affected by the impacts. This may require direct engagement with them, especially in case of severe impacts. This inclusive approach enhances the credibility and relevance of sustainability reporting.

By diligently following these steps, companies can develop a comprehensive understanding of their sustainability impacts, risks, opportunities, leading to more effective sustainability reporting and decision-making processes.

The importance of including value chain Impacts, Risks and Opportunities

The sustainability statement of the company needs to cover all significant impacts, risks, and opportunities (IROs) related to all its activities, including IROs stemming from its business relationships across the value chain. That relationship extends beyond direct contractual connections. While the disclosure of value chain information is not obligatory for all datapoints, it is required when associated with significant IROs beyond the company's own operations. The materiality assessment should identify significant IROs within the value chain, focusing on their likely occurrence across various aspects like geographies, activities, suppliers, and customers.

Even though topical standards (referring to the disclosures on environment, social and governance disclosures) may specify some value-chain data for certain metrics, additional entity-specific disclosures, including metrics, are necessary if a material IRO in the value chain is not adequately addressed by ESRS requirements. If primary value-chain information or disclosure of material IROs cannot be collected despite reasonable efforts, the company should estimate missing information using reasonable and supportable data, including proxies and sector data. This ensures a thorough and accurate assessment and disclosure of the company's significant impacts, risks, or opportunities across the value chain.

The responsibility of supervisory bodies and audit committees

Effectively managing sustainability reporting necessitates cohesive collaboration among various teams and stakeholders within a company, including top management and supervisory boards. The CSRD enhances the accountability of a company, as it mandates a collective responsibility for members of administrative, management, and supervisory bodies to ensure compliance with its requirements. This encompasses preparing and publishing management reports with all the necessary sustainability disclosures, consolidated reports, corporate governance statements, and assurance reports according to the directive's specifications, including the application of electronic formats (e.g., digital mark-ups and tags) to relevant data points. While the CSRD did not amend the sanction regime for non-compliance with the requirements of the directive, EU Member States remain free to introduce an appropriate supervisory regime that includes possible sanctions. Some countries, like France, have introduced criminal sanctions for company directors who fail to appoint an auditor of sustainability information and for obstructing a sustainability audit. In Hungary, should undertakings fail to comply with the ESG reporting obligations, the national Supervisory Authority for Regulated Activities may impose financial penalties.

For companies listed on stock exchanges, the directive bolsters the central role of audit committees and extends their role to the supervision of the assurance of sustainability data. Those committees usually consist of directors (non-executive members, with

at least one of them being independent), will monitor the sustainability reporting process. It includes digital reporting and adherence to standards, while providing recommendations to maintain the accuracy of sustainability information and ensuring the independence of assurance providers throughout the process. Parallel to audit committees, corporate sustainability reporting committees within companies or professional sectoral associations can serve as dedicated teams, or groups tasked with coordinating and overseeing the collection, analysis, and reporting to stakeholders sustainability performance data. They play an important role in defining “materiality thresholds”.

Thus, these two types of committees come at the core of the internal companies’ supervision to meet the new obligations introduced by the CSRD. Their role should be considered as a strategic opportunity to gain a competitive advantage, in a business environment that needs more sustainable practices. Treating reporting as a (costly) compliance exercise alone ignores the value reporting can bring to the company, both in terms of identifying ways to run a more efficient operation and to identify new business opportunities.

FIGURE 09 **Materiality assessment of sustainability data**

Lefebvre Sarrut's infographic in association with GRI (Global Reporting Initiative) and MEP Pascal Durand, CSRD rapporteur

LEFEBVRE SARRUT

SMEs and the value chain

Small and Medium Enterprises (SMEs), unless listed, are not covered by the CSRD. About 1,000 listed SMEs will therefore have to issue a sustainability statement according to the transposition schedule. Furthermore, the ESRS encompass a substantial array of value-chain reporting obligations, prompting companies within the directive's scope to seek sustainability information from their value-chain partners, particularly their SME suppliers and customers. Essentially, large companies will issue comprehensive information requests to SME suppliers and customers related to their material topics. Recognizing the potential additional burden on SMEs, the directive addresses the need for proportionality and relevance in information requests to suppliers. These requests will need to consider the scale, complexity, capacities, and characteristics of companies within value chains, with particular consideration for SMEs.

Still, SMEs may not yet be ready or even able to report comprehensively on their sustainability performance in the first years. This is why the CSRD provides for two mechanisms to protect SMEs from excessive demands from their customers and suppliers, who are often large companies, and to support them in the collection of reporting data.

A "value chain cap"

The CSRD stipulates that standards for listed SMEs will establish the maximum information that the ESRS can compel large companies to ask SMEs within their value chains. This provision serves as an additional safeguard against excessively burdensome reporting requirements trickling down to SMEs associated with larger companies in value chains. The EFRAG called this measure the "value chain cap".

Non-listed SMEs represent by far the largest number of SMEs in Europe and, although not mandated to comply with sustainability reporting obligations under the Accounting Directive, they often face demands for sustainability data from various stakeholders such as customers, banks, and investors. To address this, the EFRAG is developing a simplified, voluntary standard tailored for non-listed SMEs, so that they can respond to requests for sustainability information efficiently and proportionately, thus facilitating their engagement in the transition towards a sustainable economy.

Large companies have been granted additional flexibilities regarding specific environmental and social disclosure requirements, which impact reporting throughout the value chain. By extending the preparation time for reporting on certain environmental and social

SMEs and value chains supporting initiatives

SMEs play a crucial role in emerging economies where they act as key engines of job creation and income generation, contributing to up to 45% of total domestic employment and 33% of national income[6]. In recent years, it has become obvious that sustainability reporting is a critical competitive differentiator to enter global value chains, and therefore an essential tool for SMEs to improve their competitiveness and market access possibilities. To illustrate mechanisms to support SMEs, in cooperation with the Swiss Confederation's State Secretariat for Economic Affairs (SECO), GRI delivered the Corporate Sustainability and Reporting for Competitive Business[7] (CSRCB) program to support SMEs in six countries: Colombia, Ghana, Indonesia, Peru, South Africa, and Vietnam. From 2016 to 2021, it trained over 2,500 entrepreneurs from SMEs on sustainability reporting, through workshops events and one-to-one meetings.

6 *International Finance Corporation (IFC) annual report 2010: where innovation meets impact (Vol. 2) : IFC financials, projects, and portfolio 2010 (English).* Washington, D.C.: World Bank Group. http://documents.worldbank.org/curated/en/970081468331866551/IFC-financials-projects-and-portfolio-2010
7 https://www.globalreporting.org/public-policy/legislation-and-regulation/corporate-sustainability-and-reporting-for-competitive-business/

topics, the European Commission is also granting SMEs more time to prepare for future data collection requirements. For instance, companies or groups not exceeding on their balance sheet the average number of 750 employees during the financial year (on a consolidated basis, where applicable) may omit the datapoints on scope 3 emissions and total GHG emissions, for the first year of preparation of their sustainability statement. An additional delay of one or two years has been granted for the reporting of some data related to social impacts.

In practice, additional flexibility has been introduced to minimize the reporting effort from companies, recognizing in some cases their limited capacity to collect complex data from their supplier and customers. The use of credible proxies has been made possible, to help organizations overcome challenges in data collection and reporting while still providing stakeholders with meaningful insights into their sustainability performance. These can be particularly relevant for suppliers trying to provide in-scope companies with a fair response to their requests for information on sustainability matters.

Three more years

The ESRS include a transition period of three years for the reporting of sustainability information of value-chain partners, with the aim of easing the initial reporting for large companies and to help SMEs in the value chain to prepare. During this transition period, the following conditions apply:

- if not all the necessary information regarding its value chain is available, it is sufficient that the reporting company explains the efforts made to obtain the necessary information about its value chain, the reasons why not all the necessary information could be obtained, and its plans to retrieve them in the future;
- when disclosing information on policies, actions and targets, the reporting company may limit value-chain information to those available in-house, such and publicly available information;
- when disclosing metrics, the company is not required to include value-chain information, except for datapoints derived from other EU legislation.

In terms of implementation, EU Member States are responsible for assisting SMEs through financial and organizational support measures (information programs, one-stop shops, etc.)

Implementing & delegated acts

EU delegated and implementing acts are considered as secondary legislation, as opposed to primary legislation (i.e., either regulations or directives). They aim to provide a flexible and efficient mechanism for the European Commission to adapt and execute legislative measures.

In some years, secondary legislation represented up to 90% of the legislative volume produced by the European Union[8].

Delegation of power to the European Commission

In the context of EU law, the delegation of power refers to the authority granted by the EU legislator (usually the European Parliament and the Council of the EU) to the European Commission to adopt legal acts in specific policy areas. This delegation is outlined in primary legislation and allows the Commission to supplement or amend non-essential elements of the legislation. However, this delegation comes with clear limits and conditions to ensure accountability and transparency, and the Commission must act within the framework set by the legislator.

Delegated act

It is a secondary legislative act that the European Commission is empowered to adopt under the delegation of power from the EU legislator. Delegated acts allow the Commission to supplement or amend non-essential elements of the primary legislation within the limits set by the legislator. These acts are crucial for the effective implementation of EU laws, as they provide detailed rules and technical specifications necessary to ensure consistency and adaptability in various policy areas. The European Parliament and the Council have the power to object to a delegated act proposed by the European Commission. In the European Parliament, this can happen through a resolution to object that needs to be adopted by the majority of the Members of the European Parliament composing the assembly, and not only based on the of votes expressed (majority based on half the number of elected MEPs).

Implementing act

An implementing act is a secondary legislative act adopted by the European Commission to ensure the uniform application of EU regulations or directives across all Member States. Unlike delegated acts, implementing acts are not delegated by the legislator but are directly mandated by the primary legislation. They contain specific measures, such as technical details or procedural rules, necessary for the practical implementation of EU laws. While the European Commission is responsible for proposing and adopting implementing acts, it is required to consult with a committee composed of representatives from the Member States in a process called “comitology committees”.

Scrutiny period

The scrutiny period for a delegated act in the European Union is the specified timeframe during which the European Parliament and the Council can review, and potentially object, to the act proposed by the European Commission. Most of the delegated acts stemming from the CSRD have a two-month scrutiny period, which can be extended to four months upon request of the relevant committees of the Council of the EU and the Parliament. The delegated acts on the assurance level have a four-month scrutiny period.

If the Parliament believes that the Commission has exceeded its delegated powers or if there are concerns about the legality or appropriateness of the implementing acts, it can express its objections and potentially influence the Commission’s course of action, but it has no direct role neither in amending nor in adopting implementing acts. As such, Parliament’s resolutions can only exercise an indirect influence on the Commission which is not bound by them.

8 *D. Guéguen and V. Marissen, Handbook on EU Secondary Legislation, Brussels, Pact European Affairs, 2013, p. 20*

FIGURE 10 Secondary legislations mandated by CSRD

DA: Delegated Act
IA: Implementing Act

Category	Attribute	Formal deadline	Status	Provided to the EU Commission	Comment
DA	ESRS SET 1 – Sector agnostic	June 2023	Published	EFRAG	12 standards https://webgate.ec.europa.eu/regdel/#/delegatedActs/2111
DA	ESRS SET 2 – Sectoral standards	June 2026*	Early drafting	EFRAG	Standards progressively adopted, with 6 to 11 foreseen by June 2026
DA	ESRS for listed SMEs	June 2024	Public consultation on draft	EFRAG	Drafts are being finalized; possible delay foreseen for Q1 2025 tbc.
DA	ESRS for Third-country companies	June 2026	Not started	Being considered	Shall focus on sustainability impacts reporting only.
DA	Limited Assurance standards	October 2026	Not started	Internal process at Directorate general level	Based on technical advice by the CEAOB
DA	Reasonable Assurance standards	October 2028	Not started	Internal process at Directorate general level	Pending a favorable assessment report by the EU Commission
DA	Digital taxonomy (tagging & XBRL technical standards)	No formal deadline	Full ESRS datapoint released	EFRAG & ESMA	Early draft foreseen for Q4 2024.
IA	Equivalence with third-country reporting regimes	No formal deadline	-	Internal process at Directorate General level.	Lead by the European Commission
Guidelines	Voluntary standards for SMEs	June 2024	-	EFRAG	Drafts are being finalized; possible delay foreseen for Q1 2025 tbc.
Guidelines	Supervision of sustainability reporting for listed companies	No formal deadline	-	ESMA	Public consultation ended on March 15, 2024
Guidelines	Procedures for assurance	-	-	CEAOB	Guidelines to be developed by July 2024, for adoption by Q4 2024.

National implementation & penalties

The CSRD provides a harmonized framework for companies on transparency, accounting and audit, while allowing flexibility for Member States to implement its provisions in their national legal systems.

The directive shall be transposed by all Member States into their national law by 6 July 2024.

Member States do not have much flexibility regarding the content of the reporting standards, as they are set at EU level; however, they are still required to incorporate the directive's provisions into the national legal framework, and to publish the administrative provisions necessary to comply with the CSRD. When it comes to penalties for non-compliance, the directive is not very prescriptive and leaves it to Member States to define enforcing measures.

Indeed, the CSRD does not introduce any new penalties to the existing provisions of the Accounting Directive (article 51). Just like under the previous regime, Member States shall establish effective, proportionate, and dissuasive penalties for infringements of the directive, which now includes sustainability disclosures. They are also in charge of providing adequate resources for supervisory authorities that may control corporate sustainability reporting practices. For instance, France has introduced criminal sanctions for company directors that would fail to appoint an auditor of sustainability information and for the obstruction of a sustainability audit. A further instance is Hungary: should undertakings fail to comply with the ESG reporting obligations, the national Supervisory Authority for Regulated Activities may impose financial penalties.

Scope and applicability: Member States must ensure that the directive's requirements apply to the specified companies, including public-interest entities (PIEs) and others meeting certain size criteria. They are also responsible for ensuring that companies comply with the prescribed content and format of annual financial and sustainability statements, including any electronic reporting requirements.

Compliance oversight: to ensure compliance with reporting requirements, Member States are required to designate National Competent Authorities (NCAs) responsible for the oversight of the CSRD implementation. Under the previous NFRD framework, these authorities were typically financial regulators or relevant bodies, but their supervisory powers were limited to listed companies. With the integration of financial and sustainability information into a unified management report, the supervisory measures applicable to listed entities should now be extended to sustainability reporting. However, Member States retain the flexibility to decide whether to extend administrative supervision by NCAs to non-listed companies, to opt for another competent body, or to leave the handling of compliance checks to the judicial system.

Auditing requirements: the directive includes provisions related to the audit of financial and sustainability statements. Member States are responsible for implementing rules on the statutory audit of annual and consolidated accounts, including the appointment of auditors, and the independence of auditors and Independent Assurance Service Providers.

Each Member State shall therefore empower a National Competent Authority (NCA) to monitor possible breaches of these provisions (e.g. in case of failure or ethical misconduct), and to impose penalties including fines or other disciplinary measures. The fine amount may vary depending on the severity of the violation. In case of serious misconduct, auditors could have their registration withdrawn, which means that they could lose the authorization to conduct statutory audits. In addition to, or instead of, financial penalties, NCAs may require audit firms and independent assurance service providers to take corrective measures to address identified deficiencies in their audit processes, quality control, or compliance with professional standards. Similar requirements should apply to Independent Assurance Service Providers going forward.

Public oversight and transparency: the directives emphasize the importance of transparency and may require NCAs to make certain information related to penalties publicly available, while respecting business confidentiality. In that regard, the Committee of European Auditing Oversight Bodies (CEAOB) is in charge of coordinating national audit oversight bodies at EU level, including on certain aspects of cross-border enforcement and penalties. The CSRD also mandates the ESMA to issue guidelines on the supervision of sustainability reporting by national competent authorities.

Glossary

Disclaimer: The following definitions aim to clarify, simplify, and explain key concepts of the briefings. They do not replace legal acts, or definitions included in guidance materials produced by EFRAG.

Adverse impact: an adverse impact refers to a negative or detrimental effect that a particular action, decision, policy, or event has on individuals, groups, organizations, or the environment. These impacts include human-rights issues such as forced and child labor, inadequate workplace health and safety, exploitation of workers, environmental impacts (greenhouse gas emissions, pollution), or biodiversity loss and ecosystem degradation. However, rather than specifying the adverse impact by way of new definitions or criteria, the European Commission has taken the approach of referring to various instruments of conventions and guidelines. The identification of impacts as adverse is usually driven by an analysis carried out by the company on the severity of the impacts, which includes the scale of damage to the environment and of affected or potentially affected individuals, the irremediability and the likelihood of the negative impact on human rights and the environment.

Annual management report: a document that provides a summary of a company's performance, activities challenges and future plans, over the course of a fiscal year.

Assurance (external assurance): the process by which an independent third party assesses and provides assurance on the accuracy, reliability, or compliance of information or processes based on agreed-upon assurance standards. This can include audits, reviews, or certifications conducted by external parties to validate the credibility and trustworthiness of an organization's activities, reports, or systems. The CSRD requires the sustainability reporting to be audited by a statutory auditor or an Independent Assurance Service Provider. The required audit corresponds to an assurance service, and it has two levels of engagement: limited or reasonable assurance.

Branch: in EU law, a branch refers to an establishment set up by a company in a Member State, but outside its main place of business. Essentially, it's like a satellite office or facility of a company operating in another country within or outside the EU. Branches allow companies to expand their presence and conduct business in various EU countries while still being part of the same legal entity.

Captive insurance companies: a wholly owned subsidiary created to provide insurance to its non-insurance parent company (or companies). Captives are a form of self-insurance.

Digital tag: a specific label or identifier assigned to a single piece of financial or sustainability information. When a company reports its information using XBRL, it assigns the relevant digital tags to each piece of data in its financial and sustainability statements. These digital tags provide a standardized way of identifying and describing those elements, facilitating consistency and comparability in financial reporting.

Double materiality: the concept underpinning the CSRD, which states that companies need to consider and report both their impacts on the world and how sustainability issues impact the financial well-being of the company. The European Commission and EFRAG are developing additional guidance on materiality assessment.

Due Diligence: the concept of environmental and human-rights due diligence can be described as the practical steps to help companies identify, prevent, mitigate, account for and bring to an end the actual and potential adverse human-rights and environmental impacts. This regards their operations, value chains and other business relationships. The concept of due diligence is also embedded in the recommendations of the International Labour Organisation (ILO) Tripartite Declaration of Principles, concerning multinational enterprises and social policy, and was specified and further developed in the OECD Guidelines for Multinational Enterprises and OECD Guidance on Responsible Business Conduct. The European Union has agreed on a joint text of the Corporate Sustainability Due Diligence Directive (CSDDD), which sets obligations for large companies based and operating in the EU regarding actual and

potential adverse impacts on human rights and the environment, with respect to their own operations, those of their subsidiaries, and those carried out by their business partners. The directive was formally adopted by European policymakers in April 2024.

Company downstream from the reporting company: any company (for instance, distributors, customers) that receives products or services from the the company.

Company upstream from the reporting company: any company (for instance, suppliers) which provides products or services that are used in the development of the reporting company's own products or services.

Net turnover: it refers to the total revenue generated by a company after deducting certain items, such as sales rebates and value added tax and other taxes directly linked to turnover.

EFRAG: a public private organisation that provides technical expertise and advice to the European Commission on accounting matters, particularly on the development and endorsement of International Financial Reporting Standards (IFRS) and the development of European Sustainability Reporting Standards (ESRS).

European Directive / European Regulation: legal instruments issued by the European Union that set out specific objectives that all Member States are required to achieve and/or implement. Unlike a regulation, which has a direct and immediate legal effect, a directive provides a framework for Member States to develop their own national laws to meet the directive's objectives. In the case of the CSRD, little flexibility has been given to the national level when it comes to implementing the amendments to the Accounting Directive.

European Single Electronic Format (ESEF): the regulatory framework introduced by the European Securities and Markets Authority (ESMA) as part of the European Union's efforts to enhance transparency and accessibility of financial information. The ESEF requires companies listed on EU regulated markets to prepare their annual reports in a specific electronic format, known as Inline XBRL (eXtensible Business Reporting Language). Inline XBRL combines traditional human-readable financial statements with machine-readable XBRL data, allowing for easier analysis and retrieval of financial information.

European Single Access Point (ESAP): a single digital point of access to public financial and non-financial information about EU companies and investment products. It will provide for a single digital platform for the centralized collection, storage and access to information already published in accordance with existing European legislation, as well as future European directives and regulations. This includes financial regulations and ESG-related disclosure regulations such as the SFDR and the CSRD. The ESAP platform should be available from Q3 2027 and gradually phased in.

Financial materiality: a sustainability matter is material from a financial perspective if it generates risks or opportunities that do, or could reasonably affect, the company's financial position, performance, cash flows, access to finance or cost of capital - over the short, medium or long term.

Impact materiality: a sustainability matter is material from an impact perspective when it pertains to the company's actual or potential, positive or negative impacts on people or the environment over the short-, medium- and long-term. Material sustainability matters include impacts caused or contributed to by the company and impacts which are directly linked to the company's operations, products, and services through its business relationships.

Impact: the effect the company has or could have on the environment and people, including effects on human rights, connected with its own operations and upstream and downstream value chain, including through its products and services, as well as through its business relationships. Impacts indicate the company's contribution, negative or positive, to sustainable development over the short, medium or long term.

Independent Assurance Services Provider (IASP): a firm other than the usual auditors of financial information that is allowed by Member States to audit sustainability information. Depending on the local legal frameworks, IASPs can be sustainability specialists, certification bodies, lawyers, or any other entity that received an accreditation to provide sustainability assurance.

Impacts, Risks and Opportunities (IRO): specific disclosures in the ESRS that capture companies' impacts, risks and opportunities.

Key intangible resources: non-physical resources which, either alone or in conjunction with other physical or non-physical resources, can generate a positive or a negative effect on the value of the company in the short, medium and long term. In practical terms, intangibles

usually refer to human, intellectual, and social capital of a company, such as trademark(s), brand/logo, customer directory, reputation, etc. The CSRD adds a qualification of “key intangible”, which refers to a level of dependency of the company’s business model to these intangible resources.

Limited assurance: the level of assurance in relation to information that is disclosed based on the ESRS. When auditors provide limited assurance, they are stating that, based on their procedures and assessments, nothing has come to their attention that indicates the information reviewed is materially misstated. A risk assessment based on limited assurance focuses on the detailed assurance activities on topics or data that have a higher risk of error or omissions, and/or are of significant interest to the user or stakeholder. As the workload for auditors is less for limited assurance than for reasonable assurance, and more reliance is placed on inquiry and analytical procedures, there is an increased risk that errors or omissions in the report will not be discovered. As a result, the assurance provider issues a conclusion with the “double negative” wording that nothing has come to his/her attention to indicate the information is not fairly presented, in accordance with the reporting criteria. In the case of limited assurance, the assurance provider will often undertake sampling of underlying source data on business sites - but the sample will be smaller than for reasonable assurance.

Material information: any information that could influence the decisions of users, including investors and other stakeholders. Information is material where its omission or misstatement could reasonably be expected to influence decisions that users of that information make, based on the financial statements or the sustainability reporting of the company.

Materiality threshold: in the context of double materiality reporting, it refers to the criteria (qualitative and/or quantitative) used both internally to the company’s operations and externally to broader societal and environmental concerns. Setting a threshold on sustainability matters is therefore necessary to determine which topics are material to the company. It establishes the boundary beyond which sustainability impacts, risks and opportunities are considered material and provide grounds for their inclusion in corporate reporting. In EU law, materiality thresholds shall be determined by severity for actual negative impacts and severity and likelihood for potential negative impacts.

Opportunities: sustainability-related opportunities with positive financial effects.

Preparers: an individual or a company responsible for preparing and presenting financial or sustainability reports either voluntarily or legally.

Reasonable assurance: the level of assurance describing a higher level of confidence in the ESRS-based reported information. When auditors provide reasonable assurance, they are stating that, based on their audit procedures and assessments, the financial statements are free from material misstatement.
It requires the provider to undertake an initial risk assessment and then perform an in-depth investigation, collecting sufficient evidence to be able to give a high, but not absolute, level of assurance in the form of a positively worded “clean opinion”. Auditors don’t check every detail provided by the company, it would be too complex and costly. Therefore, a level of professional judgment is required, based on competence and experience. There will always be a few uncertainties, or inherent limitations due to subjective elements such as estimates, hence the wording “high”, but not “absolute”.

Proxy: it refers to a substitute or indicator used to represent a specific aspect of sustainability performance or impact when direct measurement or data collection is difficult or impractical. For example, in environmental sustainability reporting, a company might use electricity consumption as a credible proxy for carbon emissions, when these cannot be measured directly. Similarly, in social sustainability reporting, metrics like employee turnover rate or employee satisfaction scores might serve as credible proxies for overall employee well-being or engagement. The credibility of a proxy depends on several factors, including its relevance to the sustainability issue being measured, the reliability of the data source, the accuracy of the proxy in reflecting the underlying phenomenon, and transparency in how it is selected and applied in reporting.

Risks: potential or actual sustainability-related negative financial effects arising from environmental, social or governance matters that may negatively affect the company’s financial performance.

Small and non-complex institutions: banks which do not exceed certain thresholds, such as a total asset value of less than EUR30 billion and/or a low ratio of cross-border assets in more than one Member State, and which usually do not receive direct public financial assistance.

Stakeholder: those who have an interest in the company, and who can affect or can be affected by the company's activities. There are two main groups of stakeholders:

- Affected stakeholders: individuals or groups whose interests are or could be affected – positively or negatively – by the company's activities and its direct and indirect business relationships across its value chain;
- Users of sustainability statements: primary users of general-purpose financial reporting (existing and potential investors, lenders and other creditors, including asset managers, credit institutions, insurance companies), as well as other users, including the company's business partners, trade unions and social partners, civil society and non-governmental organizations, governments, analysts and academics.

Some stakeholders may belong to the two groups.

Supply chain: the full range of activities or processes carried out by suppliers upstream from the reporting company, which provide products or services used in the development of the reporting company's own products or services. This includes upstream suppliers with which the reporting company has a direct relationship (often referred to as a first-tier supplier), or an indirect business relationship.

Sustainability matters: environmental, social, economic and employee matters, respect for human rights, anti-corruption and anti-bribery matters, as well as other specific entities' governance matters. These topics are more precisely defined in the European Sustainability Reporting Standards (ESRS) – e.g., diversity policies or child labor when it comes to governance and human rights respectively.

Sustainability reporting: the process of mandatorily or voluntarily reporting information related to sustainability matters, in accordance with the ESRS).

Sustainability reporting format: the specifications of a single electronic reporting format and the format, structure and language of the management report.

Transition plan for climate change mitigation: a plan that outlines the structured roadmap for a company to convert its environmental goals into actionable steps and investment strategies, with the aim of shifting its operations toward a greener, lower-carbon model. The plan should align with global warming targets set by the Paris Agreement and the goal of achieving climate neutrality by 2050, as outlined in the European Climate Law. By engaging in this company-wide process, companies can mitigate strategic and financial risks associated with the transition, identify business opportunities, and enhance transparency for investors and financial markets. While the EU has not yet provided a legal definition for transition plans, frameworks like the CSRD and the ESRS offer detailed guidelines.

Transition plans encompass various elements, such as:

- greenhouse-gas reduction targets;
- decarbonization strategies;
- investment plans tied to the EU environmental Taxonomy-aligned Key Performance Indicators;
- alignment with overall business strategies and financial planning;
- internal and external approval processes;
- monitoring of implementation progress and assessment of emissions.

Value chain: the full range of activities, resources and relationships involved in the creation and delivery of the products or services of the company. A value chain encompasses the activities, resources and relationships the company uses and relies on to create its products or services from conception to delivery, consumption and end of life. The value chain includes companies (or suppliers) upstream and downstream from the company.

Relevant activities, resources and relationships include:

- those in the company's operations, such as human resources;
- those along its supply, marketing and distribution channels, such as materials, service sourcing, product and service sale and delivery;
- the financing, geographical, geopolitical and regulatory environments in which the company operates.

Users: (of sustainability statements) are primary users of general-purpose financial reporting (existing and potential investors, lenders and other creditors including asset managers, credit institutions, insurance companies), as well as other users, including the company's business partners, trade unions and social partners, civil society and non-governmental organizations, governments, analysts, and academics.

XBRL: XBRL-tagged data is machine-readable, making it easier for stakeholders to access, analyze, and integrate sustainability information into various platforms and systems.

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