

July 2022

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You Better Watch Out: A New EU Corporate Sustainability Reporting Directive is Seeing the Day

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On June 21, 2022, the Council of the European Union (“European Council”) and European Parliament (“Parliament”) reached a provisional political agreement on the Corporate Sustainability Reporting Directive (“CSRD”). A copy of the [full text](#) to be formally adopted by the European Parliament was released on June 30, 2022. The formal agreement will be published in the European Union (“EU”) Official Journal and enter into force 20 days after its publication. Member States will be required to integrate its provisions into their respective national laws after 18 months.

As one of the cornerstones of the [European Green Deal](#) and the [Sustainable Finance Agenda](#), the CSRD aims to create global sustainability reporting standards, end greenwashing, and increase corporate accountability. The CSRD does this by introducing more detailed reporting requirements than the existing Non-Financial Reporting Directive (“NFRD”), including obligatory disclosure related to human rights, environmental rights, social rights, and governance factors, and applies to a wider scope and number of companies than applicable under the NFRD. The CSRD additionally requires auditing processes and the publication of non-financial reporting in company management reports, putting non-financial reporting as equally important to financial reporting. The European Financial Reporting Group (“EFRAG”) will additionally create European Sustainability Reporting Standards (“ESRS”).

I. Background

The CSRD was first [proposed](#) by the European Commission (“Commission”) on April 21, 2021, and set out to adopt sustainability reporting standards for the EU. It amends and builds upon the rules set out in the NFRD. The proposal sought to address gaps in reporting for companies related to sustainability, which impede the ability of investors and stakeholders to compare and assess public information.

II. Scope

The new reporting requirements under the CSRD apply to:

1. large companies (listed and non-listed) as defined in the [Accounting Directive](#) (i.e., a company with at least two of the following criteria: (i) 250 or more employees, (ii) at least €40 million turnover in the EU, or (iii) a balance sheet of at least €20 million);
2. all companies on EU regulated markets; and

3. non-European based companies with at least one subsidiary or branch in the EU with an annual net turnover of at least €150 million in the EU.

The CSRD more than quadruples the number of companies required to report on sustainability, from the 11,000 covered by the NFRD to the nearly 50,000 that will be covered by the CSRD. Parent companies are required to assess their subsidiaries and branches and may choose to submit a consolidated report, while company groups are required to present a consolidated report. Reporting requirements also apply to Small and Medium Sized Enterprises (“SMEs”), but takes into consideration their specific characteristics and provides an opt-out clause for SMEs to delay applying the CSRD requirements until 2028.

It should be noted that the CSRD also applies to companies based abroad and with a certain turnover who have a presence in the EU. Therefore, for instance, a U.S.-based company with dozens of subsidiaries has to abide by the CSRD if even one of those subsidiaries is in the EU, provided the EU-based subsidiary’s turnover threshold is met.

III. Reporting

Companies must include their non-financial reporting into their consolidated management report together with their financial reporting. The ESRS will provide guidance on disclosure requirements and look to existing international standardization initiatives and EU policies. The ESRS is currently under public consultation to be completed on August 8, 2022. It is anticipated that EFRAG will publish initial standards in summer 2023 and specific sector standards in 2024.

IV. Auditing

The CSRD requires all companies under its scope to independently audit and certify information presented in their non-financial disclosures, in line with what is currently required for the reporting of financial information. Unlike financial auditing, it is not required that a company’s non-financial reporting be audited by a statutory auditor or audit firm, so long as the selected auditor provides a certification in line with standards to be adopted by the EU. Accreditation for non-financial auditors and assurance providers will be organized by each Member State, including determining the requirements for quality assurance, which should ensure consistent outcomes in reporting.

Enforcing equal processes for financial and non-financial information signals to companies and investors that sustainability reporting is of equal weight and importance to financial reporting, and aims to create a reliable and transparent process that will enable investors to compare data across companies confidently and accurately.

V. Timeline

For companies already subject to the NFRD, CSRD requirements enter into effect on January 1, 2024. For companies not currently subject to the NFRD, CSRD requirements enter into effect on January 1, 2025. For SMEs, small and non-complex credit institutions, and captive insurance undertakings, CSRD requirements enter into effect on January 1, 2026. Member State laws bringing into effect the CSRD and its reporting requirement must apply for financial years starting on or after January 1 of each respective year with first reports published the following year.

VI. Insights and Next Steps:

The CSRD will be an important step for ensuring accountable disclosure on sustainability. The requirements of the CSRD are also organically linked and will likely impact ongoing discussions on the

European Commission's [Proposal for a Directive on Corporate Sustainability Due Diligence](#) ("Draft Directive"), which, among other requirements, will necessitate integration of human rights and environmental due diligence into company operations, policies and procedures. Once both directives are in force, this regulatory landscape will be a significant step in making environmental rights and human rights a business imperative. It will also create incredible value and leverage to ensure accountability, as NGOs and other stakeholders could use the information presented under the requirements of the CSRD in order to bring actions against companies under their Draft Directive requirements. See this [Paul Hastings Client Alert](#) for more information regarding the Draft Directive. More information on the potential impacts of the CSRD and next steps companies can take to proactively prepare for these requirements can also be found in this [Paul Hastings Client Alert](#).



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