

The Corporate Sustainability Reporting Directive : From “Non-Financial” to “Sustainability” Reporting

May 21, 2021

On April 21, 2021, the European Commission published an ambitious new package of “sustainable finance” regulation proposals. By far the most awaited element of this release concerned the Commission’s proposal for the **review of the Non-Financial Reporting Directive** (“NFRD”) – soon to become the **Corporate Sustainability Reporting Directive** (“CSRD”).

Under the NFRD, large “public-interest” entities (that is: large listed companies, large credit and insurance institutions, and other entities designated as such by Member States) are currently required to report certain non-financial information as part of their annual management report, largely on a comply-or-explain basis.

The CSRD represents a considerable reinforcement of such reporting obligations, and a significant enlargement of their scope. Around 50,000 undertakings will be covered under the CSRD (compared to the 11,700 that are now subject to the NFRD). Significant changes will include the duty to comply with **EU-wide sustainability reporting standards**, as well as a limited **audit (i.e. “assurance”)** requirement for non-financial statements.

This alert memorandum provides an overview of the requirements proposed under the draft CSRD against the backdrop of the current NFRD regime, and situates them within other key EU sustainability rules (the **Taxonomy Regulation**, the **Sustainable Finance Disclosure Regulation** (“SFDR”), and the upcoming **Corporate Due Diligence and Accountability Directive**).

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I. Background

a. The current NFRD regime (in brief)

The NFRD (Directive 2014/95/EU⁽¹⁾), which amends the “Accounting Directive” (2006/43/EC⁽²⁾), was adopted in 2014. Companies had to report in accordance with its provisions for the first time in 2018 (covering financial year 2017).

The NFRD applies to **large** EU “**public interest**” entities (*i.e.* listed companies, credit institutions, insurance companies and other entities designated as such by Member States because of their significant public relevance) and to “public interest” entities which are parent companies of a **large group**.⁽³⁾ In order to qualify as “**large**”, undertakings (or groups, on a consolidated basis) must have an average number of employees in excess of 500, plus (alternatively) a balance sheet total exceeding EUR 20 million *or* a net turnover exceeding EUR 40 million.⁽⁴⁾ According to the European Commission, 11,700 entities currently fall within the scope of the NFRD.⁽⁵⁾

Under the NFRD, companies are required to report both on how sustainability issues affect their performance and development (the “outside-in” perspective), and on their impact on people and the environment (the “inside-out” perspective) – in what is often known as the “**double materiality**” principle of non-financial reporting. The sustainability issues falling within the scope of companies’ “**non-financial statement**” must cover, as a

minimum, environmental, social and employee matters, respect for human rights, anti-corruption and bribery.

Crucially, the NFRD largely applies on a “**comply or explain**” basis, which gives companies the possibility not to adopt the policies, and not to carry out the due diligence, that are prescribed under the NFRD.

b. The review of the NFRD

Sustainability has very much risen in importance since the NFRD was conceived, and the gap between the current legal framework and markets’ increasing need for more sustainability-related information from companies is becoming more and more evident in time.

Few companies report on sustainability risks and resilience, while many who do nevertheless fail to disclose all of the information that is really relevant for users (“users” being supervisors, investors, asset managers, lending institutions and other company stakeholders). When sustainability information is reported, it is often neither sufficiently reliable, nor sufficiently comparable. It is also too often difficult for users to find.⁽⁶⁾

In 2018, having crystallised the implications of the global sustainability transition, including the targets set under the Paris Agreement on climate change, the European Commission adopted an EU-wide “**Action Plan for Sustainable Finance**” (the “Action Plan”) – which included a comprehensive review of the NFRD regime, under “action 9”.⁽⁷⁾ In December 2019, the Commission

¹ The NFRD is accessible [here](#). In 2017 and 2019 the Commission published two sets of non-binding reporting guidelines for companies under the NFRD – see EC Communications C(2017) 4234 and C(2019) 4490, respectively accessible [here](#) and [here](#).

² The Accounting Directive is accessible [here](#).

³ Some Member States have enlarged the notion of “public interest entities” – for instance, Denmark, France and Spain have extended the NFRD to non-listed entities that exceed certain size thresholds.

⁴ Some Member States (such as Spain) have similarly decided to apply different (lower) size thresholds.

For a country-by-country overview of the national scope of NFRD reporting requirements, see Annex I to the the final report of the “Study on the Non-Financial Reporting Directive” for the Directorate-General for Financial Stability, Financial Services and Capital Markets Union of November 2020 (p. 124), accessible [here](#).

⁵ This number takes into account the extension made by Member States through the implementation of the NFRD, as illustrated under the previous footnotes 3 and 4. Under the strict scope of the Directive, only around 2,000 companies are caught.

For an overview of the reporting obligations set under the NFRD, including under Member States’ national implementing regimes, see our alert of January 20, 2017, [here](#).

⁶ Several of these shortcomings are mentioned under the Commission’s own explanatory memorandum accompanying the CSRD proposal. The full CSRD proposal of April 21, 2021, is accessible [here](#). The broader reform package announced on such date is accessible [here](#).

For simplification, although still in draft form, the proposal is referred to in this alert simply as CSRD.

⁷ The Action Plan is accessible [here](#).

reaffirmed its commitment and calendarised the review as part of the EU Green Deal.⁽⁸⁾

Public consultations on the NFRD review were held in 2020. These confirmed that, also in the view of market participants, the non-financial information currently reported by in-scope companies is often deficient in terms of comparability, reliability and relevance. Stakeholders who took part in the consultation also showed a strong degree of support to extending the scope of application of the NFRD's reporting requirements.

c. The CSRD proposal

The Commission's definitive proposal for a Corporate Sustainable Reporting Directive (2021/0104(COD)) is the centrepiece of the EU's latest package of sustainability-related regulatory reforms, published on April 21st.

The CSRD shall replace the NFRD entirely, and amend the provisions of the Accounting Directive, the "Transparency Directive" (2004/109/EC⁽⁹⁾), and the "Audit Directive" and "Audit Regulation" (2006/43/EC and 537/2014⁽¹⁰⁾), as in each case relevant.

The CSRD proposal largely addresses the stakeholder concerns that emerged in the context of the consultation. More generally, it is an additional step to eventually bring sustainability reporting – over time – on a par with financial reporting. Under the CSRD, more than 50,000 EU undertakings would in fact be required to publish "sustainability information" as part of their annual management report.

d. Legislative schedule

The CSRD proposal has now been submitted to the readings of the European Parliament and Council. Once adopted by the European Parliament and the Council, Member States will be required to implement the provisions of the CSRD into national law by December 1, 2022.

The CSRD's new sustainability reporting obligations will apply to companies' annual reports for the financial years starting on or after **January 1, 2023**.

II. Future of sustainability reporting for EU companies

a. The Taxonomy Regulation amends the NFRD

The CSRD is not the first to reinforce the NFRD's non-financial reporting requirements.

On July 12, 2020, Regulation (EU) 2020/852 "on the establishment of a framework to facilitate sustainable investment" (the "Taxonomy Regulation") entered into force.⁽¹¹⁾ This regulation (which was adopted as part of the Action Plan's "action 1") forms the backbone, among other things, of EU companies' new sustainability-related transparency requirements (including the CSRD), by laying out a common set of definitions and standards that shall be used to identify sustainability risks, and to define "**environmentally sustainable**" economic activities and investments. Although the Taxonomy Regulation so far only addresses environmental sustainability, it is expected that the Commission will similarly address social sustainability profiles in the near future.⁽¹²⁾

According to the Regulation's Article 8, undertakings that are subject to the NFRD (and those that will be later subject to the CSRD) will need to disclose as part of their annual non-financial statements how and to what extent the undertaking's activities are associated with economic activities that qualify as "environmentally sustainable" under the Taxonomy Regulation. This obligation will already apply starting on **January 1, 2022** (and so presumably for reports issued after such date, and potentially referring to the current year).⁽¹³⁾

⁸ The EU Green Deal announcement is accessible [here](#).

⁹ The Transparency Directive is accessible [here](#).

¹⁰ The Audit Directive and Regulation are respectively accessible [here](#) and [here](#).

¹¹ The Taxonomy Regulation is accessible [here](#).

¹² See Recital 6 of the Taxonomy Regulation.

¹³ This, in relation to the "climate change mitigation" and "climate change adaptation" objectives. The other 4 environmental sustainability objectives set under the Taxonomy Regulation (*i.e.*, the sustainable use and protection of water and marine resources; the transition to a circular economy; pollution prevention and control; and the protection and restoration of biodiversity and ecosystems) will have to be included as part of this disclosure starting in 2023.

The requirements introduced by the Taxonomy Regulation are by all means significant. In particular, **non-financial undertakings** will be required to disclose:

- (a) the **proportion of their turnover** derived from products or services that are associated with environmentally sustainable activities; and
- (b) the **proportion of their capital expenditure** and the **proportion of their operating expenditure** related to assets or processes that are associated with environmentally sustainable activities.

In the spring of 2021, the three EU supervisory authorities – that is, the European Securities and Markets Authority (ESMA), the European Banking Authority (EBA) and the European Insurance and Occupational Pensions Authority (EIOPA) – each published their advice to the Commission on how to specify these requirements with respect to the **financial undertakings** under their respective remit.⁽¹⁴⁾

On May 7, 2021, the Commission launched a call for public feedback on the draft delegated acts that will specify the methodology, content and presentation (including templates) for all of the above disclosures, distinguishing by type of undertaking.⁽¹⁵⁾

b. New scope of application of the CSRD

As mentioned, compared to the NFRD, the CSRD first of all significantly broadens the scope of application of sustainability reporting.

The CSRD entirely overcomes the concept of “public interest” entity. The new regime will instead concern:

- i. All “**large**” undertakings (whether listed or not);
- ii. Any undertaking with securities listed on a EU regulated market (save only for listed micro-enterprises⁽¹⁶⁾).

For purpose of item (i) above, an undertaking will be considered “**large**” if it exceeds on its balance sheet date at least two of the following¹⁷:

- a. A balance sheet total of EUR 20 million;
- b. A net turnover of EUR 40 million; and
- c. 250 employees on average over the financial year.

In order to alleviate the future compliance burden for **small and medium-sized (listed) undertakings**, the CSRD’s requirements will begin to apply to these only 3 years after the Directive’s entry into force (*i.e.*, as of January 1, 2026).⁽¹⁸⁾

c. Group reporting

Similarly to the NFRD, parent undertakings of a “large group” (*i.e.*, groups that exceed the same threshold now described, on a consolidated basis) will be required to publish a consolidated non-financial statement with respect to their entire group.⁽¹⁹⁾ Their subsidiaries (including where controlled by a company established in a third country) will in turn be exempted from the obligation to issue such individual statement, where included in a consolidated statement drafted in compliance with the CSRD.

d. Sustainability information

Also similarly to the NFRD, the kind of “sustainability information” that will need to be disclosed will concern at least the following matters, as always from a “double materiality” perspective:

Environmental matters	Social and employee matters
Respect for human rights	Anti-corruption and bribery

¹⁴ The ESAs three advice papers can be accessed (in the same order) [here](#), [here](#) and [here](#).

¹⁵ The draft Delegated Act is accessible [here](#).

¹⁶ In order to qualify as a “micro-enterprise”, a company shall remain below at least two of the following:

- (a) a balance sheet total of EUR 350,000;
- (b) a net turnover of EUR 700,000; and

(c) 10 employees over the financial year on average.

¹⁷ See Article 3, Paragraph 4, of the Accounting Directive.

¹⁸ See Article 1, Paragraph 3, of the CSRD, amending Article 19a of the Accounting Directive.

¹⁹ See Article 1, Paragraph 7, of the CSRD, amending Article 29a of the Accounting Directive.

For each of such matters, non-financial statements must include the following:

- (a) A brief description of the undertaking's business model and strategy, including:
 - (i) The resilience of the undertaking's business model and **strategy to risks related to sustainability** matters;
 - (ii) The **opportunities** for the undertaking related to sustainability matters;
 - (iii) The plans of the undertaking to ensure that its model and strategy are **compatible with the transition to a sustainable economy** and with the limiting of global warming to **1.5 °C** in line with the Paris Agreement;
 - (iv) How the interest of the undertaking's business model and strategy take account of the interests of the undertaking's **stakeholders** and of the impacts of the undertaking on sustainability matters;
 - (v) How the undertaking's business strategy has been implemented with regard to sustainability matters;
- (b) A description of the **targets** related to sustainability matters set by the undertaking and of the progress the undertaking has made towards achieving those targets;
- (c) A description of the **role of the administrative, management and supervisory bodies** with regard to sustainability matters;
- (d) A description of the undertaking's **policies in relation to sustainability matters**;
- (e) A description of:
 - (i) The **due diligence** process implemented with regard to sustainability matters;
 - (ii) The principal actual or potential adverse impacts connected with the undertaking's **value chain**, including its own operations, its

products and services, its business relationships and its supply chain;

- (iii) Any **actions taken**, and the results of such actions, to **prevent, mitigate or remediate** actual or potential adverse impacts;
- (f) A description of the **principal risks** to the undertaking related to sustainability matters and how these are managed;
- (g) **Indicators** relevant to the disclosures referred to in points (a) to (f).⁽²⁰⁾

The CSRD specifies that the above should include both **forward-looking and retrospective** information, as well as **qualitative and quantitative** information.⁽²¹⁾

Most interesting is the reference to companies' **"value chain"**, a concept that was also mentioned in the European Parliament's recommendations to the Commission (the **"Recommendations"**) for the upcoming proposal on a "Sustainable Corporate Governance and Corporate Accountability" (also known as "Mandatory Supply Chain Due Diligence") Directive.⁽²²⁾ This proposal is due by the Commission within Q3 2021. According to the current Recommendations, all companies that sell goods or provide services within the EU (whether or not headquartered in the EU) would in the future be required to conduct a due diligence of sustainability impacts down their value chain. Unlike for the CSRD, the concept of "value chain" under the Recommendations would include indirect suppliers and subcontractors of in-scope companies, as well as investment links (such as for funds) – a detail which would hold great implications for financial sector firms.

e. Reporting standards

The NFRD currently allows significant flexibility with respect to the way in which non-financial information should be reported: undertakings may rely on international, European, or national frameworks to produce their non-financial statements.⁽²³⁾ The 2020

²⁰ See Article 1, Paragraph 2, of the CSRD, amending Article 19a of the Accounting Directive.

²¹ See Article 1, Paragraph 3, of the CSRD, amending Article 19a of the Accounting Directive.

²² The final approved version of the recommendations of the European Parliament to the Commission, of March 10, 2021, are accessible [here](#).

²³ See Recital 9 of the NFRD which mentions, by way of example, EU-based frameworks such as EMAS, or international frameworks such as the United Nations Global Compact, the Guiding Principles on Business and Human Rights implementing

consultations on the review of the NFRD highlighted that this plethora of possible standards results in reduced comparability and transparency of the information.

In response to the outcome of the consultations, in June 2020 the Commission mandated the Financial Reporting Advisory Group (EFRAG) to provide recommendations for a new set of binding, EU-wide sustainability reporting standards.⁽²⁴⁾ EFRAG submitted its final advice to the Commission on February 28, 2021.⁽²⁵⁾

The CSRD would make these EFRAG-crafted standards mandatory for the companies in scope of the new regime.⁽²⁶⁾ For listed SMEs, dedicated and more limited reporting standards and methods will be developed. All such standards should be issued by the Commission through October 31, 2022 to October 31, 2023 and reviewed regularly.⁽²⁷⁾

f. Audit

Under the NFRD, auditors must confirm that the non-financial statement is included in the management report (or in a separate report) but no audit is required with respect to the contents of the statement, nor the methodology applied by a company for measuring and assessing sustainability risks and sustainability impacts. The NFRD provides the option to the Member States to require that the information reported in the non-financial statement is verified by an independent assurance services provider that is not a full-service audit firm.⁽²⁸⁾

One of the most notable changes to be introduced by the CSRD is a more complete audit – or “assurance” –

the UN “Protect, Respect and Remedy” Framework, the OECD Guidelines for Multinational Enterprises, the International Organization for Standardization’s ISO 26000, the ILO’s Tripartite Declaration of principles concerning multinational enterprises and social policy, and the Global Reporting Initiative.

²⁴ Within this framework, a multi-stakeholder Project Task-Force was appointed in order to develop recommendations about the possible content, structure and scope of the future European Standard-Setting (ESS); EFRAG, Final Report of February 2021, Proposal for a Relevant and Dynamic EU Sustainability Reporting Standard- Setting, accessible [here](#).

²⁵ EFRAG’s work on non-financial reporting standards (including the Group’s final report to the Commission) is accessible [here](#).

²⁶ See Article 1, Paragraph 4, of the CSRD, amending introducing Article 19b of the Accounting Directive.

²⁷ See Article 1, Paragraphs 4 and 7, of the CSRD, amending introducing Article 19b of the Accounting Directive.

requirement on non-financial statements. Under the CSRD, auditors shall in fact express an opinion based on a **limited assurance engagement** as regards the compliance of the sustainability reporting with the requirements of the CSRD, including the applicable reporting standards.

Detailed independence and professional competence requirements will apply to those providing assurance services.⁽²⁹⁾

g. Publication of the non-financial statement

With the CSRD, sustainability information will have to be included in companies’ management report (while the NFRD allows disclosure in a separate document).

Companies’ (financial and) non-financial statements will all have to be published in a single electronic reporting format⁽³⁰⁾, and flag sustainability reporting including as to the disclosures based on Article 8 of the Taxonomy Regulation (those relating to proportion of turnover, capex and opex, as described under Paragraph II(a)).⁽³¹⁾

h. Responsibility

The CSRD confirms the NFRD’s corporate governance and accountability principle according to which the members of a company’s **administrative, management and supervisory bodies** have “collective responsibility” for ensuring that sustainability information is drawn up and published in accordance with the requirements of the CSRD.⁽³²⁾

²⁸ See Article 1, Paragraph 10, and Article 3 of the CSDR, amending several provisions of the Accounting Directive and the Audit Regulation.

²⁹ See Article 3, Paragraphs 7 to 9, of the CSDR, amending Article 34 of the Accounting Directive.

³⁰ This step is functional to the creation of a **European Single Access Platform** to corporate reports, which is part of the EU’s Capital Markets Union action plan (see Communication (COM(2020) 0590, accessible [here](#)). A legislative proposal on this is expected within Q3 2021.

³¹ See Article 1, Paragraph 4, of the CSRD, introducing Article 19d of the Accounting Directive.

³² And where applicable, with the international accounting standards adopted in accordance with Regulation (EC) no. 1606/2002, Article 1, Paragraph 9, of the NFRD, amending Article 33, Paragraph 1, of the Accounting Directive.

i. Sanctions

The CSRD will require the Member States to provide for minimum sanctions for non-compliance with sustainability reporting requirements, these being:

- (i) A public statement indicating the natural person or the legal entity responsible and the nature of the infringement;
- (ii) The possibility to issue a cease-and-desist order; and
- (iii) Administrative pecuniary sanctions.

These shall be proportionate to the financial strength of the responsible entity and the importance of profits gained or losses avoided through the infraction.⁽³³⁾

III. Alignment with the EU's new sustainability disclosures for the financial sector

The Sustainable Finance Disclosure Regulation (Regulation (EU) 2019/2088, the “SFDR”) entered into force on March 10, 2021.⁽³⁴⁾ Aimed at preventing the “greenwashing” of financial products marketed as green (which are inundating markets globally), the SFDR imposes certain sustainability transparency and disclosure requirements on asset and fund managers, and financial advisers.⁽³⁵⁾

Following the entry into force of the SFDR, financial market participants need more detailed sustainability information from their investee companies, which companies are not currently required to surrender nor keep track of, under the NFRD. This incongruity will be remedied under the CSRD.⁽³⁶⁾

One problem to underline is certainly the lack of timing synchronisation between the two reforms (*i.e.*, between the sustainability reporting obligations of financial institutions under the SFDR, and those of non-financial institutions under the CSRD). This will leave banks and investment firms struggling to comply with their own disclosure requirements for a couple more years – and hinder the comparability of market disclosures, to the

extent that banks use different approaches to fill in the information gaps.

IV. Summary of next steps

- **Companies currently subject to the NFRD** shall begin to disclose the proportion of their activities that qualifies as “environmentally sustainable” under the Taxonomy Regulation, starting on January 1, 2022.
- The current draft CSRD will be finalised and definitively adopted by the European Parliament and Council, most probably in early 2022.
- A first set of implementing standards, specifying the information that large undertakings should report under the CSRD should be adopted by October 31, 2022.
- Member States will be required to transpose the provisions of the CSRD into national law by December 1, 2022.
- **Large companies** shall begin reporting under the CSRD for the financial year starting on or after January 1, 2023.
- A second set of implementing standards, specifying among others the information to be disclosed by listed SMEs should be adopted by October 31, 2023.
- **Listed SMEs** shall begin reporting under the CSRD for the financial year starting on or after January 1, 2026.

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³³ See Article 1, Paragraph 12, of the CSRD, introducing Article 51 of the Accounting Directive.

³⁴ The SFDR is accessible [here](#).

³⁵ See our dedicated alert on the SFDR of January 5, 2021, [here](#).

³⁶ See Article 1, Paragraph 4, of the CSRD, introducing Article 19b of the Accountability Directive.