



Purpose-driven Business Reporting in Focus

European Commission publishes proposed Corporate Sustainability Reporting Directive

Purpose-driven Business Reporting in Focus is a partner publication to Deloitte's *Need to know*. It provides updates on developments in purpose-driven business practices that are impacting corporate reporting, including progress towards sustainability standards. This publication is aimed at preparers of corporate reports, as well as their users and auditors.

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- The European Commission (EC) has published its proposed Corporate Sustainability Reporting Directive (CSRD). The objective of the proposed CSRD is to improve sustainability reporting and ensure it is brought into a company's management report to better leverage the potential of the European single market and to contribute to the transition to a fully sustainable and inclusive economic and financial system in line with the European Green Deal and the UN Sustainable Development Goals (SDGs). The next step is for the European Parliament and the Member States in the Council to negotiate a final legislative text on the basis of the EC's proposal.
- The proposed legislation expects EU Member States to transpose the CSRD by 1 December 2022 and its provisions to apply to all large companies for financial years starting on or after 1 January 2023. The requirements for listed small and medium-sized entities (SMEs) would apply for financial years starting on or after 1 January 2026.
- The scope of the CSRD covers all large companies and all companies listed on EU regulated markets except listed micro entities. It includes companies not established in the EU that are listed on EU regulated markets and EU subsidiaries of non-EU companies, with an optional exemption if the non-EU parent company publishes a consolidated sustainability report in accordance with equivalent requirements to the EU law.
- The proposal sets out the sustainability information that companies would have to include within their management report. Companies will need to provide qualitative, quantitative, forward-looking and retrospective information, including on their value chain, covering short, medium and long-term time horizons. The information provided is subject to double materiality, i.e. companies will be required to report both on how various sustainability matters affect the company and on the impacts of the activities of the company on people and the environment.
- The information will have to be provided mandatorily as part of the management report, and entities will have to report using sustainability reporting standards as issued in Europe (still to be developed with a first set of standards expected by 31 October 2022 and a second set one year later). Simplified standards would be made available to SMEs.
- The EC states that it is in the interests of the EU and European companies and investors to have standards that are globally aligned. EU standards should aim to incorporate the essential elements of globally accepted standards currently being developed and contribute to global convergence. EU standards should go further where necessary to meet the EU's own ambitions and be consistent with the EU's legal framework.
- The proposed CSRD includes mandatory assurance of the information provided (limited assurance) and mandatory digital reporting with corresponding labelling of sustainability information using a taxonomy yet to be developed.

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Introduction

The European Commission (EC) has published its [proposed Corporate Sustainability Reporting Directive \(CSRD\)](#), resulting from the process to revise the EU Non-Financial Reporting Directive (NFRD). The proposed CSRD is a central part of the EU Sustainable Finance package, a comprehensive set of measures aimed to help improve the flow of money towards sustainable activities across the EU. The proposals also include amendments to the Accounting Directive, the Transparency Directive, the Audit Directive and the corresponding Audit Regulation. The EC intends that, together, the proposals should play an essential role in transforming the corporate reporting ecosystem to enhance the quality and consistency of sustainability information.

The objective of the proposed CSRD is to improve sustainability reporting better to leverage the potential of the European single market and to contribute to the transition to a fully sustainable and inclusive economic and financial system, in line with the European Green Deal and the UN Sustainable Development Goals (SDGs). By enabling investors to re-allocate investments towards more sustainable technologies and businesses, these measures are intended to be instrumental in making Europe climate-neutral by 2050. The proposal also notes that the COVID-19 pandemic has accelerated the increase in users' needs for sustainability information, in particular as it has exposed the vulnerabilities of workers and of company's value chains.

To ensure consistent use of terms, the proposal defines "sustainability matters" (i.e. environment, social and employee matters, respect for human rights, anti-corruption and anti-bribery matters, and governance), "sustainability reporting", "intangibles" (i.e. non-physical resources that contribute to the company's value creation) and "independent assurance services provider". Intangibles are incorporated into the scope of the EC's overall definition of sustainability.

Observation: connection between sustainability and other value drivers

Sustainability is integral to business resilience and the ability to create value over time. The value of companies today is increasingly mostly represented by intangibles such as skilled employees, reputation, brand, intellectual capital, licenses to operate, and customer relationships. These are directly affected by sustainability matters. Companies that do not manage and measure them, risk underperformance or eroding their value—for example, through detrimental brand reputation, or loss of key people or customers.

Effective date

The proposed legislation expects EU member states to transpose the CSRD by 1 December 2022 and its provisions to apply to companies for financial years starting on or after **1 January 2023**. The requirements for SMEs would apply three years after the CSRD's effective date, i.e. for financial years starting on or after **1 January 2026**.

Scope

The scope of the CSRD covers all large companies¹ and all companies having securities listed on EU regulated markets except listed micro entities. It also includes companies not established in the EU that are listed on EU regulated markets and EU subsidiaries of non-EU companies.

It would not impose new requirements on small and medium-sized enterprises (SMEs), except SMEs that are listed on EU regulated markets. SMEs with transferrable securities listed on SME growth markets or multilateral trading facilities would not be included.

Observation

The extension of the scope would mean that around 49,000 entities (75% of revenue of all reporting entities) would have to disclose the required sustainability information. This compares to around 11,600 entities (47% of revenue of all reporting entities) that currently fall within the scope of the NFRD.

¹ Large companies are those that exceed the limits of at least two of the three following criteria: balance sheet total: EUR 20m; net turnover: EUR 40m; average number of employees during the financial year: 250.

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What does this mean for UK companies?

The EC is proposing to update the NFRD, which was directly implemented into UK law in 2016 as part of the strategic report requirements in the Companies Act 2006. However, at the time of writing, it is still unclear how, when or if the proposed update will also be brought into UK law as the UK is no longer part of the EU and is therefore no longer required to implement EU legislation.

UK companies will be directly affected by the CSRD if they have securities listed on EU regulated markets. It also applies directly to EU subsidiaries of UK companies.

It should be noted that the UK is introducing [requirements](#) for climate-related financial disclosures. This follows a roadmap that was published in November 2020 that charts a path towards mandatory disclosure obligations aligned with the Task Force on Climate-related Financial Disclosures (TCFD) across the UK economy over the next five years, with most of the measures to be introduced by 2023. Premium listed companies are required to report on compliance with the TCFD recommendations for periods commencing on or after 1 January 2021 and proposals are underway to extend TCFD-aligned reporting to other listed entities, large companies and LLPs.

The UK government has also expressed its support for a set of global sustainability standards and endorses the work of the IFRS Foundation in establishing an International Sustainability Standards Board. In its [statement of support](#), the UK government and regulators said: "Alongside pursuing an ambitious domestic programme, the UK intends to play its part in actively supporting the development of global disclosure standards. We will look to take forward domestic proposals in a manner which will inform, and be consistent with, international standards as they develop and are in time agreed."

The requirements

Under the proposed CSRD, companies will need to report the information and indicators necessary to understand the company's impacts on sustainability matters and to understand how sustainability matters affect the company's development, performance and position, such as:

- A description of the business model and strategy, including business model resilience and opportunities in relation to sustainability matters, the plans of the company to ensure that its business 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, strategy implementation, stakeholders' interests and impact on sustainability matters
- A description of sustainability targets and the progress made towards achieving them
- The role of the administrative, management and supervisory bodies in relation to sustainability matters
- The company's policies in relation to sustainability matters, including due diligence
- The company's most significant adverse impacts connected with the company's value chain, including its own operations, its products and services, its business relationships and its supply chain
- A description of the company's principal risks related to sustainability matters, including their principal dependencies on such matters, and how they manage those risks
- The manner in which the company has identified the information on which it reports.

Companies will need to provide:

- qualitative and quantitative information
- both forward-looking and retrospective information, and
- information that covers short, medium and long-term time horizons.

Where appropriate, reported content should also include information about the company's value chain, including the company's own operations, products and services, business relationships and supply chain.

The required information must be reported in accordance with EU sustainability reporting standards (see below) and needs to be published within 12 months of the balance sheet date. It must be accompanied by a statement by those responsible for the annual financial report that the management report has been prepared in accordance with EU sustainability reporting standards, and sustainability reporting must be tagged appropriately.

Materiality

Under existing directives, it is not only required to report on information to the extent necessary for an understanding of how sustainability matters affect the company's development, performance and position (the 'outside-in' perspective), but also on information necessary for an understanding of the impact of the company's activities on people and the environment (the 'inside-out' perspective). That is referred to as the "double materiality" perspective, in which the risks and opportunities to the company and the impacts of the company each represent one materiality perspective. The EC has specified in the proposal that companies should consider each materiality perspective in its own right and should disclose information that is material from both perspectives as well as information that is material from only one perspective.

Location of disclosures

Sustainability information will be required to be disclosed in the management report. The proposal thereby removes the existing possibility for Member States to allow companies to report the required information in a separate report that is not part of the management report. This provision is intended to support connectivity and accessibility of information, as well as bringing the responsibility of management and the board of directors for the preparation of the sustainability reporting to the same level as for the management report and financial reporting. It is also intended to help clarify the role of national competent authorities when it comes to supervision of sustainability reporting (as part of the management report).

Exemptions

The proposal includes an exemption for subsidiaries to publish sustainability reporting in their management report, if the sustainability reporting in the parent's consolidated management report complies with EU sustainability reporting standards (or, for subsidiaries with a non-EU parent, standards deemed to be equivalent by the EC), includes information related to the subsidiary, and is available when the subsidiary publishes its management report.

Sustainability reporting standards

The proposal will bring in mandatory sustainability reporting standards for EU companies that will be commensurate with the level of ambition of the European Green Deal and the EU's climate-neutrality objective for 2050. Under the proposal, the EC will be empowered to adopt EU sustainability reporting standards by means of delegated acts.

Those standards will be developed and proposed by the European Financial Reporting Advisory Group (EFRAG). Before adoption, the EC will have to consult with various EU institutions, including the European Securities Market Authority (ESMA) and other European Supervisory Authorities, the Member State Expert Group on Sustainable Finance, the Platform on Sustainable Finance, the EU Council and the EU Parliament.

European standards are set to cover:

- Environmental matters (i.e. climate change mitigation, climate change adaptation, water and marine resources, resource use and circular economy, pollution, and biodiversity and ecosystems in line with the Taxonomy regulation environmental objectives)
- Social matters (i.e. (i) equal opportunities for all, including gender equality and equal pay for equal work, training and skills development, and employment and inclusion of people with disabilities; (ii) working conditions, including secure and adaptable employment, wages, social dialogue, collective bargaining and the involvement of workers, work-life balance, and a healthy, safe and well-adapted work environment; (iii) respect for human rights, fundamental freedoms, democratic principles and standards established in the International Bill of Human Rights and other core UN human rights, the International Labour Organization's (ILO's) Declaration on Fundamental Principles and Rights at Work, the ILO fundamental conventions and the Charter of Fundamental Rights of the EU)
- Governance matters (i.e. role of the company's administrative, management and supervisory bodies (including with regard to sustainability factors and their composition), business ethics and corporate culture (including anti-corruption and anti-bribery), political engagements (including its lobbying activities), relationships with business partners including payment practices, internal control and risk management systems (including in relation to the reporting process))

The standards will have to be developed taking into account the requirements of other EU legislation and policies such as the Sustainable Finance Disclosure Regulation (SFDR, which sets disclosure requirements that apply to financial market participants and financial advisors when selling sustainable financial products) and the Taxonomy regulation (which sets a common classification of economic activities significantly contributing to environmental objectives, using science-based criteria, as well as specific disclosure requirements), the Benchmarks regulation applicable to benchmarks administrators, the capital requirements for financial institutions, and other requirements or recommendations—for instance relating to greenhouse gas emissions, or for the measurement of life cycle environmental performance of products and organisations.

Recent recommendations published by a Project Task Force of EFRAG contain proposals to develop a coherent and comprehensive set of reporting standards, covering all sustainability matters from a double-materiality perspective. Those recommendations also contain a detailed roadmap for developing such standards aligned with the timeline proposed under the CSRD, and proposals for mutually reinforcing cooperation between global standard-setting initiatives and standard-setting initiatives of the EU.

It is expected under the proposal that the first set of standards will be adopted by 31 October 2022. This will cover all reporting areas required under the proposed CSRD and at least meet the needs of financial market participants who are subject to the disclosure requirements of the Sustainable Finance Disclosure Regulation (SFDR).

The second set of standards is expected to be adopted by 31 October 2023, to cover further information, including sector-specific disclosures.

The standards will be reviewed at least every three years to take account of relevant developments, including developments in international standards, as the EC states that it is desirable for EU standards to maintain convergence.

In addition to European standards being developed for large companies, proportionate standards will be developed for SMEs, tailored to the capacities and resources of these companies. These are expected to be adopted by 31 October 2023.

SMEs listed on regulated markets will have the option to comply with the proportionate standards or the standards applicable to the large companies. Non-listed SMEs—which make up the vast majority of such companies—may choose to use the proportionate standards on a voluntary basis. This would enable any SME to report information cost-efficiently in response to the numerous requests for information they receive from other companies with whom they do business, such as banks, insurance companies, asset managers and large corporate clients.

Digitisation of information

The proposal requires companies to digitally tag reported sustainability information in accordance with a digital taxonomy. Companies will therefore be required to prepare their financial statements and their management report in XHTML format and to mark up the sustainability reporting.

Independent assurance

Under the proposal, the CSRD will require all companies within its scope to seek limited assurance of sustainability reporting, including digital tagging and the indicators to be reported in the management report under Article 8 of the Taxonomy Regulation (i.e. “green” turnover, capex and opex for corporates), as well as on the process carried out by the company to identify the information to be reported. This is to help ensure that reported information is accurate and reliable. The EC will consider at a later stage whether to move towards a reasonable assurance requirement.

European and global sustainability reporting standards

The EC states that to minimise disruption for the EU and European companies that already report sustainability information, the EU standards should take account of existing standards and frameworks for sustainability reporting and accounting where they exist. These include those of the Global Reporting Initiative (GRI), the Sustainability Accounting Standards Board (SASB), the International Integrated Reporting Council (IIRC), the TCFD, the Climate Disclosure Standards Board (CDSB), and CDP (formerly the Carbon Disclosure Project), and any sustainability reporting standards developed under the auspices of the International Financial Reporting Standards (IFRS) Foundation.

Also, the EC states that, to avoid unnecessary regulatory fragmentation that may have negative consequences for companies operating globally, the European standards should contribute to the process of convergence of sustainability reporting standards at global level.

This is further elaborated in [Questions and Answers](#) released by the EC. EU sustainability reporting standards need to be consistent with the ambition of the European Green Deal and with Europe’s existing legal framework, the Sustainable Finance Disclosure Regulation and the Taxonomy Regulation ... At the same time, it is clearly in the interests of the EU and European companies and investors to have standards that are globally aligned. EU standards should aim to incorporate the essential elements of globally accepted standards currently being developed. EU standards should go further where necessary to meet the EU’s own ambitions and be consistent with the EU’s legal framework.’

Member States will have the option to allow an independent assurance services provider that is not the statutory auditor to provide assurance on companies' sustainability reporting, as long as they are subject to requirements that are consistent with those applicable to auditors when providing assurance on sustainability reporting. Their opinion will need to be published with the annual financial statements and the management report. Where it is the statutory auditor that provides the assurance on sustainability reporting, the opinion will have to be included in the audit report.

Statutory auditors or audit firms already verify the financial statements and the management report. The assurance of sustainability reporting by the statutory auditors or audit firms would help to ensure the connectivity between, and consistency of, financial and sustainability information, which is particularly important to users of sustainability information.

It is proposed to amend the Audit Directive to make provisions for ensuring that statutory auditors have the necessary involvement, skills and knowledge to perform assurance over sustainability reporting. Member States will have to require statutory auditors and audit firms to carry out the assurance of sustainability reporting in compliance with assurance standards which are intended to be adopted by the EC via delegated acts. In the absence of assurance standards adopted by the EC, auditors shall apply national assurance standards, procedures or requirements.

The Audit Directive will also be amended to enhance the role and responsibilities of audit committees in monitoring the sustainability reporting process, including digital, the effectiveness of internal quality control and risk management systems, sustainability reporting assurance and maintaining the independence of auditors.

Further information

If you have any questions about the contents of this newsletter please speak to your usual Deloitte contact or get in touch with Veronica Poole (vepoole@deloitte.co.uk).



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