EU requires enhanced corporate sustainability disclosures

By Fiona Webster and Stephanie Rosseau
11 January 2023

Companies will be required to provide qualitative and quantitative sustainability disclosures as part of mandatory common reporting measures under the European Union's (EU) corporate sustainability reporting directive (CSRD) agreed to in November 2022, which amends the EU's current nonfinancial reporting directive (NFRD). The directive was enacted on 5 January 2023, and member states will have until 6 July 2024 to transpose the directive into national laws. The first set of standards that companies must use will be published before 30 June 2023, and the largest companies will have to submit their first report in 2025 for the financial year starting on or after 1 January 2024. Reporting by other companies, including non-EU organizations with substantial EU turnover, will be phased-in. Approximately 50,000 companies are in the scope of the CSRD, compared with about 11,700 companies under the NFRD.

Organizations impacted/reporting timeframe

- Public interest entities that are large undertakings or parent undertakings of a large group with an average of 500 employees during the financial year — and which must already report on sustainability under the NFRD — will have to prepare a report in 2025 for financial years starting on or after 1 January 2024.

- Large undertakings or parent undertakings of a large group will be required to report in 2026 for financial years starting on or after 1 January 2025, if they exceed two or more of three thresholds: (1) balance sheet total of €20 million; (2) net turnover of €40 million; and (3) average of 250 employees during the financial year.

- Listed companies (including small- and medium-sized companies, and certain small and non-complex credit institutions and captive insurance and reinsurance undertakings) must report in 2027 for financial years starting on or after 1 January 2026. A two-year transition period (for financial years starting before 1 January 2028) will allow small and medium-sized enterprises (SMEs) to opt out of sustainability reporting, subject to explaining why they have not provided sustainability information in their management report. Micro-undertakings are excluded from the directive if they do not exceed two of the following three thresholds: (1) Average of 10 employees during the financial year; (2) net turnover of €700,000; and (3) total assets of €350,000.

- Consolidated groups of non-EU companies will have to provide a sustainability report — and must disclose most of the same information as EU-based companies — if their annual EU turnover exceeds €150 million for each of the previous two financial years, and if at least one subsidiary is a large undertaking or an EU subsidiary with net turnover exceeding €40 million in the previous financial year. Sustainability reports are due in 2029 for financial years starting on or after 1 January 2028.
- An in-scope subsidiary that is included in a consolidated sustainability report issued by its parent organization does not have to issue a sustainability report.
- Companies that are unable to provide certain information on their value chain will have a partial exemption for the first three years after CSRD takes effect if certain information about an undertaking's value chain is unavailable. This exemption is subject to the company explaining the efforts made to obtain the information, and why it was unavailable or could not be reported.

Sustainability framework

Management sustainability reports should cover all material information on environmental, social and human rights, and governance matters to enable diverse stakeholders' understanding of how the organization impacts sustainability, and how sustainability impacts its development and performance. The information must be forward-looking, retrospective, qualitative and quantitative. Highlights of what should be included are as follows:

- A description of the organization's main sustainability risks; the steps taken to prevent, mitigate, remediate or end adverse impacts; and the results of those actions; and the actual or potential adverse impacts of the organization and its value chain (this is not limited to direct contractual relationships, and includes relationships inside and outside the EU).
- The report must distinguish between sustainability risks faced by the group, and those of its subsidiaries.
- A description of the organization's business and strategy as it relates to sustainability matters in the short-, medium-, and long-term, including its plans to transition to a sustainable economy, and the dates for achieving sustainability targets; the governance of sustainability matters, including the organization's sustainability policy; and due diligence processes.
- Member states must ensure that elements of an organization's sustainability reporting are verified by an accredited independent third party whose report should be made available either as an annex to the management report or by any other publicly accessible means.

European sustainability reporting standards

- The European Financial Reporting Advisory Group (EFRAG) is acting as a technical adviser to the European Commission and is responsible for developing the sustainability disclosure standards for companies. The first set of standards will be published by 30 June 2023, following a consultation period that began in November 2022. A second set of standards will be published for SMEs by 30 June 2024, to reflect their scale and complexity.
- By 30 June 2024, the European Commission will issue standards for non-EU undertakings.
- By 30 June 2024, the European Commission could adopt delegated acts that would allow for the development of sector-specific reporting standards, and other supplementary information.

Environmental, social and human rights, and governance

- Environmental information must include climate change, water and marine resources, pollution, biodiversity and ecosystems, resource use, the circular economy and transition plans to meet the Paris Agreement's targets.
- Social and human rights include working conditions (including secure employment, working time, adequate wages, social dialogue, freedom of association, works councils, information, consultation and participation rights, collective bargaining, work-life balance, and workplace health and safety); equal treatment and opportunities (including gender equality, equal pay, training and skills, employment of persons with a disability, measures to combat workplace violence and harassment); and respect for human rights (including forced and child labor), fundamental freedoms, democratic principles and standards.
- Governance matters include the organization's administrative, management and supervisory structures with regard to sustainability; the expertise and skills needed to fulfill that role, or access to the necessary skills; incentive policies offered to members of these structures that are linked to sustainability matters; information on internal controls and risk management systems in relation to the sustainability reporting process; information on corporate culture and ethics, the organization's activities that aim to exert political influence (including lobbying); and the organization's relationships with customers, suppliers and impacted local communities.

Related resources

- Explanation of delegated acts (Europa)
- Directive 2022/2464 (EUR-Lex, 16 December 2022)
- Press release (Council of Ministers, 28 November 2022)
- Press release (EFRAG, 23 November 2022)

- Directive 2014/95 (EUR-Lex, 15 November 2014)

Note: Mercer is not engaged in the practice of law, accounting or medicine. Any commentary in this article does not constitute and is not a substitute for legal, tax or medical advice. Readers of this article should consult a legal, tax or medical expert for advice on those matters.