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Sustainability Reporting for Corporates

A guide to upcoming developments

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Sustainability reporting looks set to feature prominently on the agenda for most large companies in 2022 and beyond. The anticipated extension of the 'balance sheet oath' to sustainability reporting means that, for the first time, company directors will be required to show to the outside world – explicitly and in writing – that they bear responsibility for sustainability reporting. With an understanding of the changes coming down the tracks, and some early planning, companies can ensure a smoother transition to the mainstreaming of sustainability in company reporting.

Background

In April 2021, the European Commission (Commission) adopted a proposal for a Corporate Sustainability Reporting Directive ("**CSRD**") which would oblige companies in scope to report against common EU sustainability reporting standards. If introduced, a large number of companies across the EU will be brought within the sustainability reporting regime for the very first time and this will become part of their global sustainability agenda.

The Commission has set itself ambitious legislative targets to underpin the European Green Deal. In recent years, measures such as the Sustainable Finance Disclosure Regulation and the EU Taxonomy Regulation were introduced with the aim of reorienting capital flows in the financial services sector towards a more sustainable economy. The Commission has now set its sights on enhanced sustainability reporting for corporates.

Non-financial Reporting Directive

Some 11,000 EU companies were already covered by the CSRD's predecessor, the Non-financial Reporting Directive 2014 ("**NFRD**") which was transposed into Irish law in 2017 (read Matheson's NFRD briefing here). The NFRD obliges limited categories of company to disclose information on the way they engage with social and environmental challenges. Its aim is to enable investors, consumers and other stakeholders evaluate the non-financial performance of those companies, leading to improved sustainability outcomes.

Currently, reporting requirements under the NFRD apply to large "public interest entities" (meaning listed companies, banks, and insurance companies) with more than 500 employees.

From non-financial to sustainability reporting

The CSRD proposal comes in the wake of calls for greater consistency and transparency in corporate sustainability reporting and aims to address perceived gaps in the operation of the NFRD. The CSRD proposes to amend NFRD in order to:

- increase the number of companies subject to mandatory sustainability reporting; and
- harmonise sustainability reporting standards to ensure companies provide reliable, comparable and relevant information on sustainability risks, opportunities and impacts.

The change in terminology from "non-financial" in the NFRD to "sustainability" in the CSRD signals the policy shift in recognising sustainability as core to financial outcomes.

More companies in scope

The CSRD will apply to all large companies governed by the law of, or established in, an EU member state and EU stock exchange-listed companies (except listed micro-companies). Approximately 49,000 companies will now be in scope.

A large company is one meeting two out three of the following criteria:

- at least 250 employees;
- annual turnover exceeds €40m;
- assets in excess of €20m.

Listed SMEs will become subject to sustainability reporting obligations but will have an extra three years to comply.

Exemptions will apply to subsidiaries if the parent company's consolidated management report complies with EU reporting standards (or recognised equivalent third country reporting standards). Exempted subsidiaries must publish the consolidated management report of the parent company and refer to the reporting exemption being availed of.

Enhanced reporting

The introduction of the CSRD will see a significant deepening and expansion of existing disclosure requirements to those in place under the NFRD. Companies must not only disclose how sustainability issues impact the company (impacts inward), but also how the company impacts society and the environment (impacts outward) - the "Double Materiality" concept.

Companies will be obliged to report on issues such as the:

- plans to ensure that business models and strategies are compatible with transition to a sustainable economy and with aim of limiting of global warming to 1.5 °C under the Paris Climate Agreement;
- sustainability targets and progress made to achieve those targets;
- roles and responsibilities of management;

- adverse impacts connected with the company's value chain; and
- principal risks related to sustainability matters.

Reported information must be:

- qualitative and quantitative in nature;
- both forward looking and retrospective; and
- covers short, medium and long-term time horizons.

Reporting will be in line with the Sustainable Finance Disclosure Regulation and the EU Taxonomy Regulation. The Commission recognises 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.

Companies will be required to digitally tag sustainability information for onward transmission into the European single access point database.

Mandatory assurance

A key development under the CSRD is the introduction of a general EU-wide audit (assurance) requirement for reported sustainability information. Limited in scope at first; over time, the assurance obligation is intended to become more demanding, eventually mirroring the level applicable to financial reporting.

The proposal allows individual member states to open up the market for sustainability assurance services to 'independent assurance services providers'.

Timelines

The Commission plans to adopt the CSRD in late 2022. Companies are likely to start reporting to the new standards in 2024, based on FY2023 information as it would to come into effect for reporting periods starting on or after 1 January 2023. SMEs will have an extra three years to comply.

The European Financial Reporting Advisory Group ("**EFRAG**") has been tasked by the Commission to devise common EU sustainability reporting standards. Expect to see these in mid-2022. A first set of reporting standards should be adopted by the Commission in October 2022 and a second set by October 2023 with complementary and sector-specific information.

Next steps

Sustainability should feature high on the board agenda for large companies. The task involved for companies to deliver on this obligation should not be underestimated and warrants early and careful attention accordingly.

How Matheson can help

Sustainability reporting is a fast-evolving area and Matheson continues to monitor developments closely. If you would like more information on this or other ESG matters, please get in touch with the partners below or with your usual Matheson contact.

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