CSRD: a major shift towards a climate neutral EU

by Hilde Blomme

On 21 June 2022, EU policymakers reached an agreement on the Corporate Sustainability Reporting Directive (CSRD). This law will introduce more detailed reporting requirements than the existing Non-Financial Reporting Directive (NFRD). 50,000 companies will now have to comply with the new rules, compared to 12,000 in the NFRD.

Companies will have to disclose sustainability information in their management reports according to mandatory sustainability reporting standards and present it in a digital, machine-readable format. The CSRD will also require limited assurance on sustainability reporting. These are key changes that the CSRD brings in and that we will explore below.

The CSRD brings sustainability reporting to the same level as financial reporting for the first time ever. This is fundamental to support the EU Green Deal's ambitions and transform Europe into the first climate neutral economy by 2050. Accountancy Europe welcomed the final text agreed by the co-legislators.

The accountancy profession will need to be ready for this crucial shift and make sure we can support the CRSD's reporting and assurance aspects.

Sustainability reporting

More companies to report under new rules

The co-legislators agreed to expand the NFRD's scope from large public interest entities (PIEs) with 500+ employees to all large and all listed companies (including listed SMEs) with 250+ employees as per the Accounting Directive 2013/34/EU. Non-EU companies also have to comply if they have branches or subsidiaries in the EU above certain thresholds.

Listed SMEs will be subject to proportionate requirements to help reduce the reporting burden while still addressing financial institutions and companies' demand for reliable sustainability-related data. The CSRD text also includes SME 'safeguards' to ensure SMEs' larger counterparts do not place unreasonable requests for data.

Phased-in Application

The CSRD will come into force on the 20th day after it has been published in the EU Official Journal. After that, Member States will have 18 months to transpose the text into national law. The application of the CSRD will take place in three phases:

1. companies subject to the NFRD report in 2025 on 2024 data
2. other large companies that are not presently subject to NFRD report in 2026 on 2025 data
3. listed SMEs, small and non-complex credit institutions, and captive insurance undertakings report in 2027 on 2026 data

Listed SMEs can opt-out of reporting requirements for a transitional period of two years if they provide a statement explaining why their management report does not capture sustainability information.

Non-EU companies that generate a net turnover of 150 million in the EU with a branch generating net turnover of 40 million in the EU, or a large or listed subsidiary, will have to comply with the CSRD rules as from 1 January 2028.

The CSRD exempts subsidiaries from sustainability reporting obligations if their parent company discloses sustainability information in the management report at consolidated or group level. As the CSRD states, a parent company, however, "must provide an adequate understanding of the risks and impacts if it identifies significant differences between the risks or impacts of the group and an individual subsidiary". The exemption does not apply to listed subsidiaries.

Accountancy Europe supports expanding the scope as this includes companies that significantly impact the environment and society. And while it is certainly urgent to implement the CSRD, a phased-in approach will allow companies new to sustainability reporting to set up systems and processes needed for quality reporting.

Mandating Sustainability reporting standards

The CSRD requires companies to disclose sustainability information based on mandatory sustainability reporting standards, rather than the patchwork of voluntary standards that companies have used under the NRFD. Such mandatory standards are currently being developed by the European Financial Reporting Advisory Group (EFRAG). The European Commission (EC) envisions "these will be tailored to EU policies, while building on and contributing to international standardisation initiatives". EFRAG has issued 13 proposed European Sustainability Reporting Standards (ESRS) with a consultation deadline on 8 August.

Accountancy Europe has provided its feedback on the proposed ESRS by EFRAG. In our response, we encourage the EU to seize the current window of opportunity created by the CSRD to work with the International Sustainability Standards Board (ISSB) towards an accepted global baseline on sustainability reporting standards. A globally aligned reporting system will facilitate comparability and analysis, improve transparency, and minimise the reporting burden. European standards' quality, credibility and effectiveness will heavily depend on properly supervised due process followed by EFRAG. This can be compromised by the impossible deadlines EFRAG faces in this standard setting process. The pressures on the organisation might be taking precedence over substance, quality and realism (see Accountancy Europe's letter to Commissioner McGuinness on EFRAG's draft ESRS (July 2022).

We also comment on the phase-in of disclosure requirements. The CSRD stipulates a phase-in of three years for company's disclosures on its value chain. EFRAG should consider and adopt a smart phasing-in approach starting with the most important standards for largest companies in all sectors to transition their business model and disclose company data. Gradually, disclosure requirements within each individual standard can be added and then sector-specific standards for relevant sectors. Only after that, value chain disclosures should be required.

Finally, we raise concerns over the detail level of the draft EFRAG standards, for instance, by transforming many optional disclosures in the Global Reporting Initiative (GRI) standards to requirements. Such granular requirements may impair effective reporting, obscure relevant information, and lead to a compliance exercise which does not serve verifiability.

The EC, after considering EFRAG's technical advice, shall adopt the first set of ESRS via delegated acts by 30 June 2023. The CSRD also sets a timeline for the second set – sector specific and SMEs proportionate sustainability reporting standards – to be adopted by 30 June 2024. The EC shall adopt sustainability reporting standards for non-EU companies via delegated acts by 30 June 2024.

Sustainability information Assurance

EU wide limited assurance requirement

The CSRD will introduce an unprecedented EU-wide requirement for limited assurance on sustainability information, with moving to reasonable assurance as an end goal. Moving to reasonable assurance will provide markets with the same level of comfort as assurance on financial information. It will also demonstrate that sustainability information is as crucial for business viability and stakeholder decision making as financial information (see Accountancy Europe's position paper Setting up for high-quality non-financial information assurance in Europe (June 2020).

The CSRD requires the statutory auditor to express an opinion on sustainability reporting. Member States, however, may allow for another statutory auditor, or an independent assurance service provider (IASP), to conduct an assurance engagement. The IASP has to follow equivalent requirements to the ones stated in the Audit Directive 2006/43/EC to provide assurance services over sustainability information to ensure a level playing field.

Accountancy Europe supports opening the market to assurance providers applying equivalent requirements in line with the Audit Directive, i.e., based on professional assurance standards, ethical requirements including independence, quality framework and public oversight. It is important that stakeholders can rely on consistent quality of assurance, regardless of who provides it.

Furthermore, the CSRD introduces a 'passporting regime' for an IASP to be able to provide their services across borders if a Member State opted to allow an IASP to provide assurance services on its territory. Also, shareholders with more than 5% voting rights or 5% capital of a company have the right to ask to involve an accredited third party to "prepare a report on some elements of the sustainability reporting". This accredited third party cannot belong to the same audit firm or network as the auditor carrying out the statutory audit.

When it comes to information subject to assurance, the CSRD requires limited assurance over the following items:

- compliance with the CSRD reporting rules in Article 19a, including reporting standards adopted according to Article 29b or Article 29c
- process carried out by the undertaking to identify the information reported according to those reporting standards
- compliance with the requirement to mark-up sustainability reporting in accordance with Article 29d (digitalisation)
- compliance with the reporting requirements of Regulation (EU) 2020/852 Article 8 (Taxonomy Regulation)

Our discussion paper Sustainability Assurance under the CSRD (May 2022) provides insights from practice on this new assurance requirement to reach a common understanding on its practical implications.

Educational requirements for statutory auditors

The CSRD sets educational requirements in addition to the ones in the Audit Directive for statutory auditors to be allowed to provide assurance on sustainability information.

The statutory auditor needs to gain the necessary theoretical knowledge on sustainability information assurance and the ability to apply that knowledge in practice and pass the required examination.

The statutory auditor should complete at least eight months of practical experience in the assurance of annual and consolidated sustainability reporting or other sustainability related services.

Assurance standards

The CSRD mandates the EC to adopt limited assurance standards before 1 October 2026, and reasonable assurance standards by 1 October 2028. Before adopting reasonable assurance standards, it should be assessed whether reasonable assurance is feasible for both auditors and companies. When adopting reasonable assurance standards, it should be also specified when an opinion on sustainability reporting should be based on a reasonable assurance engagement. The CSRD requires any assurance service provider to conduct assurance engagements according to the assurance standards that the EC will adopt.

The International Auditing and Assurance Standards Board's (IAASB) issued the International Standard on Assurance Engagements (ISAE) 3000 (Revised) Assurance Engagements Other than Audits or Reviews of Historical Financial Information and the Extended External Reporting (EER) Guidance. Accountancy Europe proposes to consider these as key tools to timely respond to the CSRD's assurance requirement. These feature the necessary methodological steps to respond to the assurance demand, either limited or reasonable.

See all Accountancy Europe's work on sustainability assurance. Sign up for our monthly newsletters on audit and sustainability at https://www.accountancyeurope.eu/tag/non-financial-assurance/

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