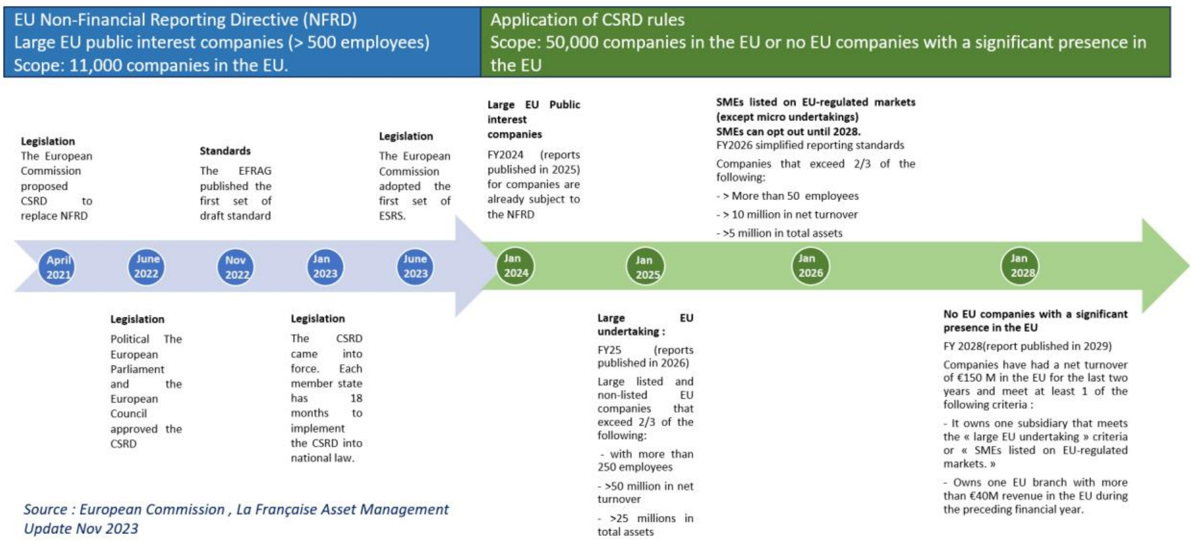
## CSRD, the beginning of a new era in sustainability reporting

*by Yingwei LIN, ESG Analyst, La Française AM*

Business activities can contribute to sustainable economic growth while inflicting harm on the very resources their long-term prosperity depends on. Increasingly, jurisdictions are promoting and enforcing standardized reporting rules to ensure that companies consider the positive and negative externalities occasioned by their business activities. However, when it comes to reporting, not all companies are equal. Few companies monitor and disclose associated risks and opportunities, and even fewer properly assess related externalities.

Under the European Green Deal, approved in 2020, the EU aims to direct capital flows to sustainable businesses and unlock investments needed to achieve its 2050 climate-neutral target[1]. Aware that the Non-Financial Reporting Directive did not provide comparable and strategic ESG information, the European Commission (EC) proposed **Corporate Sustainable Reporting Directive (CSRD)** in April 2021. The objective of CSRD is to improve the standards and comparability of ESG disclosures by extending both the scope and amount of information required. It also adopts a more prescriptive approach by specifying what information a company should publish and how it should be reported. All companies subject to CSRD must report their sustainability information using the **European Sustainability Reporting Standards (ESRS)**, developed by European Financial Reporting Advisory Group (EFRAG). More than 50k companies are expected to report under the ESRS between 2024 and 2028, including non-EU companies with a significant presence in the EU.

**Figure 1 : CSRD implementation Timeline**




*Source : European Commission , La Française Asset Management*
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## ESRS characteristics:

The final version of ESRS is *materiality-centered*, giving companies flexibility in defining the topics that are relevant to their activities. CSRD is the first regulation to require *double materiality* assessments from firms. As per the double materiality principle, companies are expected to report, across their entire value chain, on how sustainability issues affect their business activities AND on how their business activities affect the environment and those around them. *Limited assurance* is required on the reported sustainability information. However, the European Commission is considering extending this to *reasonable assurance* in the future to ensure more reliable information.

[1] European Parliament, Briefing implementation appraisal NFRD, January 2021-Link

## Rules under pressure in EU and beyond

Further delays in finalizing the CSRD are expected due to lobbying and political interference. In 2022, four associations, including the American Chamber of Commerce to the EU, wrote an open letter calling for greater alignment between the ESRS and **IFRS Sustainability Disclosure Standards (IFRS SDS)**, and to give non-EU companies an option to use other national/international standards under the CSRD[2]. The IFRS SDS are developed by the International Sustainability Standards Board (ISSB) and are also known as **ISSB standards**.

According to the EC, EFRAG and ISSB worked jointly to enhance the compatibility of their sustainability reporting standards. However, there are still significant differences between the two. The main one being that of materiality - ISSB standards are made for investors and focus mainly on financial materiality, whereas the ESRS addresses all prominent stakeholders and focusses on wider topics, such as society, workforce and environment. The ISSB's chair has been vocal about the board's intention to not adopt the double materiality principle[3]. This structural divide makes the CSRD's broader implementation even more challenging. Even though ISSB Standards represent less reporting burden for firms and have inspired commitment from c.60 jurisdictions, we believe *double materiality* is more meaningful to companies and investors when addressing sustainability topics. In November 2023, the EC announced a 2-year delay (until 2026) in the adoption of requirements for non-EU companies. For companies that opt to report under ISSB standards now, there will be reluctance to switch to ESRS in future.

There is also a threat of political interference blocking the implementation of CSRD. In October 2023, 42% of European Parliament members voted in favor of a resolution to block the adoption of ESRS[4] and called for limitations on it; claiming that it puts too much burden and complexity on EU firms[5] and could affect their competitiveness. The European Parliament election is scheduled for 2024, and its outcome will affect the EU's sustainability reporting ecosystem. The results of the ongoing SFDR consultation could also substantially change the CSRD rules as both regulations are part of the EU Green Deal.

## Everchanging standards, companies need more visibility

There is a lot of uncertainty for companies as the rules are still a ***work in progress***. In October 2023, the EC increased the size threshold for larger undertakings and small and medium-sized companies (SMEs) subject to CSRD by 25%[6]. European officials stated that the measure had been taken to ensure the competitiveness of EU companies[7]. Potentially more modifications are yet to come. Furthermore, there is a staggered implementation timeline for the CSRD. As shown in Figure 1, the implementation is progressive depending on the company's size. Companies already subject to the NFRD must report across their entire value chain starting 2024. However, smaller companies or non-EU companies with a significant presence in the EU will have more time to adopt the ESRS.

Initially, SMEs were expected to report under a simplified reporting standard as of 2026, but as of the end of 2022, they can opt out of mandatory reporting for two years. This is to give SMEs sufficient time and resources

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[2] Position paper - Joint association letter on CSRD, 21 April 2022 - Link

[3] Le Monde, Corporate accounting: "It's simplistic to expect materiality to extend beyond the economic sphere", 10 October 2023 - Link

[4] European parliament, Motion for a resolution, 11 October 2023 - Link

[5] European Parliament defeats attempt to scrap European Sustainability Reporting Standards, WWF, 18 October 2023-Link

[6] European Commission, Adjusting SME size criteria for inflation - Link

[7] European Commission, Long-term competitiveness of the EU: looking beyond 2030 - Link

to adopt good practices and spread the initial implementation cost over several years. However, voluntary measures could be inefficient in promoting sustainability reporting[8]. Companies may prefer to postpone reporting to gain additional visibility on implementation conditions, especially in the context of ever-changing requirements. On top of it, SMEs account for 99% of Europe's businesses[9] and form the value chain of many larger firms, which are dependent on them for their own disclosures. This creates a problem - a company cannot disclose and give third-party assured information on its value chain unless its suppliers report using the same standards.

In the revised set of standards, EFRAG has also substantially diminished the mandatory reporting burden for companies - the list of mandatory disclosures has been reduced from 134 to 84[10] (-40%), and mandatory data points have been cut to half. Many compulsory data points have been made voluntary. The changes were based on feedback from a variety of stakeholders and aim to create a more pragmatic and realistic standard. But, in our view, this will limit the comparability of reported information across companies as some firms will likely overlook material topics.

### Conclusion

The roll-out of CSRD has generated several debates and been subject to changes and delays in its implementation. We believe it is essential for EU regulators and member states to provide certainty to reporting companies, both in terms of rules and timeline. Regulators could also use alternative means to promote a robust ecosystem for corporate sustainability reporting before the mandatory implementation kicks in, for eg., providing subsidies for and investing in AI-enabled reporting technologies and promoting a more robust sustainability leadership structure on corporate boards. These could lay the ground for wider acceptance of CSRD when it is put in effect.



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[8] European Comission presse, Disclosure of non-financial and diversity information by large companies and groups - Frequently asked questions, 15 April 2014 - Link

[9] European Commission, Championing Europe's SMEs: Commission provides new relief to boost the competitiveness and resilience of SMEs, 12 September 2023-Link

[10] EFRAG, Draft European Reporting Standards, Due Process Note, 23 November 2022 – Link