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EU Corporate Sustainability Reporting Directive (CSRD): 5 Key Considerations for U.S. Companies

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Overview

In January 2023, the EU's new Corporate Sustainability Reporting Directive (CSRD)[1] entered into force. From January 2024, CSRD will introduce unprecedented new rules on corporate sustainability reporting that significantly increase the breadth and depth of information with regard to environmental and social matters that in-scope companies[2] must disclose as part of their annual financial and management reporting, and which will be subject to a mandatory audit and assurance standard. Non-compliance with CSRD may result in public censure, conduct orders, or administrative or criminal penalties, to be established by each of the member states.

The volume and granularity of sustainability information that must be reported under CSRD goes significantly beyond any current mandatory sustainability reporting regime globally. Notably, it will require reporting from a so-called "double materiality" perspective: companies will be required to report the sustainability-related risks and opportunities that could reasonably be expected to affect the company's cash flows, access to financing, or cost of capital over the short, medium, or long-term and the material impacts of their operations and value chains on the environment and people (which may not yet be financially material but relate to longer-term enterprise value). This will include information relating to: the company's business model and strategy, governance of and policies relating to sustainability matters, climate-related and other sustainability targets and transition plans, due diligence processes implemented in respect of environmental and social risks and impacts, and other key sustainability-related data points.

In July 2023, the European Commission adopted detailed European Sustainability Reporting Standards (ESRS) that are expected to become law by the end of 2023, following a minimum

1 Directive (EU) 2022/2464 – Link to the EU Official Journal

2 The CSRD will apply to a range of different types of undertakings, including partnerships, but for the purposes of this update, we refer to "companies."

two-month (but potentially four-month) review period by the European Parliament and the European Council. The finalization of the first set of ESRS represents a significant milestone in the development of the CSRD regime and companies now have clarity as to the first wave of the extensive and onerous requirements against which they will be required to report.[3]

U.S. companies with operations in the EU are likely to be in scope of the new requirements at some point, either at a group level (via an admission of securities to trading on a regulated market) or through their EU subsidiaries (including EU holding companies). Depending on a company's structure, CSRD may apply to the entire group simultaneously or different parts of the group from different dates. In addition, if a key part of any company's value chain is located in the EU, it is likely that the company will receive sustainability-related information requests from its EU-based value chain partners, which are themselves subject to CSRD.

U.S. companies should make a thorough internal review and potentially obtain external advice to determine whether CSRD's requirements apply to them and, if so, when and how best to comply given the facts of their business, resource and corporate objectives and priorities. Below, we discuss five early takeaways for U.S. companies as they consider application of this new disclosure regime.

Key Takeaways

1. Depending on its particular group structure, a U.S. company may have CSRD reporting exposure at multiple levels within its organization, and at different dates.

CSRD will apply progressively to companies from 2024-2028 based on specified criteria. For the majority of covered companies, reporting requirements will apply for financial years starting on or after January 1, 2025 (with reporting required from 2026).

For a detailed overview of the categories of covered entities, criteria and implementation dates based on amendments made to the annual reporting regimes under the EU Accounting Directive and the EU Transparency Directive, *see* the Table in Annex I. Below are some of the likeliest scenarios that will apply for U.S. companies:

Scenario	**Reporting obligation**	**Timing of first report**
Group parent's securities admitted to trading on a regulated market[4] (global group meets the large group threshold)[5]	Group parent must report sustainability information on a consolidated basis for the entire consolidated group	>500 employees: 2025 for the 2024 financial period

3 Complementary information requirements and additional sector-specific disclosure requirements mapped to the SASB industry sectors are due to be published in a second set of ESRS by 30 June 2024.

4 Under the Transparency Directive, an issuer is exempt from the requirement to produce an annual financial report, and therefore sustainability reporting under the CSRD, if the undertaking is an issuer exclusively of debt securities admitted to trading on an EU regulated market that meet certain minimum denomination thresholds. As an example, issuers of Euro Medium Term Note programs in Luxembourg or Ireland will not necessarily fall within scope of the CSRD, notwithstanding that their debt instruments are otherwise admitted to trading on an EU regulated market.

5 At the time of writing, the thresholds for a large group under Article 3(7) of the Accounting Directive Large groups are as follows; however the Commission has proposed to increase the financial thresholds by 25% to take account of inflation: "groups consisting of parent and subsidiary undertakings to be included in a consolidation and which, on a consolidated basis, exceed the limits of at least two of the three following criteria on the balance sheet date of the parent undertaking: (a) balance sheet total: EUR 20,000,000; (b) net turnover: EUR 40,000,000; (c) average number of employees during the financial year: 250."

Scenario	Reporting obligation	Timing of first report
EU subsidiary is a parent undertaking of a sub-group meeting the large group threshold	EU intermediate parent undertaking must report sustainability information on a consolidated basis for the sub-group of which it is the parent	2026 for the 2025 financial period
EU subsidiary is a large undertaking (without any subsidiaries)	EU subsidiary must report sustainability information on a solo basis	2026 for the 2025 financial period

Per the above, the principal triggers for the application of CSRD derive from the size of an undertaking, which is determined by reference to its revenue, balance sheet and number of employees. For a large multinational company, the application of these rules could result in:

- The group parent triggering a consolidated CSRD-aligned reporting obligation for the whole group (if the group's securities are admitted to trading on an EU regulated market);
- A large EU subsidiary triggering a reporting obligation that applies to the subsidiary alone; and/or
- An EU holding company triggering a consolidated reporting obligation for a smaller subset of companies of which it is the parent.

From 2028, CSRD will also apply in respect of non-EU companies with net turnover above EUR 150 million in the EU, where such companies have either an EU branch with net turnover above EUR 40 million or at least one EU subsidiary that is itself in scope of CSRD. U.S. companies may therefore find that they are subject to group-level reporting from 2028 in addition to any reporting requirements that apply at an earlier date.

Depending on the particular trigger for CSRD and the group's consolidation arrangements, this could result in obligations to produce a single group sustainability report or multiple reports for specific sub-groups or subsidiaries.

Whereas the Accounting Directive applies to EU undertakings, the Transparency Directive applies to issuers with securities admitted to trading on an EU regulated market, regardless of where the issuer is incorporated, meaning that for U.S. issuers with dual (or primary) listings on EU regulated markets, the entire consolidated entity under the U.S. issuer will be in scope across the entire (sub-)group under the U.S. issuer.

While an EU parent undertaking will be exempted from the obligation to prepare consolidated financial statements and a consolidated management report for its sub-group if it and its subsidiary undertakings are consolidated in the financial statements of a larger body of undertakings drawn up in accordance with prescribed accounting standards,[6] the exemptions for consolidated financial reporting and consolidated management reports operate independently of the exemptions for consolidated CSRD-aligned reporting. Accordingly, an undertaking can be exempted from consolidated financial reporting requirements but not from consolidated CSRD-aligned reporting requirements. Indeed, the text accompanying the Commission's original proposal for CSRD noted that this can be the case where an undertaking's ultimate parent prepares consolidated financial statements and consolidated management reports in accordance with EU law, or equivalent requirements if it is a non-EU country, but does not prepare consolidated sustainability reports in accordance with EU law, or equivalent requirements if it is a non-EU country.

As such, an EU subsidiary of a multinational group that is the 'parent' of a sub-group, including either EU or non-EU subsidiaries, would be required to report where its sub-group meets the large group threshold, even if the EU parent does not otherwise produce a consolidated financial report because the sub-group is already included in the financial statements of the ultimate group parent.

6 Including international accounting standards or in a manner deemed to be equivalent under EU law.

Commentary

While the obligations in the Transparency Directive apply to non-EU issuers with securities admitted to trading on a *regulated market*, they do not apply to issuers whose securities trade only on *multilateral trading facilities* (MTFs) (or, in the case of debt instruments, *organised trading facilities*).

This is an important distinction. While the first listing of securities on an EU regulated market is an issuer-driven process (such that U.S. companies should be aware of their existing obligations deriving from any such listings), securities can be traded on EU MTFs (and often are) without the issuer's direct knowledge or consent.

For EU subsidiaries of U.S. companies, the exemptions from reporting sustainability information are conceptually similar to those for financial reporting (*e.g.*, reliance on reporting by an ultimate parent under the same or equivalent standards), but the two operate independently, such that an EU subsidiary that otherwise files annual accounts on a solo basis may nonetheless be required to report sustainability information on a consolidated basis for its sub-group.

As the large group test applies in respect of both the EU and non-EU subsidiaries of an EU parent undertaking, multinationals that make use of EU subsidiaries high up in their group structure could find that a significant proportion of their global group falls within the scope of the reporting perimeter from 2026 for the 2025 financial period.

2. Reporting under the SEC's climate disclosure rule (as proposed) is unlikely to meet CSRD requirements.

As noted above, undertakings and parent undertakings of large groups are exempted from the requirement to publish sustainability-related information under CSRD/ESRS if they are included in the consolidated management report of another undertaking that has been drawn up in accordance with the requirements of CSRD/ESRS. Where that other undertaking is established in a third country (such as the U.S.), the EU undertaking will be exempt if the third-country parent carries out consolidated sustainability reporting in accordance with CSRD/ESRS or in a manner deemed to be equivalent to those sustainability reporting standards by the Commission.

This substituted compliance may not help companies reporting under U.S. standards, though. By applying a so-called "double materiality" perspective to reporting, the CSRD standards go significantly beyond the proposed SEC climate disclosure rules (*see* our [March 2022 Memorandum] for further detail). So while it is as yet unclear whether (and subject to what conditions) other sustainability reporting standards will be deemed to be equivalent to the CSRD/ESRS, the SEC rule is an unlikely candidate for substitute compliance.

It is possible that the European Commission will regard reporting conducted pursuant to a two pillar approach as equivalent. For example, a combination of the IFRS sustainability standards being developed by the International Sustainability Standard Board (ISSB) (for financial materiality), which incorporate TCFD and SASB sector-specific standards from a financial materiality perspective, and the GRI Standards, which is the only global sustainability reporting framework that seeks to identify comprehensively companies' outward impact on sustainable development (for impact materiality) could be deemed to be equivalent. Notably, the European Commission, the European Financial Reporting Advisory Group (EFRAG) and the ISSB have been working to improve the interoperability of their respective climate-related disclosure requirements in the overlapping climate disclosure standards, and this work is expected to continue. To assist entities that will apply both ESRS and the ISSB Standards, the European Commission, EFRAG and the ISSB intend to develop interoperability guidance material that could assist entities in navigating between the standards and to understand where there are incremental disclosures required by only one set of standards.

In addition, EFRAG and GRI recently published a [joint statement] outlining the high-level of interoperability between the standards. In particular, the definitions, concepts and disclosures regarding impacts in the ESRS are either fully or closely aligned to those used by GRI, and entities reporting under ESRS will be considered as reporting with reference to the GRI Standards, particularly as the ESRS will allow entities to use the GRI Standards to report on additional material topics that are not otherwise covered by the ESRS, such that entities can report in accordance with both the ESRS and GRI Standards through one report.

Commentary

Even if the IFRS sustainability standards being developed by ISSB are deemed to be equivalent, as U.S. companies will typically apply the U.S. GAAP rather than IFRS accounting standards, the relevance of the ISSB Standards is likely to be limited. The expectation that the SEC climate rule will not be deemed equivalent means that many U.S. companies are likely to face a significant uplift in the sustainability reporting that applies to some or all of their group as a result of CSRD.

Indeed, for those U.S. companies that are scoped into CSRD by virtue of their securities being traded on a regulated market, at present, the only way for them to comply will be to apply the ESRS as part of their management report. As the ESRS require impact materiality to be included in the company's management report (rather than in a separate document, as may currently be the case for companies reporting under GRI Standards), the inclusion of impact materiality in a publicly filed document in the absence of SEC requirements to produce such information could be problematic.

CSRD and the emerging ESG environment will strain how information is defined and exchanged within companies subject to different regimes (and political climates), potentially requiring new processes governing information flows and duties. It will also produce tension for multinationals major components of which may be subject to different regulatory and audit standards in the U.S., raising questions on how to ensure adequate disclosure in the EU while avoiding issues in U.S. disclosures.

For U.S. companies that are not listed in the EU, it is unlikely that they will chose to undertake consolidated sustainability reporting at the level of their group parent for the purposes of addressing the CSRD reporting obligations lower down their group structure. As such, there could be multiple separate sustainability reports prepared within a group covering different subsidiaries and sub-groups.

3. The ESRS will only require material information to be disclosed, but the materiality assessment is expected to be a significant undertaking in itself which must be subject to external assurance.

Undertaking a materiality assessment is the next step for CSRD-aligned reporting. This exercise is necessary to identify the sustainability impacts, risks and opportunities that a company must report. Material items must be disclosed, and a company's materiality assessment is itself subject to external assurance (in addition to the CSRD report).

A sustainability-related matter is "material" when it meets the criteria defined for "impact materiality" and/or "financial materiality," and the assessments are inter-related. Companies are expected to assess impacts first, which may be actual or potential. Although an issue may be material from a purely impact perspective, the Commission has indicated that the identification of material impacts will often also be material from a financial perspective (*i.e.*, trigger financial effects on undertakings). Likewise, there may be additional risks and opportunities that are financially material but which do not involve any impact on environmental capital or social capital by the company.

Whereas *actual* negative impacts are assessed based on the actual severity of the impact, *potential* negative impacts are evaluated based on their likelihood and their severity if they were to occur. Severity is assessed by scale, scope and whether the impact can be remediated.

Sustainability matters are to be regarded as financially material if they trigger or could reasonably be expected to trigger material financial effects on the undertaking by reference to risks or opportunities having (or potentially having) a material influence on the company's development, financial position, financial performance, cash flows, access to finance or cost of capital over the short-, medium- or long-term. Impacts include those connected with the undertaking's own operations and upstream and downstream value chain, including through its products and services, as well as through its business relationships.

Materiality can be assessed at the level of a particular ESG-related topic or at the level of specific disclosure requirements within each topical ESRS; however, on the basis that climate change is expected to affect (or be affected by) the vast majority of in-scope undertakings, if the undertaking concludes that climate change is not material to its business, the undertaking is required to disclose a detailed explanation of the conclusions of its materiality assessment, including a forward-looking analysis of the conditions that could lead the undertaking to conclude that climate change is material in the future.

Commentary

Conducting a materiality assessment across the topical ESRS from both an impact and financial materiality perspective is likely to require a significant degree of forward planning, investment of time and resources, and appropriate management oversight in order to take comfort in the conclusion that a topic or particular data point is not relevant to the business, particularly in light of the requirement to obtain external assurance of the materiality assessment.

4. Climate transition plans are not mandatory under CSRD, but businesses with published transition plans will be subject to detailed disclosure requirements, which may subject the adequacy of their transition plans to additional scrutiny.

CSRD requires companies to disclose the transition plans for climate change mitigation that are designed to ensure the company's strategies and business models 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. If the company does not have a transition plan in place, it shall indicate whether and, if so, when, it will adopt a transition plan.

For undertakings that have adopted a transition plan, the ESRS contain detailed disclosure requirements in order for undertakings to substantiate their plans, and to explain how they are consistent with the Paris Agreement. The company must also disclose how the transition plan is embedded in and aligned with the undertaking's overall business strategy and financial planning, whether the transition plan is approved by the administrative, management and supervisory bodies, and explain the undertaking's progress in implementing the transition plan.

Commentary

While only undertakings with transition plans will need to disclose details of such plans, the level of detail required may lead to greater scrutiny from investors, regulators and potentially civil society groups.

Strategic climate litigation against companies in EU member states have highlighted the fact that civil society groups have identified the (in)adequacy of corporate transition plans as a potential source of legal liability for companies. The level of disclosure required with respect to transition plans could lead to greater liability in the future, if the undertaking fails to take adequate steps to implement its own transition plan, or the heightened disclosure in this area may highlight past inconsistencies or inadequacies with respect to an undertakings' claimed climate action plans.

5. Value chain partners in the EU may require support in meeting their own disclosure requirements.

Disclosure obligations for covered companies extend to their operations and value chains. The ESRS define a value chain as:

> *The full range of activities, resources and relationships related to the undertaking's business model and the external environment in which it operates. A value chain encompasses the activities, resources and relationships the undertaking uses and relies on to create its products or services from conception to delivery, consumption and end-of-life.*

The ESRS require companies to include information on the material impacts, risks and opportunities associated with a company's direct and indirect business relationships in its upstream and/or downstream value chain. While companies are not required to include information on each and every actor in their value chains, they are required to apply the double materiality principle and report material information with respect to such actors as well as actions companies take to prevent, mitigate and remediate adverse impacts associated with their upstream and downstream value chain.

Transitional relief is provided for the first three years of reporting: a company that is unable to obtain required information regarding its upstream and downstream value chain can explain its efforts and challenges in obtaining it and plans to obtain the required information in the future.

Commentary

As we have seen with other sustainability disclosure regimes, U.S. companies not directly in scope of CSRD may be indirectly impacted by virtue of their position in a covered company's value chain. In such circumstances, although a U.S. company would have no regulatory obligation to provide such information, and the covered company requesting the information (*e.g.*, customer or supplier) may have other means by which to estimate relevant data for the purposes of its reporting of material information, there may be strong commercial pressures to provide information to covered companies.

In addition to CSRD, there are a number of other EU-level (such as the EU Deforestation Directive and EU Conflict Minerals Rule) and domestic EU member state regimes (including the German Supply Chain Act, and the French Duty of Corporate Vigilance Law) that already require EU companies to obtain information and/or undertake diligence in respect of their supply chains, in respect of which U.S. companies may already have received information requests.

Conclusion

The CSRD's broad scope and the disclosure it will require presents a significant challenge for global corporate groups with any nexus to the EU.

- As a first step, and as a matter of priority, U.S. companies should analyze which parts of their group, if any, will be in scope of CSRD and when.
- Covered companies should next consider whether they have appropriate oversight of, and access to data relating to, sustainability matters in their operations and value chains. Based on internal and external information available to a company, it can then identify specific areas of risk and how best to address deficiencies in respect of information needed for reporting.
- Companies should identify parties responsible for developing their CSRD-aligned reports and create ongoing processes to facilitate reporting, which exercise may involve refreshing or developing and implementing new sustainability-related policies and procedures.
- Importantly, multinationals that have already published net zero transition plans should consider whether such plans are robust and how the company will be able to demonstrate alignment to the Paris Agreement.

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Annex 1

<table>
<tr><th colspan="5">CSRD, as amending:</th></tr>
<tr><th>Timing</th><th colspan="2">EU Accounting Directive</th><th colspan="2">EU Transparency Directive</th></tr>
<tr><td>Reporting in 2025 for financial years starting on or after 1 January 2024.</td><td>EU undertakings that have historically been subject to reporting under the EU Non-Financial Reporting Directive (NFRD), namely large EU public interest entities (such as EU banks, EU insurance undertakings, and EU undertakings with securities admitted to trading on an EU regulated market) with 500 or more employees.</td><td>EU public interest entities which are parent undertakings of a large group with 500 or more employees (on a consolidated basis).</td><td>Large issuers (whether established in the EU or a third country) whose securities are admitted to trading on an EU regulated market that have 500 or more employees, unless otherwise exempt from reporting under the Transparency Directive.</td><td>Issuers (whether established in the EU or a third country) whose securities are admitted to trading on an EU regulated market that are parent undertakings of a large group with more than 500 employees (on a consolidated basis), unless otherwise exempt from reporting under the Transparency Directive.</td></tr>
<tr><td>Reporting in 2026 for financial years starting on or after 1 January 2025.</td><td>EU large undertakings.</td><td>EU parent undertakings of a large group.</td><td>Large issuers (whether established in the EU or a third country) whose securities are admitted to trading on an EU regulated market, unless otherwise exempt from reporting under the Transparency Directive.</td><td>Issuers (whether established in the EU or a third country) whose securities are admitted to trading on an EU regulated market that are parent undertakings of a large group, unless otherwise exempt from reporting under the Transparency Directive.</td></tr>
<tr><td>Reporting in 2027 for financial years starting on or after 1 January 2026.</td><td colspan="2">EU small and medium sized enterprises (but excluding micro enterprises) (SMEs) that are “public interest entities” (i.e. whose securities are admitted to trading on an EU regulated market, or which are EU banks or EU insurance undertakings).

For financial years starting before 1 January 2028, small and medium sized enterprises which are public interests entities may choose not to include sustainability reporting but in such cases, must briefly state the reasons.</td><td colspan="2">SME issuers (whether established in the EU or a third country) whose securities are admitted to trading on an EU regulated market, unless otherwise exempt from reporting under the Transparency Directive.</td></tr>
<tr><td>Reporting in 2029 for FY starting on or after 1 January 2028.</td><td colspan="2">Third-country undertakings with net turnover above EUR 150 million in the EU (calculated at a group level), provided they have: (i) at least one EU subsidiary which is a large undertaking or an SME whose securities are admitted to trading on an EU regulated market; or (ii) a branch in the EU with more than EUR 40 million net turnover.[7]</td><td colspan="2"></td></tr>
</table>

[7] Under CSRD’s third country provisions, the primary obligation applies to the EU branch of the non-EU undertaking, its large EU subsidiary or its subsidiary that is a public interest entity, rather than the third country undertaking directly. The relevant EU branch or subsidiary is required to make accessible a sustainability report covering specific limited sustainability information at the group level of the ultimate third-country parent, based on information requested from the parent (or headquarters).