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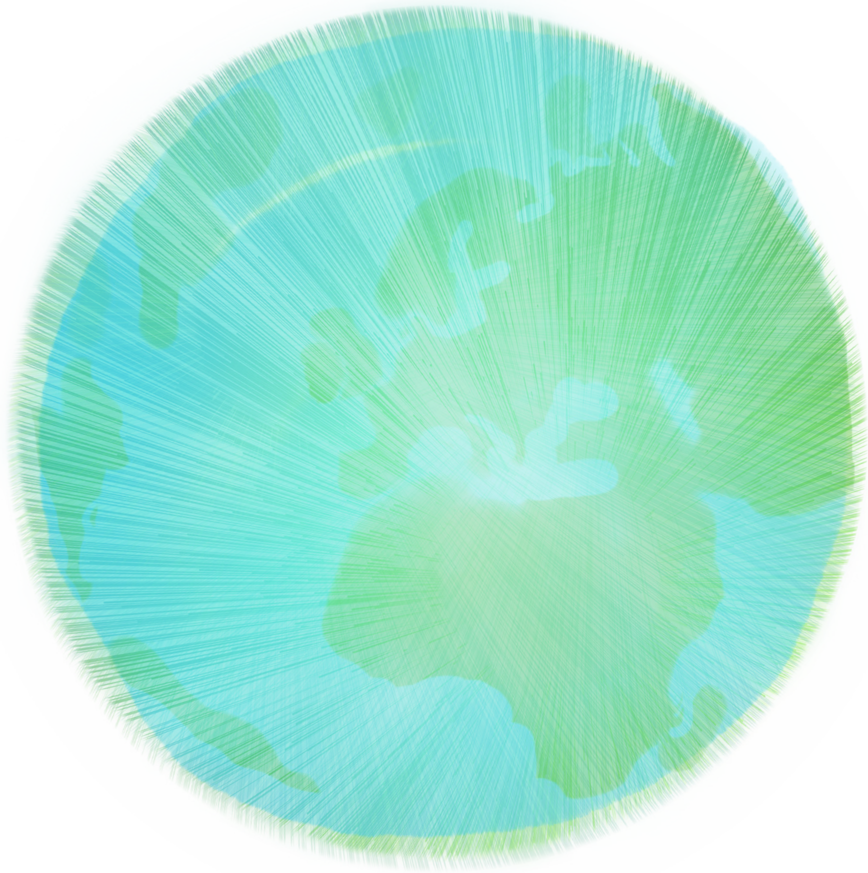


Corporate Sustainability Reporting Directive
The Future Landscape of Sustainability Reporting

There is a lot of change occurring in the sustainability reporting landscape. The EU Sustainable Finance road map is an ambitious and comprehensive package of measures to improve the flow of capital towards sustainable activities across the European Union.

As part of this, on 21 April 2021, the European Commission adopted a proposal for a Corporate Sustainability Reporting Directive (CSRD), which envisages the adoption of EU sustainability reporting standards. Since then, the European Financial Reporting Advisory Group (EFRAG) have been working to develop the standards, including a recent public consultation on its Due Process Procedures, which stipulate the requirements to be followed in its role as technical advisor to the European Commission in the preparation of draft sustainability standards. The process will include public oversight, transparency and the expertise of relevant stakeholders. In addition to this, the latest development from EFRAG saw the release of the climate standards prototype on 24 September 2021. [1]

1. News - EFRAG

Overview

The objective of the proposed CSRD is to improve the existing requirements of the EU's Non-Financial Reporting Directive (NFRD), in order to better harness the potential of the European Union in the transition to a fully sustainable and inclusive economic and financial system, in accordance with the European Green Deal and the UN Sustainable Development Goals.

The ambitious proposal will significantly expand the scope of the NFRD and strives to increase the transparency of corporate progress in terms of sustainability. The new sustainability reporting standards being developed will specify the detailed requirements of the reporting obligations under the CSRD. Their aim is to help achieve in harmonisation of sustainability reporting, while considering the EU Taxonomy Regulation, the Sustainable Finance Disclosure Regulation (SFDR) and existing international frameworks such as the Task Force on Climate-Related Financial Disclosures (TCFD), the Sustainability Accounting Standards Board (SASB) and the Global Reporting Initiative (GRI).

Recent Developments

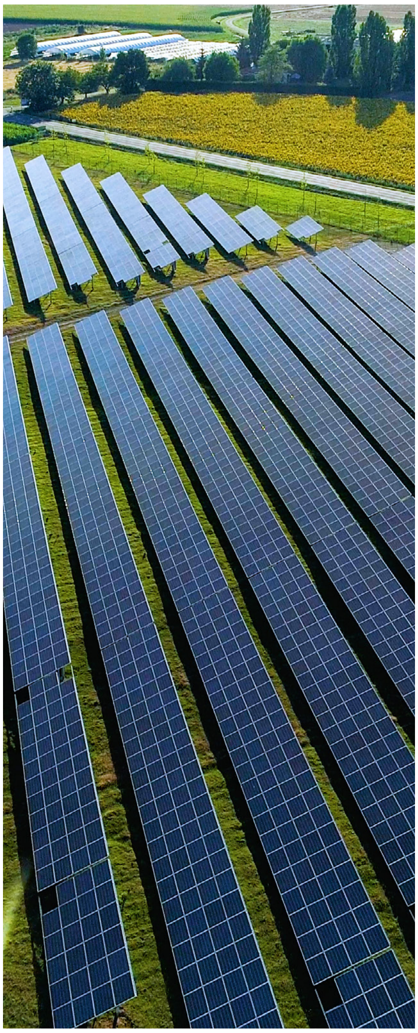
At UN Climate Change Conference ("COP26"), the International Financial Reporting Standards (IFRS) Foundation announced the formation of the International Sustainability Standards Board (ISSB) to develop a global baseline of sustainability disclosure and a commitment of leading investor-focused disclosure organisations to consolidate into the new board. IFRS Foundation also published prototype climate and general disclosure requirements, a unified set of recommendations developed over six months by representatives of the CDSB, the International Accounting Standards Board (IASB), the Financial Stability Board's Task Force on Climate-related Financial Disclosures (TCFD), the VRF and the World Economic Forum (Forum), supported by the International Organisation of Securities Commissions (IOSCO) and its Technical Expert Group of securities regulators. The CSRD standard being drafted by EFRAG is designed to be fully compatible with international initiatives while obviously onboarding the EU objectives and goals. Statements of cooperation were signed with GRI and Shift ensuring their representation and participation. Regular technical discussions are carried out with the IFRS Foundation Technical Readiness Working Group on the respective climate prototypes, approach to materiality and standards architecture and with SASB/VRF on sector/industry specific disclosures.

At the EU side event on disclosures at COP26, European Commissioner Mairead McGuinness for Financial Stability, Financial Services and the Capital Markets Union provided the following remarks, "EU standards will build on and contribute to global standardisation initiatives. We should build on what exists, and seek as much alignment as possible, while also meeting Europe's ambitious goals", which continues to support the harmonisation of sustainability reporting.

Comparison of the Non-Financial Reporting Directive to the Corporate Sustainability Reporting Directive

Highlights	NFRD/EU Directive 2014/95/EU	Proposed CSRD
Applicable Timeframe	• 30 July 2017: NFRD signed into Irish law • August 2017: Inclusion of non-financial and board diversity matters for periods beginning on or after 1 August 2017	• Mid 2022: Draft standards from EFRAG available • December 2022: Adoption EU-Directive in member states legislation • 1 January 2023: First set of Sustainability Reporting Standards • 2025: Reporting of Sustainability Metrics for 2024 and assurance over report
What companies are in Scope?	• Large public interest entities with > 500 employees • Public interest entities include: - Listed companies - Banks and Insurance companies	All large companies • > 250 employees and/or • > €40M Turnover and/or • > €20M Total Assets • Listed companies Large companies currently incorporates companies not established in the EU that are listed on EU regulated markets and EU subsidiaries of non-EU companies. Note: 1. Only limited liability companies (i.e. those in scope of the Accounting Directive) and 2. small and medium listed companies get an extra 3 years to comply.
How many companies are covered by the directives?	11,700 (Covering 47% of revenue of all reporting entities)	49,000 (Covering 75% of revenue of all reporting entities)
What are the reporting requirements?	Companies are to report on: • Environmental protection • Social responsibility and treatment of employees • Respect for human rights • Anti-corruption and bribery • Diversity on company boards (in terms of age, gender, educational and professional background)	Companies are to report on: • Business model and strategy incorporating sustainability matters and the impact of 1.5°C temperatures in line with Paris Agreements • Targets and progress made to achieve those targets • Roles and responsibilities of management • Company's sustainability policy including due diligence • Adverse impacts connected with the value chain • Description of principal risks related to sustainability matters • Reporting in line with Sustainable Finance Disclosure Regulation (SFDR) and the EU Taxonomy Regulation Companies will need to provide: • Qualitative and quantitative information • Both forward-looking and retrospective information • Information that covers short, medium and long-term time horizons
Is 3rd party assurance required?	Voluntary assurance	Mandatory assurance Limited assurance to move to reasonable in the future as the reporting framework evolves
Where should the information be reported?	Included in the annual report	Included in the management report which is generally included in the annual report
Are there any exemptions?	N/A	• Exemption for subsidiaries to publish sustainability reporting in their management report, if the sustainability reporting in the parent's consolidated management report complies with EU sustainability reporting standards • For non-EU parents if they publish information that is equivalent to EU standards and includes information related to the subsidiary and is available when the subsidiary publishes its management report
What format should the reporting be?	Online or pdf	To be submitted in electronic format (in XHTML format in accordance with ESEF regulation)

Deloitte's view:
The most notable changes under the proposed CSRD are the extension of scope to 49,000 companies, the standardisation of sustainability reporting standards, the introduction of mandatory assurance, the inclusion of the information in the management report and the reporting format in accordance with the European Single Electronic Format regulation.



Scope – Who will the CSRD apply to?

The scope has been extended from that of the NFRD to include all large and listed companies on EU regulated markets (with the exception of micro-enterprises). A "large company" can be defined as an EU company or an EU subsidiary of a non-EU company meeting two out of the three following criteria at its balance sheet date:

- Net turnover exceeding €40 million; and/or
- Net assets (total balance sheet) exceeding €20 million; and or
- Greater than 250 employees on average during the financial year.

It is expected that 49,000 entities will now be impacted by this reporting requirement and therefore it will have significant influence across the sustainability reporting space. A subsidiary shall be exempted from the obligations set out in the proposed directive if their sustainability information is included in the consolidated management report of a parent undertaking. It is necessary, however, to ensure that sustainability information is easily accessible for users, and to bring transparency about which is the parent undertaking of the exempted subsidiary undertaking which is reporting at consolidated level. It is therefore necessary to require those subsidiary undertakings to publish the consolidated management report of their parent undertaking and to include a reference in their management report to the fact that they are exempted from reporting sustainability information. A subsidiary from a parent undertaking that is established in a third country shall also be exempted from the obligations of CSRD only if the EU recognises equivalence of the reporting standard in the third country.[2] The details of these exemptions are still to be finalised.

Deloitte's view:
Under the proposed legislation, the extension of the scope of CSRD would impact non-EU subsidiaries such as subsidiaries of large US companies, asset managers or insurers.

2. Proposed EU corporate sustainability reporting directive

Scope for investment funds

In addition, large investment funds structured as companies which meet two of the three criteria above, or those listed on EU regulated markets such as ETFs, would be impacted. It is important to consider that funds are already subject to the extensive disclosure and reporting requirements under SFDR and it is essential that CSRD does not introduce duplicative reporting for the same or similar ESG issues. European Fund and Asset Management Association (EFAMA) is currently lobbying with the European Commission for the exclusion of funds from the scope of CSRD, as these are financial products already subject to SFDR. EFAMA's is also lobbying to introduce a waiver or cross-reference possibility under asset managers' CSRD disclosures to the extent that they already submit such information under SFDR at the entity level.

Scope for listed Small to Medium Enterprises (SME's)

To help ensure investor protection, all companies listed on regulated markets should in principle be subject to the same disclosure rules. Listed Small to Medium Enterprises (SMEs) listed on EU regulated markets would therefore have to fulfil the proposed new sustainability reporting requirements. Many financial institutions and asset managers support the introduction of proportionate reporting requirements for SMEs, especially listed SMEs. Listed SMEs will also have to report under the CSRD; however, they will not need to comply with requirements until 1 January 2027. This phasing-in period would also allow listed SMEs to apply the new requirements when reporting and assurance practices for sustainability information have reached a higher degree of maturity. Non-listed SMEs can also choose to use these proportionate standards on a voluntary basis.

Deloitte's view:
Although SMEs are not required to report for a number of years, it is vital they put in place processes and policies in anticipation of the CSRD and look to those in scope now for best practice. There may also be a strategic reason for SME's to align earlier to sustainability reporting standards, such as access to finance, supply chain requirements or talent attraction.

Impact – Putting Financial and Non-Financial Information on a Level Playing Field

Double Materiality

A white paper commissioned by GRI investigates the application of materiality in sustainability reporting – highlighting why disclosing impacts that go beyond those that are financially material benefits organisations while supporting sustainable development. The paper - The double-materiality concept: application and issues[3] - assesses the challenges, opportunities, and relevance of applying double-materiality in sustainability reporting. The key findings include:

- The identification of financially materiality issues are incomplete if companies do not first assess their impacts on sustainable development.
- Reporting material sustainable development issues can enhance financial performance, improve stakeholder engagement and enable more robust disclosure.
- Focusing on the impacts of organisations on people and planet, rather than financial materiality, increases engagement with the Sustainable Development Goals.

The CSRD proposal emphasises the concept of double materiality, whereby entities need to consider both the impact of sustainability topics on the company's value (financial materiality), and the entity's impact on the economy, the environment, and people (impact materiality).

Importantly, the concept also implies the need to assess the interconnectivity of the two. Building on the double-materiality principle, standards should cover all information that is material to users. EFRAG will develop a coherent and comprehensive set of reporting standards, covering all sustainability matters from a double-materiality perspective.

Extended Reporting Requirements

In accordance with the new binding sustainability reporting standards being developed by EFRAG, companies will have to disclose:

(a) a description of their business model and strategy, including:
- the resilience of their business model and strategy to risks related to sustainability matters;
- the opportunities related to sustainability matters;
- the plans to ensure that its business model and strategy 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;
- how the business model and strategy take account of the interests of their stakeholders;

(d) a description of the company's policies in relation to sustainability matters;

(e) a description of:
- the due diligence process implemented with regard to sustainability matters;
- the principal actual or potential adverse impacts connected with the undertaking's value chain, including its own operations, its products and services, its business relationships and its supply chain;
- any actions taken, and the result of such actions, to prevent, mitigate or remediate actual or potential adverse impacts;

(f) a description of the principal risks to the company related to sustainability matters, including the company's principal dependencies on such matters, and how the company manages those risks;

Information on intangibles, including intellectual, human, and social and relationship capital will also be disclosed, and where appropriate information about the company's value chain. The information shall contain forward-looking and retrospective information, and qualitative and quantitative information. It should cover short, medium and long-term horizons.[4]

3. https://www.globalreporting.org/media/jrbntbyv/griwhitepaper-publications.pdf
4. EU proposed corporate sustainability reporting directive

Harmonisation and Solving the Data Puzzle

At Deloitte, we believe the proposed CSRD and its uniform standards, can provide a consistent and comparable baseline that enables comparability of corporate disclosures across countries.

Public consultations have highlighted strong support for aligning non-financial reporting requirements with relevant European legislation and international frameworks, in particular, the SFDR, the EU Taxonomy Regulation and the TCFD.

For example, the proposed CSRD will reflect the principles of TCFD: governance, strategy, risk management and metrics and targets. A key recommendation of TCFD is scenario analysis which allows a company to understand and quantify the risks and uncertainties it may face under different hypothetical futures i.e. different climate warming scenarios. Scenario analysis is an expected requirement of CSRD and needs early commitment and involvement from stakeholders in the business.

The EU Taxonomy Regulation sets out to identify which economic activities are environmentally sustainable with six environmental objectives as criteria. The six environmental objectives in the EU Taxonomy include: climate change mitigation, climate change adaptation, sustainable use and protection of water and marine resources, transition to a circular economy, pollution prevention and control, and protection and restoration of biodiversity and ecosystems. The reporting standards to be developed for CSRD will integrate these green financial indicators and build on the "substantial contribution" and "do-no-significant harm" criteria of the taxonomy.

SFDR will apply to financial market participants and financial advisors who will disclose ESG matters at both the product and entity level. For those financial products seeking to achieve sustainable characteristics or objectives, the transparency of sustainability information will be vital. CSRD is likely to enhance the quality and availability of investee company data required for SFDR thus completing the data puzzle by creating a consistent and coherent flow of sustainability information throughout the financial value chain.

The draft CSRD is high level and mentions that the standards to be adopted by EFRAG will include various elements of existing sustainability reporting standards. Below are some of the metrics from SFDR and the EU Taxonomy which may be incorporated into the actual CSRD directive:

SFDR Mandatory Indicators

Greenhouse Gas Emission	GHG Emissions
	Carbon Footprint
	GHG Intensity of investee companies
	Exposure to companies active in the fossil fuel sector
	Share of non-renewable energy consumption and production
	Energy consumption intensity per high impact climate sector
Biodiversity	Activities negatively affecting biodiversity-sensitive areas
Water	Emissions to water
Waste	Hazardous waste ratio
Social and employee matters	Violations of UN Global Compact principles and Organisation for Economic Cooperation and Development (OECD) Guidelines for Multinational Enterprises
	Lack of processes and compliance mechanisms to monitor compliance with UN Global Compact Principles and OECD Guidelines for Multinational Enterprises
	Unadjusted gender pay gap
	Board gender diversity
	Exposure to controversial weapons (anti-personnel mines, cluster munitions chemical weapons and biological weapons)

EU Taxonomy

% of turnover derived from products or services associated with economic activities that qualify as environmentally sustainable
% of capital expenditure and % of operating expenditure related to assets or processes associated with economic activities that qualify as environmentally sustainable

Deloitte's view:
The proposed CSRD brings much-needed clarity and harmonisation to the existing landscape of non-financial reporting. For example, CSRD will make it easier for asset managers and investment firms to get ESG company data for their own compliance with reporting obligations under the EU Taxonomy and SFDR.

Introduction of Mandatory Assurance

The information disclosed under CSRD will be subject to mandatory external "limited" assurance, with the expectation being that there would be a shift towards a "reasonable" assurance requirement at a later stage. Reasonable assurance provides the user with a relatively high degree of comfort that the subject matter is not materially misstated. On the other hand, limited assurance provides a lower level of comfort and narrows the scope for the subject matter. Initially limited assurance will be expected under CSRD, as companies are only starting to put in place processes and controls to report the data and metrics. The introduction of mandatory assurance is intended to level the playing field across all those falling into scope and users will benefit from better access to comparable, relevant and reliable sustainability information from more companies. The proposal also introduces the potential for Member States to allow the assurance services for sustainability information to be provided by firms other than the traditionally engaged auditors of financial information. Assurance ensures users are more confident in the sustainability information provided, gives more credibility to your reporting processes and overall is preferable to investors. It cannot be denied that CSRD is a turning point for sustainability reporting in the EU as it holds companies accountable for the sustainability information they disclose and puts increased responsibility on management and audit professionals to assure it.

Deloitte's view:
Our view is that assurance over sustainability information will become the normal for listed and non-listed companies as stakeholders will be making key decisions based on financial and non-financial information.

Inclusion in the Management Report and Digital Format

Sustainability information is required to be included in the management report under CSRD. The management report is considered to be the directors report. In addition to this, digitalisation is an important element of change to be adopted – companies will be required to prepare their financial statements and their management report in a single electronic reporting XHTML format in accordance with Article 3 of Commission Delegated Regulation (EU) 2019/815 and to "tag" their sustainability information according to a digital categorisation system to be developed in conjunction with the sustainability reporting standards. This is to support the EU's ambition to create an open-access European ESG database with the European Single Access Point (ESAP) model and will mean the storing of information is aligned with the trajectory of a digital age. The digital categorisation system would be developed together with other sustainability reporting standards, therefore harmonising reporting and allowing information to be used for different purposes in future.

Deloitte's view:
Inclusion of sustainability reporting in the management report is a significant development of the proposed CSRD and means management bears responsibility in writing, for the first time, for the company's sustainability disclosures.

Timeline

The timeline for the implementation of the CSRD is ambitious. EFRAG aims to have the first set of draft standards ready by mid-2022 and Member States will be expected to transpose the new directive into law by 31 December 2022. Reporting will be required for large and listed entities from January 2024 and for SMEs from January 2027. Mandatory assurance comes into effect in January 2025 for the 2024 reporting period.

The requirements for the EU Taxonomy will come into effect partially from January 2022 and fully from January 2023.

The regulations are continuing to evolve and more information will be available in the near future. Refer to the European Commission website for the latest developments on the CSRD and EU Taxonomy.

EU NFRD | **CSRD (Proposed revision to EU NFRD)**

	FY2020	FY2021	FY2022	FY2024	FY2025
Reporting requirements	• EU Non-Financial Disclosure Directive (EU NFRD)	• EU NFRD • EU Taxonomy: Disclosures on extent to which activities contribute to: climate change mitigation & adaptation	• EU NFRD • EU Taxonomy: Disclosures as set out in FY2021 plus extent to which activities contribute to: 1. Protection of water & life in water 2. Transition to a circular economy 3. Pollution prevention 4. Protection of biodiversity	• Mandatory EU sustainability reporting standards outlining CSRD reporting obligations • Application of a double materiality lens in reporting • EU Taxonomy disclosures (as set out in FY22)	
Format	Annual Report	Annual Report	Annual Report	• Externally published Management Board Report • Mandatory digital reporting in ESEF format	
Assurance	If required by law	If required by law	If required by law	• Mandatory (limited) assurance of reported information	

What companies should be doing now

Given the significance of the proposed CSRD obligations, companies need to start preparing for its implementation now.

Phase 1

Phase 2

Phase 3

Baseline Assessment

- (Re)assess existing sustainability reporting process (including internal controls and governance) to understand the baseline.
- Consider auditor's perspective on materiality process and the KPIs that are currently in place.
- Assessment of the baseline – benchmarking with selected industry peers.
- Interviews with key internal stakeholders to get an understanding of existing data management process (design, capture, record, calculate, compile).
- Map out global supply chain and assess sustainability topics using double materiality concept.

Getting assurance ready

- Regulation scan: Which regulatory obligations will come into force and when?
- Training plan for key employees on EU regulations.
- Create a matrix per strategic KPI on the requirements of limited and reasonable assurance.
- Analyse the existing carbon reporting process and investigate the feasibility of replicating this for other KPIs.
- Implement internal control framework on non-financial information.

Create roadmap

- Create an actionable roadmap with key internal stakeholders to get assurance ready (limited and eventually to reasonable assurance).
- Develop a taxonomy mapping and a governance plan.
- Data management framework and insights on the required audit documentation.
- Consider digital solutions for more efficient data management, effective internal controls and valuable insights to ensure reliable environmental, social & governance (ESG) (aka sustainability) reporting.

How can Deloitte Help
At Deloitte, we have designed a framework to support sustainability risk integration and the provision of assurance over your ESG disclosures that can support boards of directors, audit committees and management in their journey towards compliance with CSRD disclosure requirements or other ESG frameworks.

Benchmarking and gap analysis

What is it:
Independent benchmarking of your current disclosures against recommendations and/or identifying gaps in your disclosures, processes or controls and reporting privately to management and those charged with governance.

What is it used for:
Benchmarking and gap analysis provides the basis of a roadmap to ESG disclosures.

Designing and Implementing ESG frameworks

What is it:
Designing and implementing a policy and risk management framework that captures processes, controls and reporting privately to management and those charged with governance on the ESG integration.

What is it used for:
Policy and framework can be used to integrate CSRD requirements into the business model.

Assurance over selected ESG metrics

What is it:
Private or public independent ISAE 3000 assurance over your CSRD disclosures and metrics.

What is it used for:
Assurance over CSRD disclosures will be mandatory for CSRD compliance by 2024. Prior to this, Deloitte can perform assurance readiness which is designed to provide early feedback on sustainability information, systems and controls. This means that management can remediate any issues identified prior to assurance testing in 2024.

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