Questions and Answers: Corporate Sustainability Reporting Directive proposal

Brussels, 21 April 2021

Revision: why was there a need to review the Non-Financial Reporting Directive (NFRD)?

The reporting rules introduced by the Non-Financial Reporting Directive established important principles for certain large companies to report sustainability information on an annual basis. It introduced a 'double materiality perspective', meaning that companies have to report about how sustainability issues affect their business and about their own impact on people and the environment.

There is ample evidence, however, that the information that companies report is not sufficient. Reports often omit information that investors and other stakeholders think is important. Reported information can be hard to compare from company to company, and users of the information are often unsure whether they can trust it.

Problems in the quality of sustainability reporting have knock-on effects. It means that investors lack a reliable overview of sustainability-related risks to which companies are exposed.

Investors increasingly need to know about the impact of companies on people and the environment. They need to know this partly to meet their own disclosure requirements under the Sustainable Finance Disclosure Regulation. More generally, if the market for green investments is to be credible, investors need to know about the sustainability impact of the companies in which they invest. Without such information, money cannot be channelled towards environmentally friendly activities.

Finally, problems in the quality of reporting create an accountability gap. High quality and reliable public reporting by companies will help create a culture of greater public accountability.

Scope: why does the proposed Corporate Sustainability Reporting Directive cover more companies?

The reporting rules introduced by the Non-Financial Reporting Directive apply to so-called "public interest entities", meaning listed companies, banks, and insurance companies. The rules apply to companies that are large (i.e. they are not SMEs, as defined in the Accounting Directive), and have more than 500 employees. In other words, only about 11.000 companies were covered by the NFRD.

Consultations carried out by the Commission found that many stakeholders are in favour of extending reporting requirements to additional categories of companies. Today's proposal will extend the scope of these requirements to include all large companies, whether they are listed or not and without the previous 500-employee threshold. This change would mean that all large companies are publicly accountable for their impact on people and the environment. It also responds to demands from investors for sustainability information from such companies.

In addition, the Commission is proposing to extend the scope to include listed SMEs, with the exception of listed micro-enterprises. For reasons of investor protection, it is especially important that investors have access to adequate sustainability information from listed companies. Furthermore, if listed SMEs do not report sustainability information, they may find themselves at risk of exclusion from investment portfolios. This risk will grow as sustainability information becomes ever more important throughout the financial system.

Small and Medium-Sized Enterprises (SMEs): what does the proposal mean for smaller companies?

The proposal would not put any new reporting requirements on small companies, except for SMEs with securities listed on regulated markets. In addition, to limit the burden on listed SMEs, they will be allowed to report according to standards that are simpler than the standards that will apply for large companies. The reporting requirements of this proposal would also not apply to SMEs with transferable securities listed on SME growth markets or multilateral trading facilities (MTFs).

That said, many SMEs are facing growing requests for sustainability information – typically from banks that lend them money and large companies that they supply. The transition to a sustainable economy is likely to mean that collecting and sharing sustainability information becomes common business practice for companies of all sizes. Therefore, in parallel to the new rules proposed today for large companies, the Commission is also proposing the development of separate, proportionate standards for SMEs. SMEs listed on regulated markets could use these simpler standards to meet their legal reporting obligations, while non-listed SMEs could choose to use them on a voluntary basis. These standards would be carefully adapted to the capacity of SMEs. They would make it easier for SMEs to report information to banks, large-company clients and other stakeholders. They can help SMEs play a full role in the transition to a sustainable economy. Furthermore, the requirements for listed SMEs would apply only three years after they apply to other companies, given the economic difficulties faced by smaller companies as a result of the COVID-19 pandemic.

Standards: how and by whom will these new EU sustainability-reporting standards be developed?

The European Financial Reporting Advisory Group (EFRAG) will be responsible for developing these draft standards. EFRAG is a private association established in 2001 created with the encouragement of the Commission to serve the public interest.. Majority financed by the EU, EFRAG relies on a public-private partnership model and its role has been to advise the Commission on the adoption of international financial reporting standards into EU law.

At the request of the Commission, EFRAG recently published technical recommendations and a roadmap for the development of EU sustainability reporting standards. In parallel, the Commission asked the President of EFRAG to make recommendations for possible changes to EFRAG's governance to enable it to take on the role of developing such draft standards. According to these recommendations, EFRAG will develop draft standards with the necessary due process and with expert input from stakeholders.

Before adopting any standards, the Commission will consult the Member States Expert Group on Sustainable Finance and seek the opinion of the European Securities and Markets Authority. It will also consult the European Banking Authority, the European Insurance and Occupational Pensions Authority, the European Environment Agency, the European Union Agency for Fundamental Rights, the European Central Bank, the Committee of European Auditing Oversight Bodies, and the Platform on Sustainable Finance. These consultations will help to ensure a broad consensus on the content of the standards, and coherence with relevant EU legislation and policies.

International: how will EU reporting standards fit with global standards, especially the standards that the International Financial Reporting Standards Foundation is planning?

EU sustainability reporting standards need to be consistent with the ambition of the European Green Deal and with Europe's existing legal framework, the Sustainable Finance Disclosure Regulation and the Taxonomy Regulation. They need to cover not just the risks to companies but also the impacts of companies on society and the environment (the so-called 'double materiality' principle). At the same time, it is clearly 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. EU standards should go further where necessary to meet the EU's own ambitions and be consistent with the EU's legal framework.

The Commission supports initiatives by the G20, the G7, the Financial Stability Board and others to develop a baseline of global sustainability reporting standards that would build on the work of the Task Force on Climate-related Financial Disclosures. The proposals of the International Financial Reporting Standards (IFRS) Foundation to create a new Sustainability Standards Board are relevant in this context, as is the work already carried out by established initiatives including the Global Reporting Initiative (GRI), the Sustainability Accounting Standards Board (SASB), the International Integrated Reporting Council (IIRC), the Climate Disclosure Standards Board (CDSB) and CDP.

The proposed EU sustainability reporting standards would build on and contribute to standardisation initiatives at global level. This will require constructive two-way cooperation between EFRAG and relevant international initiatives. With a view to laying the groundwork for such cooperation, EFRAG and the Commission have convened two meetings in recent months with the main international sustainability reporting initiatives.

Coherence: how is the CSRD linked to other EU initiatives on sustainable finance?

The CSRD would ensure alignment with other EU initiatives on sustainable finance, in particular the Sustainable Finance Disclosure Regulation (SFDR) and the Taxonomy Regulation. The aim is to reduce complexity and the potential for duplicative reporting requirements.

This proposal would ensure that companies report the information that investors and other financial market participants subject to the SFDR need. Specifically, that means that the reporting standards would include indicators that correspond to the indicators contained in the SFDR.

Article 8 of the Taxonomy Regulation requires companies falling within the scope of the existing Non-Financial Reporting Directive – and the additional companies brought under the scope of the proposed CSRD, if approved by the co-legislators – to report on the extent to which their activities are sustainable. The indicators for this will be specified in a separate Commission Delegated Act. Companies will have to report these indicators alongside other sustainability information mandated by the proposed CSRD. The reporting standards to be developed under the CSRD would fully take into account these indicators and build on the 'substantial contribution' and 'do-no-significant-harm' criteria of the Taxonomy.

Audit: what does the proposal say about the audit of sustainability information?

The proposal would for the first time introduce a general EU-wide audit (assurance) requirement for reported sustainability information. This will help to ensure that reported information is accurate and reliable. It should go a long way towards addressing the concerns of investors and other stakeholders about the reliability of the sustainability information that companies report today.

Although the objective is to have a similar level of assurance for financial and sustainability reporting, a progressive approach is needed. The Commission is proposing to start with a 'limited' assurance requirement. This represents a significant advance on the current situation, while not imposing a 'reasonable' assurance requirement (a stronger, more demanding level) for the time being. A limited assurance requirement is less costly for companies, and better corresponds to the current capacity and technical ability of the market for audit (assurance) services. Reasonable assurance of sustainability reporting is difficult at this stage in the absence of sustainability assurance standards. The proposal therefore gives the Commission the possibility of adopting such standards. If the Commission does adopt sustainability assurance standards, then the legal requirement would automatically become a requirement for reasonable assurance instead of limited assurance.

The Commission's proposal allows Member States to open up the market for sustainability assurance services to so-called 'independent assurance services providers'. This means that Member States could chose to allow firms other than the usual auditors of financial information to assure sustainability information.

Digitalisation: will the proposal make information available in a digital format?

The Commission's proposal anticipates the increasing digitalisation of sustainability information. This trend holds out the possibility over time of lower reporting costs for companies and radical improvements in how investors and other stakeholders can compare and use reported information. Specifically, the proposal would require companies to prepare their financial statements and their management report in XHTML format in accordance with the ESEF Regulation[1] and to 'tag' their reported sustainability information according to a digital categorisation system as and when specified in that Regulation. This digital categorisation system would be developed together with the sustainability reporting standards.

This will mean that sustainability information can easily be incorporated in the European Single Access Point envisaged in the Capital Markets Union Action Plan, for which the Commission will put forward a proposal later this year. Digitalisation of companies' sustainability reporting is also in line with the Digital Finance Strategy, which aims at enhancing access to data and re-use of data within the financial sector.

Costs: will this proposal create extra costs for companies?

The Commission's proposal aims to reduce reporting costs for companies over the medium to long term. Although the proposed CSRD would imply additional costs in the short term for companies subject to its requirements, most companies will face an increase in costs anyway because of the growing demand from investors and other stakeholders for corporate sustainability information. This problem is exacerbated by the existence of several overlapping standards and frameworks and inconsistent information requests from investors and other stakeholders. The Commission's proposal is an opportunity for an orderly, cost-efficient solution to the problems posed by this increase in demand, based on building consensus around the essential information that companies should disclose.

Timing and next steps: co-legislators to negotiate

The next step is for the European Parliament, and the Member States in the Council, to negotiate a final legislative text on the basis of the Commission's proposal.

In parallel, EFRAG will start work on a first set of draft sustainability reporting standards. These draft standards could then be ready for consideration by the Commission once the Parliament and Council have agreed a legislative text. EFRAG aims to have the first set of draft standards ready by mid-2022.

The final timetable will depend on how the Parliament and Council progress in their negotiations. If they reach agreement in the first half of 2022, then the Commission should be able to adopt the first set of reporting standards under the new legislation by the end of 2022. That would mean that companies would apply the standards for the first time to reports published in 2024, covering financial year 2023.

For More Information

Commission Communication: EU Taxonomy – Corporate Sustainability Reporting, Sustainability Preferences and Fiduciary Duties

EU Taxonomy delegated act

Press release

Q&A - Taxonomy Climate Delegated Act and Amendments to Delegated Acts on fiduciary duties, investment and insurance advice

Factsheet – the April 2021 sustainable finance package

DG FISMA's website on sustainable finance

List of used acronyms

(in order of appearance)

DA: Delegated Act

CSRD: Corporate Sustainability Reporting Directive

NFRD: Non-Financial Reporting Directive

SFDR: Sustainable Finance Disclosure Regulation

TEG: Technical Expert Group (on sustainable finance)

IPSF: International Platform on Sustainable Finance

SMEs: Small and Medium-sized Enterprises

MTFs: Multilateral Trading Facilities

EFRAG: European Financial Reporting Advisory Group

GRI: Global Reporting Initiative

SASB: Sustainability Accounting Standards Board

IIRC: International Integrated Reporting Council

CDSB: Climate Disclosure Standards Board

CDP: formerly the Carbon Disclosure Project

ESEF: European Single Electronic Format

[1] Article 3 of Commission Delegated Regulation (EU) 2018/815 of 17 December 2018 supplementing Directive 2004/109/EC of the European Parliament and of the Council with regard to regulatory technical standards on the specification of a single electronic reporting format (OJ L 143, 29.5.2019, p. 1).

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