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Corporate Sustainability Reporting Directive: What Directors Need to Know and Do

with Éamon Ó Cuív, Partner, McCann FitzGerald LLP

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Increased demand for sustainability reporting

- To make companies more accountable for their impact
- To avoid greenwashing
- To direct capital towards more sustainable companies and investments
- To allow investors to take into account sustainability-related risks and opportunities
- To identify risks which could threaten financial and economic stability

Shortcomings of the existing Non-Financial Reporting Directive Regime

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- Only applies to a large public interest entities with over 500 employees.
- Information not comparable/reliable due to use of different reporting frameworks.
- Not subject to external audit.
- Does not meet requirements of investors, lenders and other stakeholders.
- Often published in a separate sustainability report.

Corporate Sustainability Reporting Directive (CSRD)- Scope

Scope of CSRD* expanded to cover:

- All EU large companies meeting **two** of:
  - 250 employees and/or
  - €40M net turnover and/or
  - €20M balance sheet total.
- EU SMEs listed on a regulated market (other than micro undertakings).
- EU parent companies, where the group of companies satisfy the large group criteria (i.e. collectively meet the large company criteria above on a consolidated basis).
- Non-EU parent undertakings that have net turnover over €150m in the EU and either:
  - EU branch with net turnover over €40m; or
  - EU Subsidiary which is a large company or listed SME.

*These scope considerations are subject certain exemptions, including where reports are prepared on a consolidated basis by a parent company, and the rules should be considered carefully and specific advice taken where necessary.

CSRD – Main Features

- Sustainability report must be included in the directors' report
- Subject to external audit, initially on a limited assurance basis but moving towards reasonable assurance.
- Single electronic reporting format – to be in XHTML format.
- Less onerous reporting obligations for SMEs.
- Introduction of new European Sustainability Reporting Standards
    - Developed by EFRAG
    - Final drafts of 12 ESRS submitted to EC in November 2022
    - 2 cross-cutting standards, 10 topical standards
    - 4 reporting pillars (Governance, Strategy, Impact risk and opportunity, and Metrics and targets)
    - 3 reporting layers (sector agnostic, sectors specific and entity-specific)
    - Designed to be interoperable with international standards
    - Separate standards for SMEs and non-EU parent companies. Equivalence regime also provided for.

CSRD Reporting Timelines

- CSRD must be transposed into domestic legislation by 6 July 2024 (consultation on Member State options launched by DETE).
- Entities currently subject to NFRD – FY starting on or after 1 January 2024.
- Large companies/in-scope parent companies not currently subject to NFRD – FY starting on or after 1 January 2025.
- Listed SMEs – FY starting on after 1 January 2026 (SMEs can opt-out to FY 2028).
- In scope non-EU parent companies – FY starting on or after 1 January 2028

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Taxonomy Regulation - Overview

- Environmentally Sustainable Economic Activity:
  - Substantially Contributes to specified environmental objectives (or is an "enabling" or "transition" activity)
  - Does not significantly harm any environmental objectives
  - Complies with minimum safeguards
  - Complies with technical screening criteria
- 6 Environmental Objectives
  - Climate change mitigation
  - Climate change adaptation
  - Sustainable use and protection of water / marine resources
  - Transition to circular economy
  - Pollution prevention and control
  - Protection and restoration of biodiversity and ecosystems

Taxonomy Regulation - Technical Screening Criteria

- Technical Screening Criteria contain the specific detailed criteria to be satisfied in relation to the ‘substantial contribution’ and ‘do no significant harm’ tests.
- Technical Screening Criteria adopted for Climate Change Mitigation and Climate Change Adaptation objectives.
- Technical Screening Criteria for remaining 4 environmental objectives still outstanding.
- Criteria are dynamic, subject to ongoing review and amendment and may be expanded to cover other activities.

Taxonomy Regulation - Reporting

- Article 8 Taxonomy Regulation – requires in-scope undertakings to report on how and to what extent their activities are 'taxonomy-aligned', including by reference to specific key performance indicators (KPIs).
- For non-financial companies, the KPIs include the proportion of turnover, capital expenditure and operating expenditure that is 'taxonomy-aligned'.
- Different KPIs for banks, investment firms and insurance undertakings reflecting the nature of their business.
- Reporting timelines:
  - Non-financial companies reported on Taxonomy-eligible activities with respect to FY 2021– this year, will begin to report on full taxonomy alignment with respect to FY 2022.
  - Financial companies have 2 years of eligibility reporting on FY2021 and FY2022 before starting full alignment reporting in 2024 (in respect of FY 2023).
- Scope is linked to NFRD/CSRD – if a company is within scope of NFRD/CSRD, it also needs/will need to report under the Taxonomy Regulation.

Corporate Sustainability Due Diligence Directive (CSDDD)

- Scope – more limited than CSRD, covers:
  - EU companies with over:
    - 500 employees; and
    - €150M net worldwide turnover.
  - EU companies with over:
    - 250 employees; and
    - €40M net worldwide turnover of which 50% generated in high-impact sector.
  - Non-EU companies with over €150M net EU turnover.
  - Non-EU companies with over €40M net EU turnover of which 50% generated in high-impact sector.
- Due diligence: integrate human rights/environmental due diligence into corporate policies and produce/update due diligence policy. Transition plan to be adopted for large companies.
- Identify adverse impacts, Prevent potential impacts and End actual impacts. Adverse impacts defined by reference to international instruments listed appended to CSDDD.
- Establish and maintain a complaints procedure.
- Monitor effectiveness of procedures.
- Report under CSRD or otherwise publish an annual statement on website.
- Penalties/civil liability for non-compliance.
- Timelines – phased approach. Will apply first to very large companies (over 1000 employees and €300m net worldwide turnover) 3 years from the entry into force of CSDDD.

Questions?

McCann FitzGerald

McCANN FITZGERALD

Principal Office
Riverside One, Sir John Rogerson's Quay
Dublin 2 D02 X576
+353 1 829 0000

New York
Tower 45, 120 West 45th Street, 19th Floor
New York, NY 10036
+1 646 952 6001

London
Tower 42, Level 38C, 25 Old Broad Street
London EC2N 1HQ
+44 20 7621 1000

Brussels
40 Square de Meeûs, 1000 Brussels
+32 2 740 0370

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