

SUSTAINABILITY REPORTING OBLIGATIONS FOR COMPANIES A REALITY. DOES IT ALREADY AFFECT YOURS?

On 16 December 2022, the *Corporate Sustainability Reporting Directive* (hereinafter the "CSRD")¹ was published in the Official Journal of the European Union. Entering into force on 5 January 2023, it is foreseen that Member States will have a transposition period of one and a half years after its entry into force (until 6 July 2024).

Faced with a significant increase in demand for corporate sustainability disclosures, mainly from the investment community, due to a growing awareness of the financial implications of the risks faced by companies in relation to environmental aspects, as well as a new form of investment products that precisely aim to achieve sustainability objectives and ensure consistency with the objectives of the Paris Agreement, the European Union highlights the need to revise the previous Directive on non-financial reporting², an initiative that was welcomed by the European Parliament which, in addition, made the following requests in observation of certain shortcomings: it asked to extend its scope of application to other categories of companies, as well as to subject sustainability reporting to a mandatory verification process.

The European Commission, in its report of 21 April 2021, on the review of the Non-Financial Reporting Directive³, pointed out the main problems it presented, including the limited comparability and reliability of the information on sustainability that companies were obliged to present. Under the previous Directive, companies were not obliged to use a common reporting framework or standard, only non-binding guidelines for companies within the scope of the Directive. These guidelines alone did not ensure comparability of disclosures sufficient for investor users to make sound decisions, and the previous Directive did not ensure the reliability of disclosures by not providing for effective auditing practices.

¹ **Directive (EU) 2022/2464 of the European Parliament and of the Council of 14 December 2022** amending Directive 2013/34/EU of the European Parliament and of the Council of 26 June 2013 on the annual financial statements, consolidated financial statements and related reports of certain types of companies, Directive 2004/109/EC, Directive 2006/43/EC and Regulation (EU) No. 537/2014 as regards sustainability reporting by companies.

² **Directive 2014/95/EU of the European Parliament and of the Council of 22 October 2014** amending Directive 2013/34/EU as regards disclosure of non-financial information and diversity information by certain large companies and certain groups.

³ Commission report of 21 April 2021 on the review clauses of Directives 2013/34/EU, 2014/95/EU and 2013/50/EU and the related adequacy check on the EU framework for corporate disclosure ("Commission report on review clauses and related adequacy check").

In this context, and with the aim of increasing the comparability of data as well as harmonising standards, on 28 November 2022, the Council of the European Union approved the final text of the new CSRD, which extends the scope of application to 50,000 companies in the European Union, compared to around 11,700 that were obliged to publish information on sustainability issues under the previous Directive; introduces more detailed sustainability reporting requirements; strengthens the accountability of companies, thereby improving the system for holding them accountable for their activities and their standards; and strengthens the system for holding them accountable for their activities and activities.700 that were obliged to publish information on sustainability issues under the previous Directive; it introduces more detailed sustainability reporting requirements; it strengthens the accountability of companies, thereby improving the system for holding them accountable for their activities and impact on the environment and on people (which could lead to increased public trust in companies) and, finally, it harmonises the sustainability reporting requirements that companies must disclose in order to increase the comparability of data.

WHICH COMPANIES ARE OBLIGED TO REPORT ON SUSTAINABILITY ISSUES UNDER THE CSRD DIRECTIVE?

In view of the increased needs of users for sustainability information, the new CSRD requires all large companies and all companies, except micro-enterprises, whose securities are admitted to trading on a regulated market in the Union to provide sustainability information. It therefore extends the obligation to the following categories:

- **All large undertakings** domiciled in the European Union, whether or not they are public-interest entities within the meaning of Directive 2013/34/EU⁴, defined as those which, at the balance sheet date, exceed the numerical thresholds of two of the following three criteria: (i) they have a balance sheet total of EUR 20 million; (ii) they have a net turnover of more than EUR 40 million; (iii) they have an average number of employees during the financial year of more than 250.
- The **parent companies of a large group** domiciled in the European Union, whether or not they are public-interest entities under the same terms established in Directive 2012/34/EU. Large groups shall be understood to be those consisting of a parent company and its subsidiaries that are to be included in a consolidation and that, on a consolidated basis, exceed the numerical limits of at least two of the three criteria set out above.
- **All small and medium-sized enterprises** domiciled in the European Union, with the exception of micro-enterprises, **whose securities are admitted to trading on a regulated market in the Union or are otherwise considered to be public interest entities within the meaning of Directive 2013/34/EU.**
 - **Small enterprises**" are defined as enterprises which, at the balance sheet date, do not exceed the numerical limits of two of the following criteria: (i) the total balance sheet is

⁴ Public-interest entities are defined, by reference to Article 2(1)(a) of Directive 2013/34/EU, as entities which are regulated by the law of a Member State and whose securities are admitted to trading on a regulated market in any Member State, as defined in Article 4(1)(14) of Directive 2004/39/EC of the European Parliament and of the Council of 21 April 2004 on markets in financial instruments.

4 million; (ii) the net turnover does not exceed EUR 8 million; (iii) the average number of employees during the financial year is equal to or less than 50.

- **Medium-sized enterprises are** defined as enterprises which do not qualify as micro or small enterprises and which, at the balance sheet date, do not exceed the numerical thresholds of two of the following three criteria: (i) a balance sheet total of EUR 20 million; (ii) a net turnover of EUR 40 million; (iii) an average number of employees during the financial year of 250.
- For the purpose of narrowing the subjective application limits of the CSRD, micro-enterprises shall be defined as those which, at the balance sheet date, do not exceed the numerical limits of at least two of the following three criteria: (i) a balance sheet total of 350,000 euros; (ii) a net turnover of 700,000 euros; (iii) an average number of employees during the financial year of 10.
- To subsidiaries and branches of Union companies located in third countries, subject to certain conditions.
- **The exempt subsidiary company regime.** Notwithstanding the above, the CSRD provides for an exemption regime where:
 - a) An undertaking which is a subsidiary is exempt from sustainability reporting obligations where that undertaking and its subsidiary undertakings are included in the consolidated annual report of a parent company, prepared in accordance with the Directive; or
 - b) An undertaking which is a subsidiary of a parent company which is established in a third country, where that subsidiary and its subsidiary undertakings are included in the consolidated sustainability information of that parent company and where that consolidated sustainability information is prepared in accordance with the sustainability reporting standards adopted by the European Commission pursuant to this Directive or in a manner equivalent to such reporting standards, as determined in accordance with an implementing act on the equivalence of sustainability reporting standards.
 - c) This exemption shall also apply to qualifying public interest entities, with the exception of large undertakings which are public interest entities as defined in Article 2(1)(a) of Directive 2013/34/EU.

PHASED IMPLEMENTATION REGIME

It is foreseen that Member States will have, as explained above, a period of one and a half years from its entry into force to bring into force all laws, regulations and administrative provisions necessary to transpose the CSRD. By 6 July 2024 at the latest, Member States will have to communicate to the Commission the text of these provisions.

However, implementation of the provisions of the Directive is foreseen in four stages:

- Large undertakings already subject to the previous Non-Financial Reporting Directive, which are public-interest entities and exceed at the balance sheet date an average number of 500 employees during the financial year, as well as public-interest entities which are parent companies of a large group and exceed at the balance sheet date, on a consolidated basis, the average number of employees during the financial year, will be required to report on sustainability issues for the years beginning on 1 January 2024 in the year 2025.
- Large companies and parent companies of a large group not currently subject to the previous Non-Financial Disclosure Directive, i.e. those whose securities are not admitted to trading on a regulated market in the European Union, will be required to report on sustainability issues in 2026 for financial years beginning on or after 1 January 2025.
- Small and medium-sized enterprises, with the exception of micro-enterprises, whose securities are admitted to trading on a regulated market in the European Union, shall be required to report in 2027 on sustainability issues for financial years starting on or after 1 January 2026.

However, such small and medium-sized enterprises that are public interest entities may, for all financial years starting before 1 January 2028, waive the sustainability reporting requirements set out in the Directive, provided that they briefly state in their annual report why sustainability reporting was not provided.

- Third-country companies with a net turnover in the European Union exceeding EUR 150 million and at least one subsidiary or branch in the European Union above certain thresholds will be required to report in 2029 for financial years starting on or after 1 January 2028.

CONTENT OF THE SUSTAINABILITY REPORT

Large, small and medium-sized enterprises, with the exception of micro-enterprises, that are public-interest entities should include in the management report the information necessary to understand the impact of the company on sustainability issues, and the information necessary to understand how sustainability issues affect the company's performance, results and position, and this information should be clearly identified in a specific section of the management report.

EXTERNAL AUDIT OF SUSTAINABILITY REPORTING

The previous Directive did not oblige Member States to require companies to have their sustainability information verified by an independent audit service provider.

management reports, although it allowed for the possibility that they could demand it if they considered it necessary.

While the amending Directive does not impose an obligation to verify the reported information, it introduces an obligation for the statutory auditor or audit firm to provide an opinion on the compliance of the sustainability reporting with Union requirements on the basis of a limited assurance engagement in order to reach a reasonable level of verification by 2028.

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