

CSRD Directive - a revolution in ESG reporting

The adoption of the CSRD by the European Parliament means that companies will soon have to publish detailed information on ESG issues. This will make companies more accountable and facilitate the transition to a sustainable economy.

The new act amends the 2014 Non-Financial Reporting Directive (NFRD) and strengthens existing provisions in this area to align them with the requirements of the EU's transition towards a sustainable economy. Thanks to the introduced changes, investors and stakeholders will have access to comparable, reliable and easily accessible information on ESG.

Member States have 18 months to implement the CSRD into their national law.

The new ESG reporting rules will large public interest companies with more than 500 employees (PLC), all large companies with more than 250 employees and a turnover of 40 million Euro per year, and companies listed on regulated markets, with the exception of micro-enterprises. These companies are also responsible for evaluating information about their subsidiaries.

The regulations also apply to SMEs, taking into account their specificities. For a transitional period, they can benefit from a derogation: they will be exempt from the Directive until 2028.

In the report, in the field of environment, social policy and corporate governance, the following issues should be taken into account:

- business model
- policies, including due diligence processes in place.
- the outcome of these policies
- risk and risk management
- key performance indicators related to the activity.

In addition, disclosures will need to be made about the business strategy and resilience of the business model to risks related to sustainability issues.

Carbon footprint in the supply chain

The CSRD directive obliges 10 times more companies to report non-financial data for than from the current NFRD directive. One of the important elements of reporting CO2 emissions is the carbon footprint created in the supply chain.

Thus, companies with the obligation to report non-financial data will expect their suppliers to reduce the carbon footprint of their services and products so that they do not interfere with the emission reduction strategy. Suppliers will therefore have a choice – to reduce greenhouse gas emissions or accept the loss of contracts.

The change in the regulations regarding ESG reporting will make companies who fall under the CSRD directive pay special attention to who they sign contracts with. Therefore, measuring the carbon footprint may soon provide small and medium-sized companies with a competitive advantage on the market.

A double - materiality perspective

The NFRD (now superseded by the CSRD) introduced the concept of a double materiality under which both the risk to which the company is exposed to, and the impact exerted by it should be reported. In practice, this means that companies will have to report how their business activities affect the environment and how external factors of sustainability (such as climate change or human rights) affect the company. Of course, information relevant to both perspectives and information relevant to only one of them should be disclosed.

ESRS – a single framework for non-financial reporting

By the end of June 2024, the EU Commission is expected to adopt a coherent and comprehensive set of sustainability reporting standards developed by EFRAG (European Financial Reporting Advisory Group), addressing all sustainability issues from a double materiality perspective. ESRS indicators will be developed based on existing international initiatives, i.e. GRI or ISSB. The draft standards can be divided into general (obligatory for all reporting entities), sectoral and simplified standards for the SME sector.

These standards will address all major environmental factors, including impacts on and dependence on climate, air, land, water and biodiversity. They will specify the level and scope of greenhouse gas emissions and removals attributed to a given entity, including the extent to which the entity applies compensations and what is their source. Achieving a climate-neutral economy requires adapting standards for greenhouse gas accounting and offsetting. The drafted standards must be consistent with the Taxonomy.

Cross-cutting standards	E: Environmental Standards	S: Social Standards	G: Corporate Governance Standards
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General rules (ESRS 1)	Climate Change (ESRS E1)	Employees (ESRS S1)	Corporate governance, risk management and internal audit (ESRS G1)
General Disclosures on Strategy, Governance and Materiality Assessment (ESRS 2)	Pollution (ESRS E2)	Employees in the value chain (ESRS S2)	Business Practices (ESRS G2)
	Water and marine resources (ESRS E3)	Society (ESRS S3)	
	Biodiversity and ecosystems (ESRS E4)	Consumers and end users (ESRS S4)	
	Resource use and circular economy (ESRS E5)		

Taxonomy

The taxonomy aims to help solve the problem of greenwashing by creating harmonised European rules defining what investments are environmentally sustainable. This regulation came into force at the beginning of 2022. It specifies that a given activity may be considered environmentally sustainable if it meets four conditions in total, i.e.:

- makes a significant contribution to at least one of the six environmental objectives (climate change mitigation; climate change adaptation; sustainable use and protection of water and marine resources; transition to a circular economy; pollution prevention and control; protection and restoration of biodiversity and ecosystems);

- does not cause serious damage to any of the environmental goals
- is carried out in accordance with minimum guarantees
- meets the technical eligibility criteria

Taxonomy records are crucial primarily for entities from the financial industry and large companies. However, they can also be of great importance in practice for other entrepreneurs. It is likely that some banks or other money lending institutions will increasingly finance activities only or largely in accordance with the Taxonomy. In such a case, entrepreneurs wishing to obtain a loan on favourable terms may in practice be required to prove that their activity is compliant with the Taxonomy. Otherwise, they may not get the funds they need or get them on unfavourable terms.

Foreign companies operating in the EU are also covered by the directive

Third-country entities with significant operations in the territory of the European Union will also be required to provide information on sustainability, in particular on their social and environmental impact (sustainability reporting standards for third-country entities will be developed). The rules will apply to companies that have a subsidiary or branch in the EU that generates a net turnover exceeding 40 million EURO.

When are the first ESG reports under the CSRD?

In the first place, information will be presented in 2025 for the financial year of 2024 by the largest entities that already report the so-called non-financial information pursuant to the Accounting Act. These are large public interest entities that employ more than 500 people. A year later, the first reports will be presented by other large entities. Small and medium enterprises will submit reports for the first time in 2027 for the financial year of 2026.

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