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Technical Line

How the EU's Corporate Sustainability Reporting Directive affects non-EU-based multinationals

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What you need to know

- Many entities headquartered outside the EU, including many US multinationals, will have to make extensive new sustainability disclosures under the EU's Corporate Sustainability Reporting Directive. If they haven't already done so, these entities need to carefully evaluate whether they are in the scope of the CSRD.
- Non-EU entities that are in the scope of the CSRD will also need to determine when they need to start applying it, which may be as soon as 2024 for calendar-year entities.
- All affected entities also are required to fulfill the requirements of the EU Taxonomy Regulation, which are complex.
- Affected entities should consider how they will gather the information required under the CSRD and European Sustainability Reporting Standards and whether they will need to set up new processes, systems and controls.

Overview

The Corporate Sustainability Reporting Directive (CSRD),[1] a European Union (EU) legislative act that was finalized in January 2023, includes a mandate to report sustainability information under a reporting framework provided by the European Sustainability Reporting Standards (ESRS) that is initially developed by the European Financial Reporting Advisory Group (EFRAG).

The scope of the CSRD is far reaching and affects EU-based entities as well as non-EU-based public and private entities with operations in the EU through subsidiaries or branches in the EU. In addition, the CSRD contains certain reporting requirements that only apply to non-EU

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entities. Determining whether an entity is in the scope of the CSRD may be complicated, particularly for entities headquartered outside the EU, so all entities need to carefully evaluate whether they are in the scope of the CSRD and, if so, how they will be affected.

Although the CSRD was finalized in January 2023, a key aspect of sustainability reporting under the CSRD is still outstanding. EU Member States must include the requirements of the CSRD into their local laws by 16 June 2024. Any EU directive, including the CSRD, is binding on EU Member States, although they have some authority to choose the form and methods to achieve the required result as they incorporate the directive into their local laws. Individual EU Member States are permitted to broaden the scope and reporting requirements (often referred to as "gold plating").

The CSRD also contains options individual EU member states can apply (e.g., allowing an independent assurance provider other than the entity's statutory auditor to provide assurance). Therefore, companies should monitor the local laws of the relevant EU jurisdictions to determine how they will be affected.

Further, all ESRS need to be issued through a regulation (referred to as a delegated act) by the European Commission (EC), the executive arm of the EU. The EU issued a delegated act for the first set of ESRS on 31 July 2023. Future delegated acts will be required for the other sets of ESRS (e.g., sector-specific standards, standards for listed small and medium-sized entities (SMEs), standards for non-EU entity reporting), which will be developed by EFRAG.

Public and private non-EU-based entities (e.g., entities based in the US) with significant operations in the EU need to evaluate the scope of the CSRD requirements in detail to determine how they would be affected.

Scope

Non-EU entities with debt or equity securities listed on an EU-regulated market

The CSRD applies to any non-EU entity (e.g., an entity headquartered in the US) that has equity or certain debt securities listed on EU-regulated markets, except for micro companies (i.e., companies with fewer than 10 employees and annual turnover (i.e., revenue) below €900,000 or balance sheet total (i.e., total assets) below €450,000[2]). This scoping is based on the legal entity that has listed the securities (e.g., any subsidiary that has securities listed on EU-regulated markets, regardless of its jurisdiction of incorporation, should consider the scoping analysis below).

Refer to the *Additional non-EU entity consolidated reporting* section that addresses non-EU entities that have €150 million in net turnover in the EU and that do not have a subsidiary in the EU but have a branch that has more than €40 million in net turnover in the EU.

Subsidiaries

The CSRD applies to the following entities (including entities located in the EU that are subsidiaries of non-EU entities):

- All entities with securities (equity or certain debt) listed on EU-regulated markets, except for micro companies
- A "large undertaking" that is an EU entity, meaning an entity that meets at least two of the following criteria: (1) has more than €50 million in net turnover, (2) has more than €25 million in balance sheet total and (3) has more than an average of 250 employees during the year[2]

- Insurance entities and credit institutions regardless of their legal form, except for micro companies

These criteria need to be applied on both a legal entity basis (i.e., an individual EU subsidiary basis) and a consolidated basis for the EU entity, including any non-EU subsidiaries of the EU entity (i.e., the EU entity needs to evaluate whether it, together with its EU and non-EU subsidiaries, meet the thresholds above on a consolidated basis), regardless of whether the EU entity has financial reporting requirements at that level.

How we see it

Many non-EU entities have EU holding companies (e.g., Irish, Dutch, Luxembourg subsidiaries) that may have been established for tax purposes. The CSRD applies to any EU holding company, inclusive of its EU and non-EU subsidiaries, that meets any of the criteria above, even if the EU holding company does not meet the criteria on a standalone basis (i.e., without considering its subsidiaries), does not report at that level for financial reporting purposes and/or does not have significant operations in the EU.

Reporting options

Non-EU entities that are not large and listed have several reporting options under the CSRD.

Once a non-EU entity determines that its subsidiary or subsidiaries are in the scope of the CSRD, it needs to evaluate which entity or entities will issue the reports and which entities are to be included in such report(s). That is because an EU subsidiary is exempt from issuing a standalone report if a parent entity includes the subsidiary in its consolidated report that fully complies with the ESRS ("the subsidiary exemption").

Standalone reporting for large and listed entities

Any entity that is listed and meets the criteria for a large undertaking described above is required to issue a standalone report under the CSRD, inclusive of its EU and non-EU subsidiaries. That is, it cannot rely on the subsidiary exemption.

Standalone reporting for EU subsidiaries that are not large and listed entities

The CSRD has several reporting options for EU subsidiaries that are not large and listed. For example, each in-scope EU entity can issue its own report that fully complies with the ESRS, but it must include its subsidiaries (both EU and non-EU) in the report.

Consolidated reporting for EU subsidiaries that are not large and listed with EU parents

An EU entity is not required to issue (i.e., it is exempt) its own report if an EU parent entity includes the subsidiary in its consolidated report that fully complies with the ESRS. That is, even though an EU subsidiary meets the scoping criteria above (but isn't large and listed) on its own, it is not required to issue a standalone report when it is included in a consolidated report of an EU parent company that fully complies with the ESRS.

Consolidated reporting for non-listed EU subsidiaries with non-EU parents

Similarly, an EU-based subsidiary in the scope of the CSRD that does not have an EU parent (and is not large and listed) is not required to issue its own report if it is included in the non-EU parent's sustainability report that fully complies with either the ESRS or standards the EC deems equivalent to those of the EU. While the EC has not yet determined the equivalence criteria and what standards are equivalent, the CSRD requires that any equivalent standards cover environmental, social and governance (ESG) topics (i.e., not just climate topics) and require the use of the double materiality concepts discussed below.

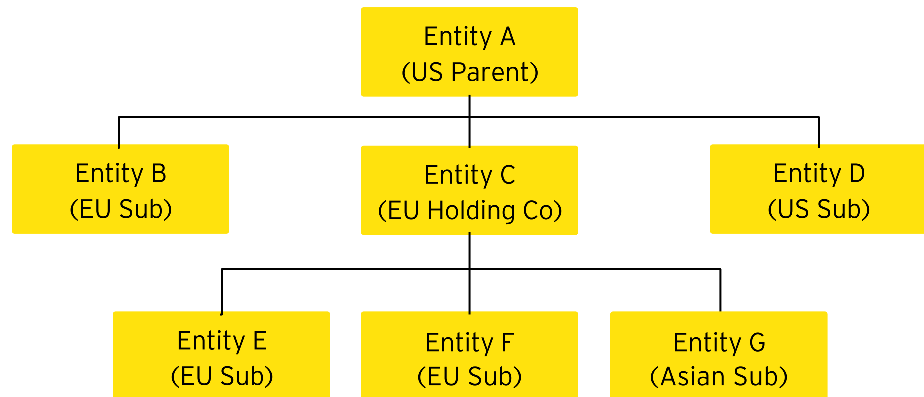
Artificial consolidation for non-listed EU subsidiaries with non-EU parents

As a transitional provision until 2030, a non-EU parent can select for purposes of its CSRD report an EU subsidiary to consolidate all of the non-EU parent's EU subsidiaries in the scope of the CSRD (including those subsidiaries' EU and non-EU subsidiaries). The selected entity would include EU subsidiaries that are not consolidated for financial reporting purposes. That is, the entities consolidated by the selected EU subsidiary for the CSRD report would not be the same as those consolidated by it for financial reporting purposes. However, the EU subsidiary selected must be one of the EU subsidiaries that generated the greatest turnover in the EU during at least one of the preceding five financial years, on a consolidated basis where applicable.

The following example illustrates how these different reporting options may apply to a simplified entity structure.

Illustration 1 – Reporting options for a simplified entity structure

Facts: Entity A is a parent company headquartered in the US that has the following structure:



- Entity B is a large undertaking (as described in the scoping section above).
- Entity C is a small undertaking on its own but, on a consolidated basis, is a large undertaking.
- Entity E is a large undertaking and is listed on an EU-regulated market.
- Entity F is a large undertaking.
- No additional subsidiaries exist besides those presented.
- Entity C is one of the EU subsidiaries that generated the greatest turnover in the EU in at least one of the preceding five financial years.

Analysis: The EU-based entities in the consolidated group that are in the scope of the CSRD can fulfill their reporting obligations in several different ways. Each of the following scenarios indicate how the group could comply with its reporting obligations.

- **Standalone reporting:** Since Entity E is large and listed, it must submit its own sustainability report. Under this reporting option, Entity B, Entity F and Entity C (including all of Entity C's subsidiaries) would also need to submit separate sustainability reports.
- **Consolidated reporting within the EU:** Since Entity E is large and listed, it must submit its own sustainability report. Under this reporting option, Entity B and Entity C (on a consolidated basis, which for Entity C would include Entity E, Entity F and Entity G) would also need to submit separate sustainability reports. Entity F does not have to

report separately because it is included in the consolidated sustainability report of its parent, Entity C.

- **Consolidated reporting at the non-EU parent level:** Since Entity E is large and listed, it must submit its own sustainability report. Entity A (inclusive of its subsidiaries) can submit a sustainability report that fully complies with the ESRS. Under this reporting option, Entity B, Entity C (on a standalone or consolidated basis) and Entity F do not have to report separately because they are included in the consolidated sustainability report of Entity A. However, the US-based subsidiary, Entity D, which would not otherwise have to report, has to be included in the consolidated sustainability report of Entity A.
- **Artificial consolidation:** Since Entity E is large and listed, it must submit its own sustainability report. Through 2030, Entity C (including all of its subsidiaries) can submit a sustainability report that includes Entity B. Entity B is included, even though it is not consolidated by Entity C for financial reporting purposes. After 2030, another reporting option will need to be selected.

How we see it

Determining the level of reporting for a non-EU entity that has entities in the scope of the CSRD can be complex. A non-EU entity may want to consider the following:

- The extent of its existing data gathering systems, processes and controls (both within the EU and globally)
- The amount of information it wants to provide or is comfortable providing publicly to comply with and, therefore, be subject to EU regulations (e.g., in some circumstances an entity may wish to limit reported information to only EU subsidiaries)
- The requirement to disclose some information at the consolidated entity level (i.e., if an entity reports at the consolidated non-EU entity level to fulfill the reporting requirement of EU subsidiaries, it will not have to separately report at the consolidated level, as discussed below)

Additional non-EU entity consolidated reporting

Separately, a non-EU company that generates €150 million in net turnover in the EU and has either of the following is required to report starting in 2028 at the consolidated level of the ultimate parent:

- A subsidiary in the scope of the CSRD (as defined in the Subsidiaries section above)
- A branch with net turnover of more than €40 million in the EU (if the non-EU company has no EU subsidiary in the scope of the CSRD)

A non-EU entity in the scope of the CSRD can report at the consolidated level by applying any of the following standards:

- Separate EU sustainability reporting standards that EFRAG will develop in the future
- The ESRS
- Standards that are deemed equivalent to those of the EU, which have yet not been determined by the EC

While separate EU sustainability reporting standards for non-EU companies haven't yet been developed, they aren't expected to cover all reporting areas that are included in the ESRS.

How we see it

The CSRD does not specify how an entity should calculate whether it has €150 million in net turnover in the EU. Some entities have questioned whether the amount should include revenue generated by non-EU entities from customers in the EU. Other entities have questioned whether the amount should include revenue generated by EU subsidiaries from customers outside the EU.

Based on our current understanding, we believe an entity should calculate revenue in the EU based on whether the customer is in the EU, regardless of the location of the entity that generated that revenue.

Effective dates

The CSRD is effective for the following periods, with reporting in the following year, based on an entity's size:

- Fiscal year 2024 for entities that are currently subject to the Non-Financial Reporting Directive (NFRD) (i.e., large entities that are public-interest companies with more than an average of 500 employees during the year) and, based on our current understanding, other listed entities (such as non-EU entities) that have equity or certain debt securities listed on an EU-regulated market that meet the NFRD thresholds
- Fiscal year 2025 for large entities that are not subject to reporting in fiscal year 2024
- Fiscal year 2026 for listed SMEs, unless they opt out for two additional years and disclose why they haven't provided the sustainability information, and small and noncomplex credit institutions and captive insurance entities
- Fiscal year 2028 for non-EU companies that are subject to the CSRD (e.g., a non-EU parent with an in-scope EU subsidiary or branch that meets the thresholds described in the Additional non-EU entity consolidated reporting scope section above)

The following table lists the effective dates for different types of calendar-year entities and the related reporting standards they need to follow:

<table>
<tr><th>Reporting entity type</th><th>Effective date</th><th>Report issued in</th><th>Reporting standards</th></tr>
<tr><td>Entities already subject to NFRD and other large and listed entities with over 500 employees</td><td>1 January 2024</td><td>2025</td><td rowspan="3">First set of ESRS:
▸ Cross-cutting standards
▸ Topical sector-agnostic standards
Second set of ESRS:
▸ Relevant sector-specific standards[3]</td></tr>
<tr><td>Large EU subsidiaries of non-EU entities</td><td rowspan="2">1 January 2025</td><td rowspan="2">2026</td></tr>
<tr><td>Large and listed entities with fewer than 500 employees</td></tr>
<tr><td>Listed SMEs
Insurance companies and credit institutions that are SMEs</td><td>1 January 2026 (option to delay to 2028)</td><td>2027 (option to delay to 2029)</td><td>Second set of ESRS: Standards for SMEs</td></tr>
<tr><td>Additional non-EU entity consolidated reporting</td><td>1 January 2028</td><td>2029</td><td>Second set of ESRS: Third country standards[3]</td></tr>
</table>

Disclosures are required for comparative periods, but an entity can defer the presentation of comparative information by one year (i.e., not provide the comparative information in the year of adoption). To ease transition to reporting under the CSRD, certain disclosure requirements in the ESRS (e.g., certain value chain metrics, quantitative and anticipated financial effects) are phased in, with some phase-ins dependent on an entity's size.

Required disclosure location

The CSRD and ESRS require presentation of the required sustainability information in the management report for an EU entity. However, if an EU subsidiary in the scope of the CSRD fulfills its reporting requirement by being included in a sustainability report of a non-EU parent, the EU subsidiary may include the required disclosures in a consolidated sustainability report (rather than a consolidated management report) of the non-EU parent (e.g., an entity registered with the Securities and Exchange Commission would not be required to include that information in Form 10-K), with a link to that report in the management report of the EU subsidiary.

The CSRD also requires an entity to mark up its sustainability report using an electronic reporting format (European Single Electronic Format — ESEF). This will allow interested parties to access the reports in the European Single Access Point, which is currently under development.

ESRS disclosure requirements

The ESRS establish the disclosure requirements under the CSRD. The first set of ESRS includes 12 standards that cover a broad spectrum of ESG topics. These standards include both cross-cutting and topical standards, which are both required. In addition, sector-specific standards, standards for SMEs and standards for global consolidated reporting for non-EU entities will be developed by EFRAG in the future.

Cross-cutting standards
ESRS 1 General requirements
ESRS 2 General disclosures

Topical sector-agnostic standards		
Environment	**Social**	**Governance**
ESRS E1 Climate change	ESRS S1 Own workers	ESRS G1 Business conduct
ESRS E2 Pollution	ESRS S2 Workers in the value chain	
ESRS E3 Water and marine resources	ESRS S3 Affected communities	
ESRS E4 Biodiversity and ecosystems	ESRS S4 Consumers and end-users	
ESRS E5 Resource use and circular economy		

ESRS 1 includes the mandatory concepts and principles that need to be applied when preparing sustainability reports under the CSRD. An entity should disclose all material information about its sustainability-related impacts, risks and opportunities in accordance with the applicable standards. ESRS 1 also includes the concept of double materiality discussed below.

ESRS 2 includes the disclosure requirements of sustainability reporting that are cross-cutting, including general characteristics of the entity, an overview of the entity's business and disclosures on estimates, estimation uncertainty, changes in preparation and presentation, and prior period errors. Additionally, ESRS 2 also requires disclosures about strategy, governance and the materiality assessment of sustainability impact, risks and opportunity.

The topical standards include sector-agnostic disclosure requirements for ESG matters aimed at helping users of an entity's sustainability report understand the entity's impact on these matters, the entity's material risks and opportunities related to these matters, and the impact of these matters on the entity's ability to create value. The topical standards include disclosure requirements that cover policies, targets, action plans and resources, as well as performance measurement in relation to the ESG matters.

Materiality

The ESRS uses the concept of "double materiality," which means a disclosure is material if it is material from what is called an "impact" perspective, a financial perspective or a combination of both. A sustainability matter is material from an impact perspective if it pertains to the entity's material actual or potential, positive or negative impacts on people or the environment. A sustainability matter is material from a financial perspective if it triggers or may trigger material financial effects on the entity, including its cash flows, development, performance, position and cost of capital or access to financing.

Entities subject to the CSRD are also subject to the EU Taxonomy Regulation, which is complex itself.

This definition considers both affected stakeholders (e.g., employees, customers, vendors, the community) and other users of the sustainability reporting information (e.g., investors, creditors). However, materiality does not apply (i.e., all disclosures are required, including their datapoints) to ESRS 2, which addresses disclosures on governance, strategy, impact, risk and opportunity management and monitoring of the effectiveness of actions and progress toward targets. In addition, certain datapoints in the ESRS are required by other EU laws.

The double materiality assessment is made at the reporting level.

How we see it

The concept of double materiality in the ESRS is broader than the definitions of materiality used by the SEC and the International Sustainability Standards Board and will require management to apply additional judgment to determine which matters should be disclosed from an impact perspective. Because double materiality is a new concept for entities, EFRAG has issued draft interpretive guidance on how to evaluate double materiality that will be finalized in 2024.

Taxonomy requirements

Entities that are subject to the CSRD (excluding non-EU entities that are required to report at the consolidated level in fiscal year 2028) are also required to comply with the EU Taxonomy Regulation (EU Taxonomy).

The EU Taxonomy establishes a common language and clearly defines what constitutes "sustainable" economic activities that potentially contribute to one of six environmental objectives: climate change mitigation, climate change adaptation, use and protection of water and marine resources, transition to a circular economy, pollution prevention, and control, protection and restoration of biodiversity. The EU Taxonomy is a way of categorizing the economic activities of an entity as sustainable or not sustainable by asking two questions in sequence:

- Are the types of products and services an entity provides capable of contributing to specific sustainability objectives?
- Does the company provide those products and services in a way that is actually sustainable?

An entity must determine which economic activities (e.g., electricity generation from wind power) meet the EU Taxonomy's criteria for the entity's industry and then analyze those activities for alignment with a set of screening criteria used to assess harms and safeguards.

The EU Taxonomy rules, which are complex, are intended to result in key performance indicators regarding the percentage of an entity's revenue, operating expenses and capital expenditures that comes from, or is related to, sustainable activities judged against the EU's largely science-based criteria that can be compared with those of its peers.

Assurance requirements

The CSRD requires the financial statement auditor or, if an EU Member State chooses when incorporating the CSRD into its local law, an other professional services firm or independent assurance service provider accredited by the EU Member State, to provide limited assurance, with a planned transition to reasonable assurance after the EC conducts a feasibility analysis, over the following:

- Compliance with the CSRD, including the ESRS
- The process carried out by the company to identify the information reported in accordance with the ESRS
- Compliance with the requirement to mark up the sustainability report using an electronic reporting format
- Compliance with the reporting requirements of Article 8 of the EU Taxonomy Regulation discussed above

This limited assurance is required for the initial year of reporting. There is a planned transition to reasonable assurance after the EC conducts a feasibility analysis. Entities should continue to monitor for developments in this area.

Auditors and other assurance service providers, if applicable, will be required to apply assurance standards for sustainability reporting that will be issued by the EC through a delegated act before 1 October 2026.

Next steps

- Non-EU entities should consider what entities in their consolidated group, if any, are subject to the requirements of the CSRD. Entities should then consider what level they will report at (e.g., the highest consolidated level in the EU, a global consolidated level).
- Entities should monitor relevant EU jurisdictions to determine how they incorporate the CSRD into local law, which could impact several aspects of compliance, including the scoping analysis and who may perform third-party assurance.
- Entities should evaluate their existing resource levels to determine whether they currently have the appropriate level and amount of expertise and experience necessary to evaluate the scoping and reporting requirements of the CSRD and ESRS.
- Entities should also consider their existing systems, processes and controls over gathering the information required under the CSRD and ESRS and determine whether they will need to implement new or enhanced processes, systems and controls.

Endnote:

[1] https://eur-lex.europa.eu/legal-content/EN/TXT/?uri=CELEX:32022L2464

[2] The EU adopted a delegated act in November 2023 to increase the size criteria used in the definition of micro companies, SMEs and large entities. The new thresholds will apply for fiscal years beginning on or after 1 January 2024.

[3] In October 2023, the EC proposed delaying the adoption of sector-specific and third-country standards from June 2024 to June 2026. Entities should monitor the status of this proposal when determining the reporting standards to be used to prepare reports for the related effective dates.

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