Does your US company need to comply with the new EU Corporate Sustainability Reporting Directive (CSRD)?

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Introduction

Mandatory sustainability reporting may be coming your way – not just from US regulators, but from the European Union (EU).

You have no EU headquarters? You are privately held? You still may be subject to mandatory reporting if your EU operations are sufficiently substantial. Given the intense preparations required for any new reporting regime, any public or private company that anticipates having revenue from EU operations in the mid-€100 million range, and either an EU branch or EU subsidiary, should be busy answering this question: is there a possibility the new EU Corporate Sustainability Reporting Directive (CSRD) will apply to us?

Unless the answer is a definitive "no," the time is now to lay the groundwork for the reporting requirements and their attendant controls and processes, policies, governance teams, technology and information systems, staffing and training.

While the CSRD is intended to align with or complement existing sustainability-focused regulations and voluntary frameworks and standards, including those from the Global Reporting Initiative (GRI) and the International Sustainability Standards Board (ISSB), even companies with robust reporting controls and processes should be laser-focused on the CSRD requirements since many are more extensive.

This thought piece discusses some key considerations regarding CSRD requirements and their application to US-domiciled companies. While a detailed description of the CSRD requirements is beyond the scope of this piece, a high-level comparison with commonly used sustainability reporting standards is provided below.

KEY TAKEAWAYS

- US-domiciled public and private companies with significant EU revenue may be subject to CSRD's reporting requirements.
- Extensive sustainability-related information will be required for the global operations of in-scope US companies.
- CSRD required disclosures are more extensive than those of existing sustainability standards, frameworks and regulations.
- Companies not covered by CSRD may be subject to data requests from in-scope companies in their value chains.
- The first reports covering non-EU companies are not due until 2029, but preparation will take time.

What is CSRD?

In January 2023, the EU adopted the Corporate Sustainability Reporting Directive (CSRD; 2022/2464/EU), extending the reach and breadth of a prior EU regulation that provided for sustainability-related disclosures by EU entities. The CSRD requires covered companies to disclose historical and forward-looking information about sustainability matters, including environmental, social, employee, human rights, and governance, as well as detailed information about sustainability risk management, metrics, and value chain due diligence. The specifics of the reporting requirements are set forth in the European Sustainability Reporting Standards (ESRS), the first set of which were issued in July 2023.

European Sustainability Reporting Standards (ESRS) approved in July 2023

Cross-cutting standards		Environment		Social		Governance	
ESRS 1	general requirements	ESRS E1	climate change	ESRS S1	own workforce	ESRS G1	business conduct
ESRS 2	general disclosures	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				

What US-domiciled companies are covered?

In addition to large EU-domiciled companies, the CSRD applies to:

1. all EU-listed companies, wherever incorporated, and
2. any public or private company headquartered outside the EU that has consolidated annual “net turnover”[1] in the EU exceeding €150 million in each of the last two fiscal years *AND* either (each a “Covered” entity):
   a. an EU branch with net revenue exceeding €40 million in the last fiscal year *OR*
   b. an EU subsidiary that meets two of the following criteria for the last fiscal year:
      i. average of more than 250 employees during the year
      ii. annual net turnover of more than €40 million balance sheet over €20 million

Do US parent companies with a Covered EU subsidiary or branch only need to provide disclosures regarding the Covered EU entity?

No. The disclosure requirements will, when fully phased in, cover the entire consolidated group of the ultimate parent of a Covered subsidiary or branch. The Covered entity will have the obligation to file the group report.

When are the CSRD disclosures first due for US companies?

Compliance with CSRD will be phased in. The earliest group information will need to be published for a non-EU-listed US-domiciled company is 2029 (covering fiscal 2028), though its Covered subsidiaries may need to report separately beginning 2025 (for its fiscal 2024). Until January 2030, group reporting for the US parent need only include all its Covered subsidiaries.

Can other reporting requirements satisfy the CSRD disclosures?

Perhaps. A non-EU parent consolidated report must comply with the reporting standards adopted pursuant to CSRD or “in a manner equivalent” to the CSRD standards as determined in accordance with standards on equivalence yet to be promulgated by the European Commission (EC). Since the CSRD disclosure requirements exceed those of other current reporting regimes, it is not clear if any existing standard would be deemed equivalent to CSRD, though it is possible that the EC deems an existing standard to be equivalent for some CSRD disclosures.

1 Generally, “net turnover” means amounts derived from the sale of products and provision of services after deducting sales rebates and value added tax and other taxes directly linked to turnover.

We already issue an ESG report in accordance with TCFD, GRI and SASB. Will CSRD require significantly more disclosure?

In issuing the ESRS, the European Financial Reporting Advisory Group (EFRAG) took into account existing sustainability and greenhouse gas frameworks and standards.[2] Even so, at a high level CSRD goes beyond the recommendations of the Task Force on Climate-Related Financial Disclosures (TCFD) and the voluntary GRI Standards and SASB Standards in several significant ways.[3] Companies reporting under both TCFD and GRI (in accordance) will be the best prepared for the CSRD requirements. It is worth noting, however, that the detailed reporting requirements for non-EU parent consolidated reports have yet to be issued and are expected to be slightly less onerous with respect to disclosures of group sustainability risks and opportunities.

UNIQUE CHARACTERISTICS OF CSRD'S ESRS COMPARED TO TCFD, GRI AND ISSB

(1) Double materiality applies. Companies must report on sustainability topics that they determine are material based on the company's impacts on people and the environment (impact materiality as used by GRI) *and* on the effects of sustainability matters on the company's development, performance and position (financial materiality as used by SASB and TCFD).

- Companies will need to disclose their due diligence processes for identifying, assessing, monitoring, mitigating and remediating actual and potential adverse impacts, building on GRI but applicable also to financially material topics.

(2) Topics that must be assessed for materiality may be new to some companies, such as biodiversity and the circular economy.

(3) Similar to TCFD, companies must report on governance, strategy, impact, risk and opportunity management, and metrics and targets but for *ALL* material topics, not just climate.

(4) Building on TCFD, where climate change is a material topic, a company must disclose its plans to ensure that its business model and strategy are compatible with the transition to a sustainable economy and with limiting global warming to 1.5ºC in line with the Paris Agreement en route to achieving climate neutrality by 2050.

(5) The required disclosures – and thus a company's due diligence, analysis, topic management and resulting actions - concern the company's entire value chain, not just its own operations. This includes its products and services, its business relationships (not limited to contractual) and its supply chains. This is similar to GRI, but also applies to financially material topics. Additionally, unlike GRI, CSRD does not permit the exclusion of value chain information if it is unavailable or incomplete; estimates from all reasonable and supportable information must be used.

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[2] See EFRAG Explanatory Note. See also papers issued by EFRAG regarding interoperability between ESRS and GRI and International Sustainability Standards Board's recently issued sustainability standards, respectively.

[3] TCFD recommendations and SASB standards are both governed by the International Financial Reporting Standards Foundation's International Sustainability Standards Board (ISSB), which issued the first of several international sustainability disclosure standards (IFRS S1 and S2) in July 2023. While TCFD and SASB currently remain as standalone initiatives, IFRS S1 and 2 fully incorporate the TCFD recommendations, and the SASB standards will eventually transition into industry-specific IFRS sustainability disclosure standards.

(6) For each material topic, companies must either disclose measurable outcome-oriented targets or provide an explanation for why they have not been adopted. If targets have not been adopted for a material topic, the company must disclose what processes are in place to measure the effectiveness of its policies and actions in relation to each material topic's impact, risk and opportunity.

(7) Independent limited assurance audits of disclosures are mandatory under CSRD. Detailed record-keeping will be essential.

(8) Companies that are subject to CSRD reporting obligations will also need to comply with disclosure requirements of the EU Taxonomy (2020/852/EU) for sustainable activities. The EU Taxonomy provides criteria for what can be considered an "environmentally sustainable" economic activity as part of the EU's Sustainable Finance Framework. Covered companies must report:

- how and to what extent the company's activities are associated with "environmentally sustainable" economic activities, and
- specified information about turnover, capital and operating expenditures related to "environmentally sustainable" economic activities.

Should my company pay attention to CSRD requirements if we have no EU operations?

Yes, for several reasons.

- Since CSRD requires information about entire value chains, companies subject to CSRD (at a parent or subsidiary level) will be asking their business partners to provide relevant information that they need for their own reporting. Processes should be in place to manage these requests.
- Financial and investor communities may want the same level of sustainability information from companies globally. Enhanced transparency may be a competitive advantage, including with ESG and other ratings providers.
- As regulators and standard-setting bodies work more closely to align disclosures, CSRD regulations will likely inform the development of international voluntary standards as well as regulatory efforts in the US.

What should my company consider doing now?

If your company has any current or planned EU operations, or is considering an acquisition with EU operations, we suggest trying to understand now whether it will be subject to CSRD reporting. Given the complexity of the CSRD requirements, we recommend starting sooner rather than later.

A good place to begin might be to review the readiness of your company's internal controls and other systems to handle CSRD data and reporting obligations. If CSRD will apply to your company, the foundation for identifying, capturing and assessing data can be laid well in advance, with training and close coordination of a wide cross-section of functions including human resources, information technology, legal, finance, operations, environmental, health and safety, community relations and audit. The need for ESG data accuracy, completeness and reliability goes far beyond CSRD. Efforts to improve the quality of ESG data and data collection processes can benefit the entire business.

Similarly, we suggest reviewing company supply chain relationships, processes, and information-gathering abilities, including their readiness to absorb value chain data requests.

Lastly, we suggest reviewing your company's current sustainability reporting efforts as part of a larger consideration of moving towards reporting in accordance with GRI and TCFD in the near term. This can be done as part of regular engagement with investors, ESG rating agencies, and other important stakeholders to better understand their evolving sustainability disclosure needs and expectations. Transparent, comprehensive, and clear communication is always valuable to your shareholders and other stakeholders – and ultimately to the business itself.

The CSRD (and its implementing standards) is complex and far-reaching: Refinitiv estimates that at least 10,000 companies outside of the EU will need to disclose information following CSRD's requirements, with one-third of those being U.S. companies.[4] Understanding its implications is a necessity—even for companies far from Europe's borders.

[4] Holger, Dieter. (April 5, 2023). "At Least 10,000 Foreign Companies to be Hit by EU Sustainability Rules." *The Wall Street Journal*.

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