An Overview of the CSRD Regulations and Its Implications for Organizations

WHITEPAPER

Abstract

Corporate Sustainability Reporting Directive (CSRD) is a set of environmental, social, and governance (ESG) reporting requirements in effect in the European Union that require organizations to develop a comprehensive understanding of sustainability reporting. It is intended to replace the existing Non-Financial Reporting Directive (NFRD) and has been incorporated, effective January 2024. The CSRD requires organizations to act on their underlying sustainability data in order to prepare for the regulatory reporting and practices to come. CSRD is a set of directives that aims to bring greater transparency, accountability, rigor, and comparability for sustainability reporting with a great deal of focus on the value chain to achieve an organization's overall sustainability goals. The directive is founded on the concept of double materiality, which implies that businesses must consider how they will manage environmental risk and opportunities through their corporate strategies and disclose ESG issues that may affect the business. The directive is aimed to enable European Union to be the world's first economic power to achieve the Net Zero goals. In Part 1 of this two-part whitepaper series on CSRD, we take a look at the underlying principles and an overview of the implications of this directive as it comes into effect this year.

Key Takeaways

Introduction

Corporate Sustainability Reporting (CSRD) is an amendment to EU's NFRD (Non-Financial Reporting Directive). The CSRD will supersede the NFRD, which requires companies to disclose non-financial information in annual reports as of 2018. The European Commission found that the information disclosed by companies did not meet investor demand, in part because the information reported was not comparable or reliable. Some companies did not report everything users wanted, some did not report at all, and some were not easy to find. Companies themselves also faced uncertainty about what to report and how to report it. The CSRD expands the scope of the NFRD to include other companies, including large and listed companies. It also increases the amount of information companies must report. The information should be disclosed digitally, machine-readable and reported in accordance with European Sustainability Reporting Standards (ESRS). Companies are required to focus more on traceability and transparency across the reporting process because of the external assurance requirements.

What is CSRD?

- The CSRD is comprehensive and requires companies to report against mandatory EU sustainability reporting standards.
- It requires sustainable information assurance and is based on double materiality.
- All information must be published as part of the company's management reports and disclosed in a machine-readable digital format.

Goals of CSRD

CSRD which is a revision of Non-Financial Reporting Directives (NFRD), outcome of review admissions made by the European Commission on NFRD as part of the European Green Deal with two goals -

- Improving the disclosure of environmental, social, governance (ESG) data by companies to better inform investors about the sustainability levels of their investments.
- To support the changes being implemented by the new Taxonomy regulation and Sustainable Finance Disclosure Regulation (SFDR).

The main objectives of the CSRD are:

1. Standardization of ESG disclosures to reduce inconsistency and information gaps thereby making it easier for stakeholders, including investors and regulators, to comprehend, evaluate and compare the sustainability performance of different companies.

2 CSRD aims to increase transparency around corporate sustainability initiatives by mandating comprehensive disclosures hence enabling better-informed decision-making for investors, consumers, and other stakeholders.

3 CSRD aims to align the sustainability disclosures of the companies with other EU legislative initiatives, such as the European Green Deal, EU Taxonomy and the SFDR, creating a more streamlined and efficient framework for ESG reporting.

CSRD at a Glance

The CSRD will replace the current NFRD and has been incorporated from 1st January 2024 (for reporting in 2025).

- The CSRD covers sustainability in a broad sense and includes disclosure requirements for a wide range of Environmental, Social and Governance (ESG) aspects
- For large listed companies, the CSRD will take effect as of fiscal year 2024 and thereafter will also apply to many companies not covered by the current NFRD (non-financial reporting directive).
- Standardization of ESG disclosures to reduce inconsistency and information gaps thereby making it easier for stakeholders, including investors and regulators, to comprehend, evaluate and compare the sustainability performance of different companies
- The CSRD requires an external auditor to provide assurance on sustainability reporting, initially with limited, but with reasonable assurance at a later date.

Figure 1 : CSRD at a glance

One of the key elements of CSRD is that the information provided under the CSRD must cover all essential activities in the value chain, including assets held by the undertakings.

In addition, the definition of materiality has been expanded under the CSRD to include non-financial materiality considerations in addition to financial considerations.

Financial materiality as defined in ESRS 1: Outside in

The definition of financial materiality in sustainability reporting is different from the concept of materiality used in determining what information should be included in an undertaking's financial statements. According to EFRAG, *"Financial materiality in the context of sustainability reporting is a characteristic of a sustainability matter or information in relation to the undertaking. For the purposes of preparing sustainability reporting, a sustainability matter is material from a financial perspective if it triggers or may trigger significant financial effects on undertakings, i.e., it generates or may generate significant risks or opportunities that influence or are likely to influence the future cash flows and therefore the enterprise value of the undertaking in the short-, medium- or long-term, but it is not captured or not yet fully captured by financial reporting at the reporting date."*

("Alignment with IFRS Sustainability Standards - EFRAG")[i]

Non-financial (Impact) materiality as defined by ESRS 1: Inside out.

According to EFRAG - *"Impact materiality is a characteristic of a sustainability matter or information in relation to an undertaking. ("Double Materiality Guidelines - EFRAG"). A sustainability matter is material from an impact perspective if it is connected to actual or potential significant impacts by the undertaking on people or the environment over the short-, medium- or long-term. ("Alignment with IFRS Sustainability Standards - EFRAG"). This includes impacts directly caused or contributed to by the undertaking in its own operations, products or services and impacts which are otherwise linked to the undertaking's upstream and downstream value chain, and not limited to contractual relationships".*

("Alignment with IFRS Sustainability Standards - EFRAG")[ii]

Key Elements of CSRD

Some of the key elements introduced by CSRD are as detailed in the Figure below –

Key elements introduced

- **Double Materiality** – To include financial and non-financial impact
- **Due Diligence requirements on ESG topics**
- **Mandatory phase-in assurance** process
- Information must cover all essential activities in the **value chain**, including assets
- **Inter-operability with global standards** – IFRS, ISSB , GRI alignment
- Information on **Climate risk disclosures**
- Information on **Governance approach, targets and metrics** for material topics.
- **Pathways** for emissions and energy reduction as part of targets and metrics

Figure 2 : Key elements introduced in CSRD

ESRS Standards

The European Financial Reporting Advisory Group (EFRAG) has drafted a set of detailed guidelines known as European Sustainability Reporting Standards (ESRS) to assist in the implementation of the CSRD. The EFRAG guidelines specify details on the information that the companies subject to the CSRD will need to report on. These standards have been framed in close collaboration with the existing global sustainability reporting standards bodies like GRI, IFRS and ISSB to ensure interoperability and reduce the reporting burden on organizations.

Phase-in Assurance

While the NFRD only requires a statutory or audit firm to screen the non-financial statement in a management report, CSRD guidelines state that the report needs to be certified by an accredited independent auditor or certifier. The independent certifier must make sure that the sustainability details follow the certification standards that have been adopted by the EU. The audit requirement will be required for limited assurance at the beginning of the application of the CSRD with the aim to move towards reasonable assurance. The Commission will adopt assurance standards for limited assurance before the 1st of October 2026.

Climate Risk Disclosures

While a lot of emphasis is given to metrics and KPIs, CSRD has ensured due focus is also laid on quantifying the impacts of climate change via the climate risk disclosures. This is in line with the erstwhile TCFD principles (now part of ISSB) on climate related financial impact and the actions organizations will be taking to mitigate the climate risks through governance, strategy, metrics, and targets for the same.

Metrics and Targets

CSRD mandates the organizations to report and disclose metrics and targets for key performance indicators like energy, emissions, and water in prescribed formats such that these metrics are comparable year on year for the organization and also across industries/ organizations. This is to ensure greater transparency in the way metrics are disclosed.

Difference between CSRD and NFRD

CSRD is an evolution of NFRD, with the aim of strengthening sustainability reporting and non-financial disclosure requirements, extending the scope of reporting entities, and harmonizing the reporting process across EU member states. It represents a more comprehensive framework for companies to report on their environmental, social, and governance performance.

	CSRD	NFRD
Purpose	The primary aim of CSRD is to enhance the consistency, comparability, and reliability of sustainability reporting across European Union member states. It expands on the existing Non-Financial Reporting Directive (NFRD) and introduces more detailed reporting requirements.	NFRD, which is being replaced by CSRD, was focused on improving the transparency of large public-interest entities concerning non-financial information. It aimed to provide stakeholders with insight into companies' environmental, social, and governance (ESG) performance.
Applicability	CSRD is expected to have broader applicability. It extends the scope of reporting entities compared to NFRD and includes more small and medium-sized enterprises (SMEs).	NFRD applied to large public-interest entities, including listed companies, credit institutions, and insurance companies, with over 500 employees.
Reporting Requirements	CSRD introduces more detailed and harmonized reporting requirements. It specifies mandatory reporting on a wider range of sustainability topics, including environmental, social, and governance matters. It sets out specific reporting standards to be followed.	NFRD had less detailed requirements compared to CSRD. It required companies to report on environmental, social, and governance matters only to the extent necessary for an understanding of the company's development, performance, position, and impact of its activities.
Materiality and Due Diligence	CSRD introduces the concept of double materiality, which means companies should report on ESG matters that both influence the company and are influenced by the company. It also requires companies to conduct due diligence on ESG matters	NFRD did not explicitly require double materiality or due diligence in the same way as CSRD.
Assurance	CSRD suggests that certain large companies may need to have their sustainability reports assured by independent auditors.	NFRD also allowed for the voluntary assurance of non-financial statements but did not prescribe it as explicitly as CSRD does.

Figure 3 : Differences between CSRD and NFRD

To whom does it apply?

The Corporate Sustainability Reporting Directive (CSRD) applies to a wide range of companies and organizations operating within the European Union. The directive expands the scope compared to its predecessor, the Non-Financial Reporting Directive (NFRD). CSRD is designed to ensure that a broader range of entities disclose sustainability and non-financial information. Here are the key groups to which CSRD applies:

All "large undertakings" (whether listed or not)	Large companies (listed and not listed) are defined as exceeding two of the following three criteria (either as a single entity or on a consolidated group basis): • Balance sheet total > €25mn • Net turnover > €50mn • Employees > 250
Listed SMEs, (except listed micro-enterprises) small and non- complex credit institutions, and captive insurance undertakings	Listed SMEs are defined as having securities listed on a regulated EU market, and meeting at least two of the following criteria: • Balance sheet total > €5mn • Net turnover > €10mn • Employees > 50
Non-EU undertakings	A non-EU parent company with i) an EU-established large/listed subsidiary or a listed SME subsidiary, or ii) a large EU branch, meeting the following criteria: Generate a net turnover of more than €150,000,000 in the EU (for two consecutive years) and have either: for a subsidiary meets the criteria of a large company or listed company. for a branch has a turnover of more than €40 million.

The subsidiary or branch will be responsible for preparing a sustainability report for the third country undertaking at a consolidated level.
These sustainability reports will need to be prepared according to one of the above.

Corporate Sustainability Reporting Directive (CSRD)

NFRD remains in force until Companies become eligible for CSRD

Figure 4 : The CSRD - Who does it apply to?

Large Companies

CSRD applies to large public-interest entities (PIEs). These are typically companies that are publicly traded and have more than 250 employees. The definition of PIEs encompasses various types of organizations, including listed companies, credit institutions, and insurance companies.

Non-Public Companies

CSRD extends its application to non-public large companies, including certain large unlisted companies and subsidiaries of larger groups. The exact criteria for determining whether a company falls into this category may vary by EU member state.

Small and Medium-Sized Enterprises (SMEs)

While CSRD primarily focuses on large companies, it may also apply to some SMEs. The specific criteria for SMEs' inclusion may differ from one EU member state to another.

Public Sector Organizations

CSRD can apply to certain public sector organizations, including public companies.

It's important to note that the precise thresholds and criteria for determining the applicability of CSRD may vary across EU member states, as they have some discretion in implementing the directive. Companies that fall under the scope of CSRD are required to report on a broad range of environmental, social, and governance (ESG) matters, following specific reporting standards outlined in the directive. Compliance with CSRD is essential for these entities to enhance transparency and accountability regarding their ESG performance and impacts.

How to get started with CSRD? The Tech Mahindra Advantage

Effective CSRD implementation in an organization is a multi-layered process that spans multiple stakeholders and will need involvement and systemic changes in People, Process and Technology. Data is a key element for the overall implementation of CSRD.

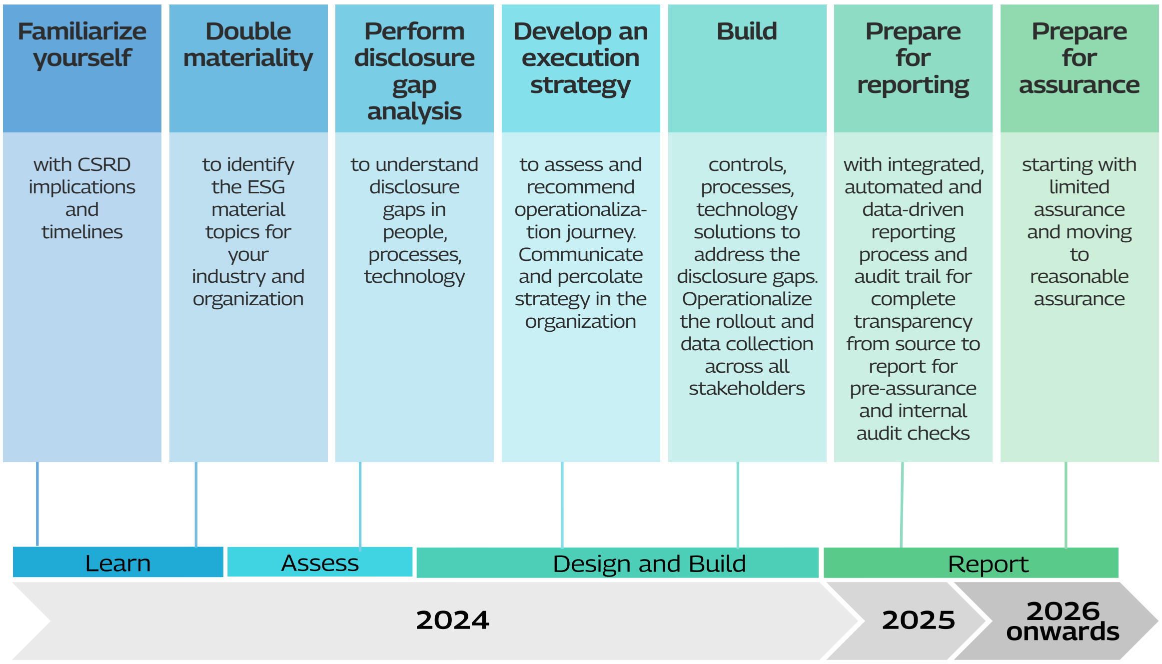

Figure 5: Roadmap to CSRD readiness

Education and Awareness

Start by educating your organization's leadership, sustainability teams, and relevant staff about the concept of double materiality. Ensure everyone understands the shift in perspective from traditional single materiality reporting.

Stakeholder Engagement

Identify your key stakeholders, such as investors, customers, employees, regulatory bodies, and NGOs. Engage with them to understand their expectations, concerns, and priorities regarding ESG issues. This stakeholder dialogue is essential for the second dimension of materiality.

Materiality Assessment

Perform a materiality assessment from both dimensions: inside-out and outside-in. Identify ESG issues that could have a material financial impact on your organization (first dimension). Simultaneously, determine how your company's activities impact external ESG factors and stakeholders (second dimension).

ESG Integration

Integrate ESG considerations into your organization's strategic planning, risk management, and decision-making processes. Consider how ESG factors may affect your financial performance, and how your actions may impact external ESG issues.

Data Collection and Analysis

Invest in robust data collection and analysis systems to monitor and assess ESG metrics from both dimensions. You'll need accurate data to support your double materiality disclosures.

Reporting Frameworks

Understand the additional reporting frameworks and standards , such as GRI (Global Reporting Initiative) and the Sustainability Accounting Standards Board (SASB) and their mapping to CSRD. Comply with these standards in your ESG reporting.

Disclosure and Reporting

In your ESG reports, provide comprehensive and transparent information about ESG issues. Clearly articulate how these issues affect your financial performance and how your organization impacts external factors. Ensure your reporting aligns with the principles of double materiality.

Assurance and Verification

Consider independent assurance or verification of your ESG reports. Some organizations seek third-party assurance to enhance the credibility of their disclosures.

Internal Collaboration

Foster collaboration between different departments within your organization, such as finance, sustainability, legal, and communications, to ensure a coordinated approach to ESG reporting.

Continuous Improvement

Regularly review and refine your double materiality reporting processes. Adapt to changes in ESG regulations, market expectations, and emerging ESG issues.

Engage in Industry Dialogues

Participate in industry forums, conferences, and working groups to stay updated on best practices and industry standards related to ESG reporting and double materiality.

Leadership Commitment

Secure commitment and support from your organization's leadership, as the successful adoption of double materiality requires top-down engagement and a company-wide culture of responsibility.

Benchmarking and Peer Comparisons

Benchmark your organization's ESG performance against peers and industry standards. This can provide valuable insights into areas for improvement.

Feedback and Transparency

Encourage feedback from stakeholders on your ESG reports and use this input to improve transparency and responsiveness to their concerns.

The entire approach for CSRD-driven business development consists of three parallel tracks in three phases. CSRD driven business design phase defines the company-specific ESRS standard content that should be covered in the annual report. CSRD is not just a reporting framework. CSRD is also seen as a development framework – the content illustrates topics that are crucial for organizations to understand and take the right actions towards sustainability. In order to implement defined ESRS standard requirements there might be a demand to enhance company business processes. Track 3 focuses on the implementation of a technology platform for reporting and monitoring ESRS standard based business activities. Technology is a key enabler for efficient and highly automated reporting and business process execution.

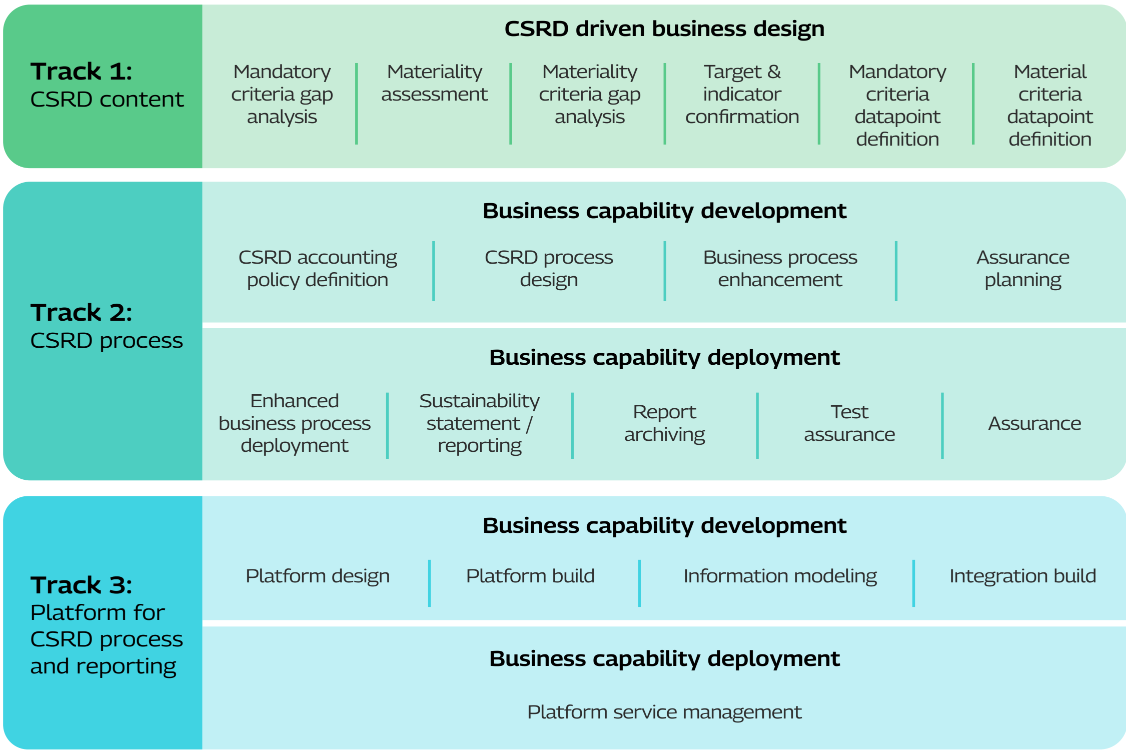

Figure 6: Embedding CSRD guidelines in business reporting

The work starts with gap analysis of requirements defined in ESRS 2 general disclosures. Mandatory criteria gap analysis consists of activity where relevant existing company information from various sources are reviewed and matched to ESRS 2 general disclosures. The company can assess its readiness to report against the ESRS 2 standards by conducting a gap analysis. The outcome of mandatory criteria gap analysis is the matrix that provides an understanding of the company's overall maturity for reporting against ESRS 2 requirements.

In the next phase, the materiality assessment, the work continues with the identification of how important and material topic specific standards are from the company and its stakeholders' point of view. During the systematic materiality assessment process most relevant and significant ESG topics are included in the company's CSRD scope and less relevant topics are scoped out by explicit disclaimers. Mandatory criteria cap analysis and materiality assessment define data points the company is required to report on its sustainability performance. Data points set key requirements for the next development tracks regarding CSRD process development (Track 2) and the development of a platform for CSRD process and reporting (Track 3).

Data Management Platform

Development of the platform for CSRD process and reporting follows common business solution development methodologies and phases. The platform development starts with the design of business solution services and information model. ESRS standards set special demands for the information model. The model should consider information management of quantitative and qualitative information in parallel. ESRS standards define requirements for disclosures of various business and social policies. Policies are usually implemented in textual format and stored in documents.

Owing to Tech Mahindra's end to end capabilities from Consulting to execution, our solutions address the People, Process and Technology requirements holistically.

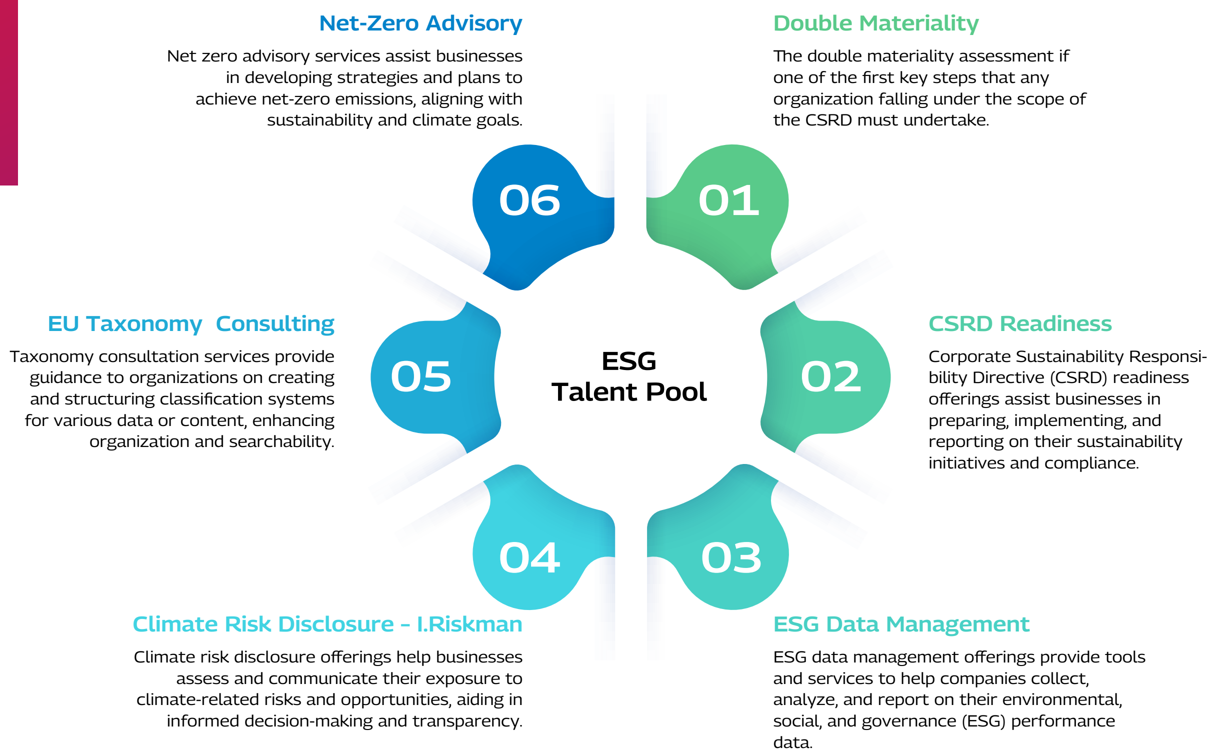

Figure 7 : Tech Mahindra's CSRD offerings

Conclusion

As EU based organizations in the ambit of CSRD embark on the reporting journey in 2024, even non-EU companies are realizing that their European entities might be subject to the requirements in the coming years, which could mean that they would be forced to reevaluate their sustainability reporting disclosure strategy at local and corporate levels. Apart from double materiality assessments, the scoping of CSRD would be another significant and very often complex step for companies as they begin to prepare for CSRD readiness.

Tech Mahindra's end to end approach can help organizations address these challenges and implement an effective CSRD implementation.

For a further deep dive analysis of CSRD, please refer to Part -2 of our CSRD series.

Authors

Kari Lehtinen

Manager- Sustainability

Tanu Sood

Group Manager-
Sustainability Offerings

Vansh Kumar

Associate Manager-
Sustainability Offerings

Shanky Singh

Technical Manager-
Sustainable Finance

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