Time to (really) show your hand

New EU Corporate Sustainability Regulation

Transformative Legal Experts

Contents

1. Background

On 31 July, the European Commission adopted the **Delegated Regulation** – European Sustainability Reporting Standards ("**Delegated Regulation**"), which complements the Accounting Directive (2013/34/EU) ("**Accounting Directive**"), in the context of the sustainability reporting standards.

The Accounting Directive requires large companies and listed small and medium-sized companies ("**SMEs**"), as well as parent companies of large groups, to include certain information on sustainability in a dedicated section of their management report ("**Sustainability Report**" or "**Sustainability Statement**"), to make it possible to:

i) understand the company's impacts on sustainability matters;

ii) understand how sustainability matters affect the company's development, performance and position.

The European Sustainability Reporting Standards ("**ESRS**") of the Delegated Regulation are now the first set of standards that companies should refer to when preparing the Sustainability Statement.

The ESRS arise in a context where companies have shown that they are not disclosing sustainability information sufficiently and appropriately. This has led to cases of omission of information relevant to investors and stakeholders, difficulties for investors to compare information published by different companies, and inaccuracies in the information disclosed.

The ESRS of the Delegated Regulation are now the first set of standards that companies should refer to.

2. Companies subject to the Delegated Regulation

Although the sustainability reporting requirements set out in the Accounting Directive apply to companies with different characteristics and sizes, the Delegated Regulation has been prepared for the range of companies described below. The European Commission will also prepare further Delegated Regulations depending on the characteristics and size of the other companies subject to the sustainability reporting requirements.

Companies subject to non-financial reporting requirements under the Non-Financial Reporting Directive, i.e., companies with more than 500 employees[1], are covered by the Delegated Regulation. These companies will be subject to the Delegated Regulation from 1 January 2024 and will have to publish their first Sustainability Statement in 2025.

Other large companies[2] will be subject to the Delegated Regulation from 2025 and will have to publish their first Sustainability Statement in 2026.

By the end of June 2024, the Commission will adopt a set of rules proportionate to the circumstances of SMEs.

Listed SMEs are not obliged to comply with the Delegated Regulation. By the end of June 2024, the Commission will adopt a set of rules proportionate to the circumstances of SMEs. Listed SMEs will only be required to draw up the Sustainability Statement from 1 January 2026 (with the possibility of voluntarily opting out during the first two financial years).

Third-country companies with an annual turnover in the European Union of more than €150 million that also have a branch in the European Union with a turnover of more than €40 million, or a subsidiary that is a large company or a listed SME, will have to comply with the sustainability reporting requirements at group level. They will be subject to this requirement from 1 January 2028 and the first Sustainability Statement will be published in 2029. The European Commission will adopt a set of standards specific to the circumstances of these companies.

3. Main features of the Delegated Regulation

3.1. THE FRAMEWORK

The Delegated Regulation provides for reporting in four areas:

i) **Governance**: the governance processes, controls and procedures used to monitor, manage and oversee impacts, risks and opportunities;

ii) **Strategy**: how the company's strategy and business model interact with its material impacts, risks and opportunities, including how the company manages these impacts, risks and opportunities;

1 The Non-Financial Reporting Directive applies to large public interest organisations with an average number of employees of more than 500, as well as public interest organisations that are parent companies of a large group with an average number of employees of more than 500, on a consolidated basis.

2 Companies which, at the balance sheet date, exceed at least two of the following three criteria: a) Balance sheet total: €20 million; b) Net turnover: €40 million; c) Average number of employees during the period: 250.

Annex I describes the standards to be followed in the preparation and presentation of sustainability issues

iii) **Impacts, risks and opportunities**: the process(es) by which the company: (a) identifies impacts, risks and opportunities and assesses their materiality; (b) manages material sustainability issues through policies and actions;

iv) **Metrics and targets**: the company's performance, including the targets it has set and the progress made towards achieving them.

Annex I of the Delegated Regulation describes the standards to be followed in the preparation and presentation of sustainability issues, including the expected information for each standard.

The standards are divided into two categories[3]:

i) **Cross-cutting standards**: these establish the general requirements for the preparation and presentation of information, as well as the reporting requirements;

ii) **Topical standards**: these refer to sustainability issues and are organised into Environmental, Social and Governance topics.

CROSS-CUTTING STANDARDS
ESRS 1 – General requirements
ESRS 2 – General disclosures

TOPICAL STANDARDS	SUSTAINABILITY ISSUES COVERED BY THE TOPICAL ESRS[4]	
	TOPIC	SUB-TOPIC
ESRS E1	Climate change	• Climate change adaptation • Climate change mitigation • Energy
ESRS E2	Pollution	• Pollution of air • Pollution of water • Pollution of soil • Pollution of living organisms and food resources • Substances of concern • Substances of very high concern • Microplastics
ESRS E3	Water and marine resources	• Water • Marine resources
ESRS E4	Biodiversity and ecosystems	• Direct impact drivers of biodiversity loss • Impacts on the state of species • Impacts on the extent and condition of ecosystems • Impacts and dependencies on ecosystem services
ESRS E5	Circular economy	• Resources inflows, including resource use • Resource outflows related to products and services • Waste
ESRS S1	Own workforce	• Working conditions • Equal treatment and opportunities for all • Other work-related rights
ESRS S2	Workers in the value chain	• Working conditions • Equal treatment and opportunities for all • Other work-related rights
ESRS S3	Affected communities	• Communities' economic, social and cultural rights • Communities' civil and political rights • Rights of indigenous peoples
ESRS S4	Consumers and end-users	• Information-related impacts for consumers and/or end-users • Personal safety of consumers and/or end-users • Social inclusion of consumers and/or end-users
ESRS G1	Business conduct	• Corporate culture • Protection of whistle-blowers • Animal welfare • Political engagement and lobbying activities • Management of relationships with suppliers including payment practices • Corruption and bribery

3 There is a third category of standards yet to be defined: sector-specific standards applicable to all companies in a given sector.
4 This list is merely a tool to support the assessment of materiality.

3.2. INFORMATION THAT MUST BE REPORTED

Companies are always required to report the information set out in “ESRS 2 - General disclosures”, but are only required to report information set out in other standards where there are material sustainability issues.

It will be up to companies to determine which sustainability issues are material. To do this, companies will need to analyse sustainability issues in terms of both financial materiality and impact materiality (dual materiality). This is defined as:

- Financial materiality: the sustainability issue creates risks or opportunities that affect (or could reasonably be expected to affect) the company’s financial position, financial performance, cash flows, access to financing or cost of capital in the short, medium or long term;

- Impact materiality: the sustainability issue has an actual or potential impact, positive or negative, on the company, people or the environment in the short, medium and long term, including the company’s own operations and the downstream and upstream value chain, through its products and services, as well as its business relationships.

For a sustainability issue to be material, either financial materiality or impact materiality is sufficient; it is not necessary to have both. The materiality assessment process carried out by the company will be subject to external control, in accordance with the provisions of the Accounting Directive.

Finally, if a company determines that there are no material sustainability issues within the scope of a particular topical standard, it may omit all reporting requirements for that standard and provide a brief explanation of the conclusions of the materiality assessment of that topic. In the specific case where a company concludes that there are no material sustainability issues related to ESRS E1 Climate Change, the company must provide a detailed explanation of the reasons for its conclusion.

3.3. TRANSITIONAL ARRANGEMENTS

The Commission has introduced a phased implementation of some of the reporting requirements set out in the Delegated Regulation, taking into account the potential difficulties that some companies may face in complying with the reporting requirements, in particular smaller companies that are subject to Sustainability Reporting requirements for the first time.

To this end, the Commission has established that:

- in the first year of application, all companies can omit:
  - i) expected financial impacts related to environmental issues other than climate change (pollution, water, biodiversity and use of resources); and
  - ii) certain data points relating to the workforce (social protection, people with disabilities, work-related health problems and work-life balance).
- companies with fewer than 750 employees may choose not to report:
  - i) in the first year of application of the standards, the data on greenhouse gas emissions under 3 (ESRS E1) and the reporting requirements specified in the standard on own workforce (ESRS S1); and
  - ii) in the first two years of application of the standards, the reporting requirements specified in the biodiversity (ESRS E4) and value chain workers (ESRS S2), affected communities and consumers and end-users (ESRS S4) standards.

PLMJ is available to assist companies with the implementation of the new regulations and to clarify any relevant issues in this area.

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About PLMJ

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"PLMJ is the most organised firm and the most committed at doing things on schedule and to the time that is asked. They are the most up to date and one of most professional law offices that work with us."

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About the Responsible Business area

→ What we do

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