

C S R D

Corporate
Sustainability
Reporting
Directive

Sustainability in annual reports: What companies need to know

August 2023

CSRD: WHAT LIES AHEAD?

The Corporate Sustainability Reporting Directive (CSRD) was adopted in November 2022 and is to be transposed into national law by the EU member states by January 1st 2024. The CSRD will change the scope and nature of non-financial reporting under the Non-Financial Reporting Directive (NFRD), which until now has only applied to large, capital market-oriented companies and financial institutions. It will expand the group of stakeholders and significantly increase the scope of reporting.

ESG IN THE FOCUS OF THE ANNUAL REPORT

Directive 2022/2464 (CSRD) is intended to improve sustainability reporting by companies within the EU. Through the standardization of the disclosure areas and the formulation of concrete information requirements, comparability and transparency regarding the sustainability of corporate activities are to be established. The ESG criteria, which have been relevant for capital market-oriented companies for some time, will be defined in detail and the sustainability report to be published will become an audit-relevant part of the annual financial statement. The sustainability report must be accessible free of charge and digitally.

WHO IS AFFECTED?

- Up to **15,000** companies **throughout Germany** and up to **50,000** companies **throughout the EU**
- **From 2024, large capital market-oriented companies and financial institutions** with more than **500 employees**
- **From 2025, large companies** that meet 2 of the 3 criteria:
 - > 250 employees
 - > 20 Mio.€ Balance sheet total
 - > 40 Mio.€ Net sales revenue
- **From 2028**, small and medium-sized capital market-oriented companies, excluding micro-enterprises
- Third country companies with a significant volume of activity in the EU

OPPORTUNITIES & BENEFITS

- **Transparency for investors** and the public
- **Coherent requirements** in all EU member states
- Quick access to **comparable** and **reliable data**

SCOPE OF APPLICATION - WHO IS AFFECTED?

1. COMPANIES BASED IN THE EU

The reporting obligation begins on January 1st 2024 for large capital market-oriented companies of public interest as well as for banks and insurance companies that employ an average of **more than 500 employees** per year. From the **2025 financial year, the reporting obligation will also apply to all other large companies**. From the beginning of the **2026 financial year, capital market-oriented small and medium-sized enterprises (SMEs)** will also be obliged to include sustainability reporting in their annual financial statements. Micro-enterprises and small, non-complex credit institutions and insurance companies are exempt from reporting.

Exemption: SMEs can apply for an exemption for a period of two years if they explain in their management report why they do not provide sustainability information. Parent companies of large groups are also required to prepare a consolidated sustainability report. Subsidiaries with EU parent companies can be exempted from preparing their own sustainability report if they are included in the

consolidated sustainability report of the parent company and meet certain requirements. Subsidiaries that are also the parent company of a group can also make use of the exemption. However, **large capital market-oriented subsidiaries do not have the option of exemption.**



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BECEPTUM International GmbH does not offer consulting services in the areas of tax law or auditing.

SCOPE OF APPLICATION - WHO IS AFFECTED?

2. SUBSIDIARIES OF PARENT COMPANIES WITH A REGISTERED OFFICE OUTSIDE THE EU

In order to ensure transparency for companies that do not have their headquarters in the EU (so-called third-country companies) but generate significant sales on the territory of the Union, their EU subsidiaries or EU branches will be taken into account in the future. If the **EU subsidiary** itself is obliged to publish a sustainability report, it must also include **information** from the parent company **at group level**, as long the entire group of companies has achieved a turnover of **more than €150 million in the Union territory** in each of the previous two financial years. If there is no such subsidiary, **the obligation is transferred to the EU branch** - but only if it has achieved net sales of more than 40 million euros in the previous financial year. The EU companies concerned must use their best efforts to obtain the information at group level. If the third country company does not provide the required information, this must be explicitly mentioned in the sustainability report.

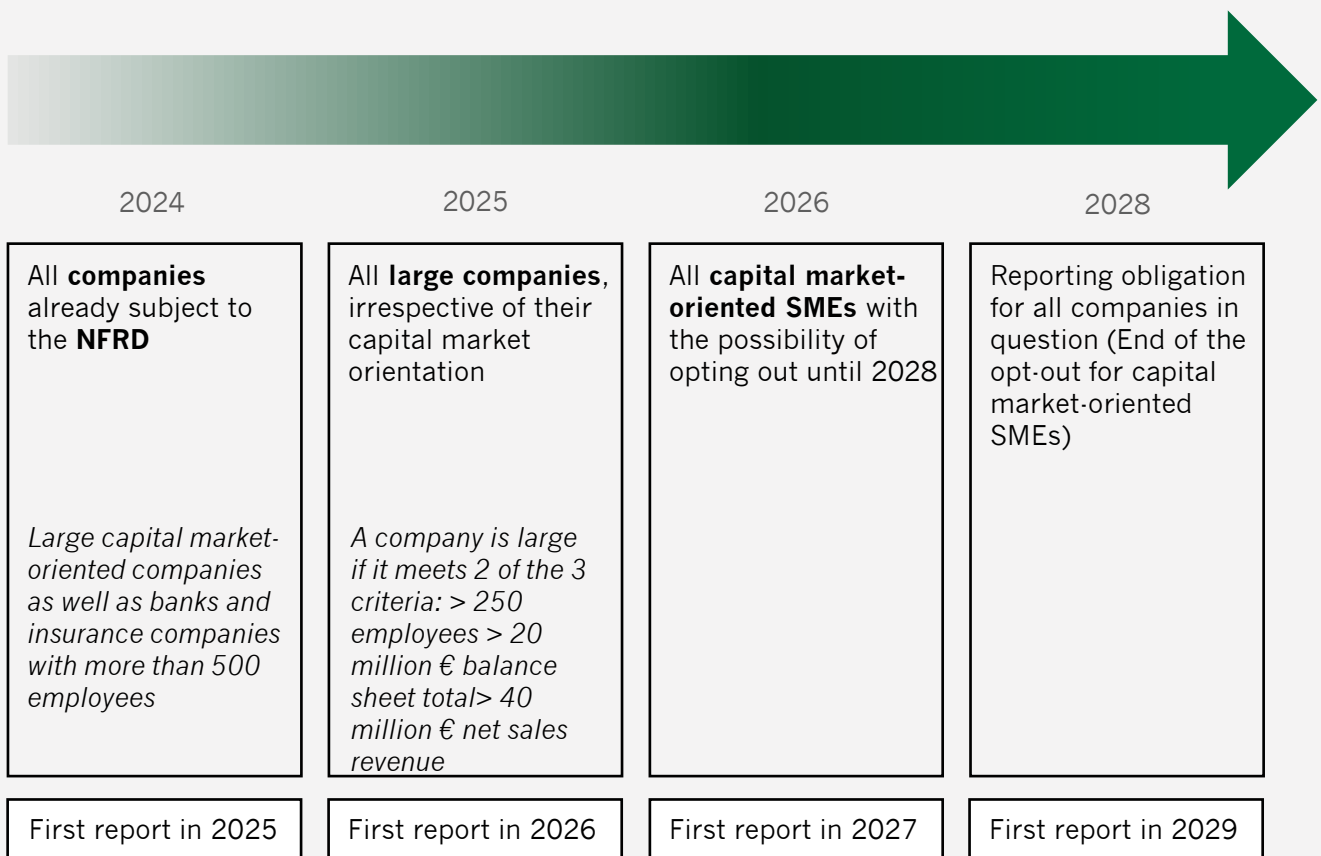
Exemption: Analogously to subsidiaries of EU parent companies, subsidiaries of third country companies can also be exempted by a consolidated sustainability report of the parent company, as long as it complies with ESRS (European Sustainability Reporting Standards) or equivalent standards. Here, too, the following applies: Large capital market-oriented subsidiaries cannot be exempted by a consolidated sustainability report of the parent company.



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WHO HAS TO REPORT AND FROM WHEN?



HOW WILL THE REPORT BE REVIEWED?

In future, **sustainability reports will have to be externally audited**, initially with limited assurance. The goal is to establish a comparable level of assurance for sustainability reporting as for financial reporting in the medium term. The EU Commission will therefore decide by October 2028 at the latest whether an audit with reasonable assurance is feasible and

introduce the necessary audit standards. According to the CSRD, an audit by the auditor is foreseen. However, the member states have the option of approving other auditors or accredited independent assurance providers for the audit in addition to the auditor.

REPORT CONTENTS & DOUBLE MATERIALITY

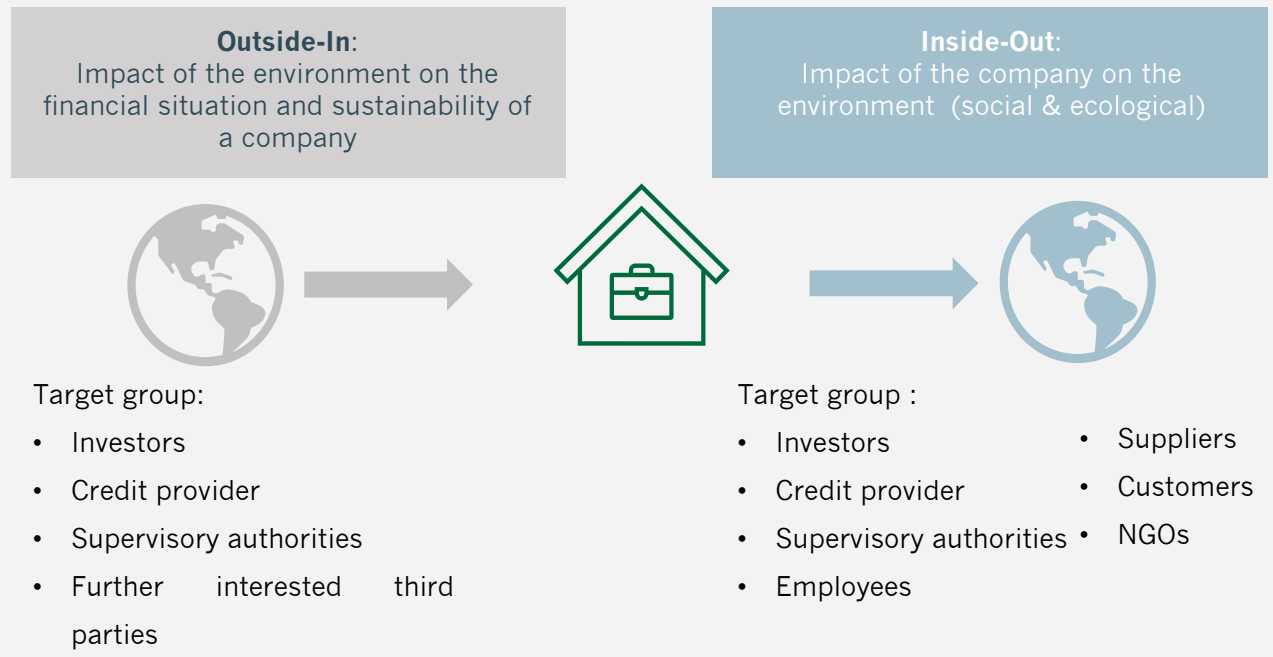
The content required for sustainability reports is defined by the European Sustainability Reporting Standards (ESRS). For this purpose, the European Financial Reporting Advisory Group (EFRAG) developed data and content requirements in the dimensions E, S and G. On 07/31/2023 the European Commission published the European Standards for Sustainability Reporting.

The standards are industry-independent and currently comprise 84 disclosure requirements. A draft for sector-specific requirements is also expected in 2023. In order to maintain the principle of proportionality, EFRAG will also draft separate reporting standards for small and medium-sized entities. **Companies must continue to provide information on the impact of their activities on people and the environment, as well as the impact of different sustainability categories on the company (double materiality).** The information provided should cover data on the entire value chain of the company, including its own business activities, products and services, business relationships and supply chains, cover short, medium and long-term periods and contain information in accordance with Article 8 of the EU taxonomy.

European standards for sustainability reporting directive:

E	S	G
ESRS E1 Climate change	ESRS S1 Own workforce	ESRS G1 Business Conduct
ESRS E2 Pollution	ESRS S2 Employees in the value chain	open
ESRS E3 Water & Marine Resources	ESRS S3 Affected communities	open
ESRS E4 Biodiversity & Ecosystems	ESRS S4 Customers & end consumers	open
ESRS E5 Use of resources and circular economy	open	open

REPORT CONTENTS & DOUBLE MATERIALITY



In order to determine which information is relevant for disclosure, the principle of **double materiality** must be applied. The example of a furniture retailer can be used to illustrate which disclosures are to be presented in the reporting **segment "ESRS1 Climate Change" in the inside-out perspective**. For this, the company must first ask itself the question: **Where does CO2 arise in my value chain?** In the case of the furniture retailer, CO2 emissions occur at various points in the value chain: The main sources include the production of furniture, transport from the manufacturer to the retailer, and sales and delivery to customers. These **emissions must be quantified and published on an ongoing basis**. The next step is to ask: How can CO2 be avoided, or the CO2 balance be improved otherwise? These goals can be achieved by, among other things, choosing the right manufacturers, optimizing transport routes, increasing energy efficiency, promoting recycling and using renewable energy sources. For example, the energy needs of the salesrooms could be met with solar energy and manufacturers with the smallest possible carbon footprint could be preferred in the selection of suppliers. Energy-efficient lighting and air conditioning can improve the carbon footprint, as can the provision of e-vehicles and charging points for customers and employees. **Planned improvement measures must be presented in the sustainability report** and their implementation made transparent in subsequent years. For the plan to reduce the carbon footprint, the **years 2030 and 2050** are considered **mandatory milestones**.

CHALLENGES FOR COMPANIES

The expansion of the user group is especially relevant in Germany, as the **German economy is mainly carried by non-capital-market-oriented SMEs, which now must prepare sustainability reports for the first time**. Despite staggered **implementation deadlines, the companies affected in the future should start implementation early**. Among other things, the following challenges arise:

1 Definition of the necessary information in terms of double materiality

- Complete analysis of one's own business model regarding impact factors (e.g. drawing up a carbon footprint, resource consumption, supply chain compliance, etc.).
- Comparison with peers/industry standards (possibly: dealing with missing benchmarks)
- Dealing with information deficits and information obstacles

2 Development of a sustainability strategy

- Maturity analysis of own company and analysis of opportunities and risks vis-à-vis customers, competitors, suppliers, financing partners and the public
- Development of a sustainability target for the company
- Derive a sustainability strategy and a corresponding transformation agenda

3 Establishment of stable reporting processes and structures

- Consolidation of data (special attention to media discontinuities and verification through the dual control principle)
- Clear responsibilities in reporting with the involvement of the specialist departments (compliance, purchasing, IT, etc.)
- Dealing with deadlines (ultimo + X) and ad-hoc requirements

CHALLENGES FOR COMPANIES

4 Selection/integration of software for tracking CO2 intensity and supply chain compliance

- Definition of the requirements profile with focus on cost efficiency, legal certainty, user-friendliness and integration
- Involvement of all relevant departments in the selection process
- Early roll-out for data validation and/or identification of vulnerabilities

5 Integration into general management and risk control processes

- Standardized inclusion of ESG criteria in the selection of suppliers and service providers
- Clear ESG requirement profile for business model development and M&A targets including escalation levels
- Early warning system for information deficits or missed deadlines

6 Integration of ESG into corporate culture and design of communication strategy

- Involvement of all relevant specialist units (accounting, compliance, purchasing, sales, etc.)
- Creation of a sustainable corporate culture
- Dealing with critical information and damage limitation in public relations work

7 Identification of auditors and preparation of the first report

- Adequate time and cost budget considering the personnel capacities tied up by the preparation of the annual financial statements
- Comparison with peers and establishment of a comparative data basis in the previous year of the first reporting year
- Timely preparation with the involvement of the press office

CONCLUSION

Through the principle of mandatory transparency, which has already proven to be an effective instrument in European banking regulation, the CSRD should lead to increased sustainability discipline on the part of European companies. The idea is that if third parties gain a comprehensive picture of a company's ESG compliance by reading its annual report, the pressure to do business sustainably increases. The CSRD obliges about **50,000 companies in the EU** to publish a standardized sustainability report. For quite a few of them, this represents a **significant challenge**, which is further intensified by the tight deadlines. While regular reporting and governance structures are part of everyday life in listed companies, **classic SMEs** are now not only confronted with the preparation of a sustainability report (bureaucracy), but also face a critical public due to the publication obligation.

In order to attract good staff, convince investors and **survive on the market in the long term**, a self-critical analysis of one's own business model in terms of carbon footprint, compliance with human rights in the supply chain, fair wages, recyclability of one's own products, etc. is therefore **of high strategic importance**. The process of implementing CSRD must therefore not only be considered from the perspective of those primarily affected (Accounting and Compliance), but **must also include the management levels of Procurement, Business Development, Customer Service and Product Development**, because sustainable action is a requirement for a successful sustainability report. In return this implies a maturity analysis, a target concept and a corresponding sustainability strategy.

BECEPTUM is a boutique consultancy with focus on sustainable business and corporate development. Founded in autumn 2019 with offices in Munich and Berlin, BECEPTUM integrates holistic sustainability management with the levers of corporate value creation. Through expertise and various services in the field of ESG, we accompany our clients in the operationalization of their sustainability strategy - from the appropriate management system to strategic partnerships and financing. With certified experts for supply chain regulations and climate risks, regular ESG monitorings and an individual training offer, we are a reliable partner for our clients in all aspects of sustainability.

Get in contact!

We will be happy to discuss your current and future challenges and potential solutions with you.

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