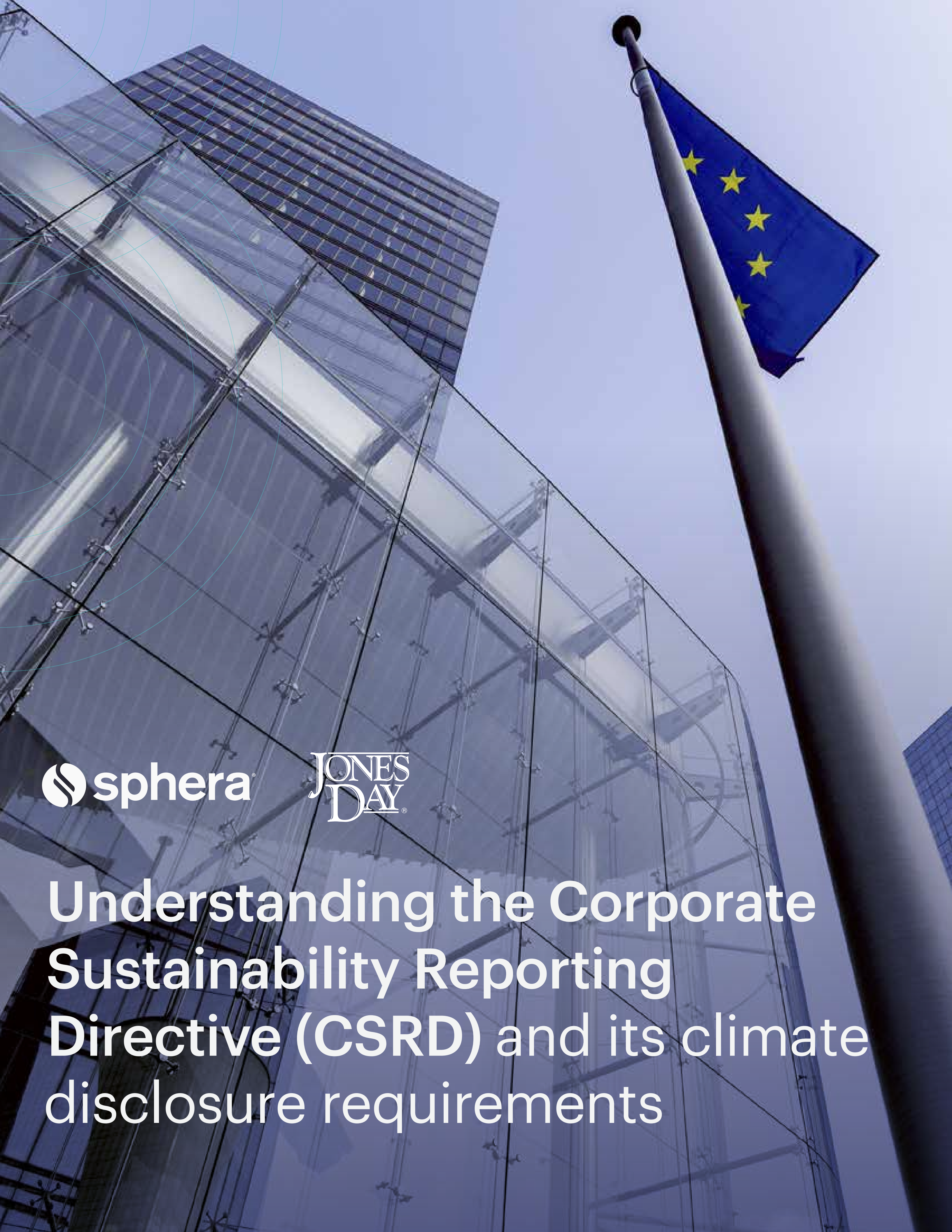


Understanding the Corporate Sustainability Reporting Directive (CSRD) and its climate disclosure requirements

INTRODUCTION

The Corporate Sustainability Reporting Directive (CSRD) is ushering in a new paradigm for sustainability reporting in the European Union (EU). The directive is an effort to raise the significance of sustainability reporting to the level of financial reporting, while establishing transparent, comparable information regarding companies' environmental, social and governance (ESG) performance.

The CSRD amends the pre-existing Non-Financial Reporting Directive (NFRD), significantly broadening its scale, scope and reach. The CSRD is underpinned by a number of new concepts and requirements that do not currently exist in any other reporting regime, including, for example, the double materiality assessment we discuss further below. The CSRD has extraterritorial effect and brings the global operations of non-EU headquartered groups that do significant business in the EU directly within scope. The CSRD also requires in-scope companies to assess and report on material aspects of their upstream and downstream value chain. Accordingly, the scale of the CSRD combined with its new concepts presents a unique and daunting challenge.

Companies and groups subject to the CSRD will be required to disclose information about their impact on sustainability matters, as well as information on how sustainability matters affect the company's performance and future development. The new sustainability disclosures required by the CSRD are set out in 12 extremely granular European Sustainability Reporting Standards (ESRS). Ultimately, the CSRD seeks to establish an overarching, unified reporting standard consistent (and ideally interoperable) with the most widely accepted international reporting frameworks, including the Global Reporting Initiative (GRI), the International Sustainability Standards Board (ISSB) and the Task Force on Climate-Related Financial Disclosures (TCFD). But the CSRD goes significantly beyond these international standards.

The ultimate output of the CSRD is the new sustainability report containing the required disclosures. However, in getting to that output, companies will need to examine their operations, value chain and business partners through the lens of sustainability in a way that few (if any) will ever have done before.

This guide equips business leaders with the essential information they need to begin their CSRD journey, including details on key implementation dates, the principal components of the directive and recommended preparatory measures.

CSRD SCOPE AND TIMELINE

The CSRD represents a significant expansion of sustainability reporting for companies based in Europe, as well as for select non-EU headquartered groups that do business in Europe. The framework will affect all “large” companies and their subsidiaries, as well as EU and non-EU companies with securities (debt or equity) listed on EU-regulated markets. Working out which entities, groups and sub-groups the CSRD applies to is in many cases a significant and complex exercise in its own right.

The directive ultimately expands reporting requirements to approximately 50,000 companies, covering nearly five times the scope of the NFRD. Because the directive extends to direct and indirect business relationships across the value chain, Sphera’s sustainability experts also expect that the directive will create market pressures that lead more organizations to accommodate CSRD reporting requirements. Companies that are not directly caught by the CSRD, but which are able to provide the required data to in-scope groups, may secure a commercial advantage.

Companies will be required to follow the 12 general ESRS standards, as well as forthcoming sector-specific standards. The European Financial Reporting Advisory Group is also developing a set of standards (NESRS) for non-EU companies. The ESRS include two cross-cutting standards and 10 additional topical standards covering all aspects of “E,” “S” and “G.” The cross-cutting standards (ESRS 1 and 2) set out how firms should approach meeting their disclosure standards, as well as provide crucial guidance on how to conduct the double materiality assessment.

Key dates for CSRD compliance

500+ EMPLOYEES €50M+ NET TURNOVER €25M+ BALANCE SHEET	250+ EMPLOYEES €50M+ NET TURNOVER €25M+ BALANCE SHEET	SMALL AND MEDIUM-SIZED ENTERPRISES (SMES) *definitions vary by country*	€150M+ NET TURNOVER IN THE EU + AT LEAST ONE “LARGE” SUBSIDIARY OR BRANCH IN THE EU
FY 2024	FY 2025	FY 2026	FY 2028
The CSRD applies to all companies previously required to report sustainability measures under the NFRD, with reports set to publish in 2025 for FY 2024. This applies to all EU companies with over 500 employees and net turnover that exceeds €50 million or a balance sheet of at least €25 million.	The CSRD now applies for non-listed, large companies that are not presently subject to the NFRD. Reports are due in 2026 for FY 2025. This includes companies with more than 250 employees, and net turnover of at least €50 million or a balance sheet of at least €25 million for 2 consecutive years.	The CSRD applies to listed small and medium-sized enterprises (SMEs), small and non-complex credit institutions and captive insurance undertakings. Reports are due in 2027 for FY 2026. An opt-out will be possible for SMEs during a transitional period.	The regime applies to non-European parent companies with a strong presence in the EU. This applies to groups that (i) generate net turnover of €150 million in the EU and (ii) have at least one “large” subsidiary or branch in the EU. The CSRD report must cover the entire consolidated group under the non-EU parent, including non-EU entities.

4 KEY COMPONENTS OF THE CSRD

The following four pillars are fundamental to sustainability reporting under the CSRD

1. Double materiality

The CSRD requires companies to perform a double materiality assessment to identify and report on the material sustainability issues most relevant to their business and stakeholders. The double materiality assessment requires firms to assess whether an impact, risk or opportunity is material from either an impact perspective or a financial perspective. If a matter is material from either perspective (it does not need to be material from both perspectives), then it will be material for the CSRD. Accordingly, CSRD disclosures will provide a more comprehensive view of material topics, helping stakeholders to better understand actual and potential issues affecting the company.

Impact materiality focuses on identifying a company's material impacts on people and the environment over the short, medium and long term. It covers a company's actual and potential impacts, both negative and positive, in the short, medium and long term. There is complex guidance about how companies need to consider, for example, whether a potential risk is material, as well as the extent to which firms are entitled to factor in mitigating actions to address identified risks.

Financial materiality involves the assessment of matters from a traditional financial reporting perspective. However, a sustainability matter is material from a financial perspective if it triggers or could reasonably be expected to trigger material financial effects on the company, for example, on its financial position, financial performance, cash flows, access to or cost of capital. According to ESRS 1, a sustainability issue that is material to a company either from an impact and/or financial perspective meets the double materiality standard and must be disclosed in the reporting under the CSRD.

2. Value chain reporting

The core CSRD report will cover the same entities as the financial statements: the "own operations" of the reporting group. However, the CSRD report is then extended to include information on the material impacts, risks and opportunities connected with the company through its direct and indirect business relationships in its upstream and/or downstream value chain. This extended reporting requirement means that companies are required to include material impacts, risks and opportunities connected to its value chain.

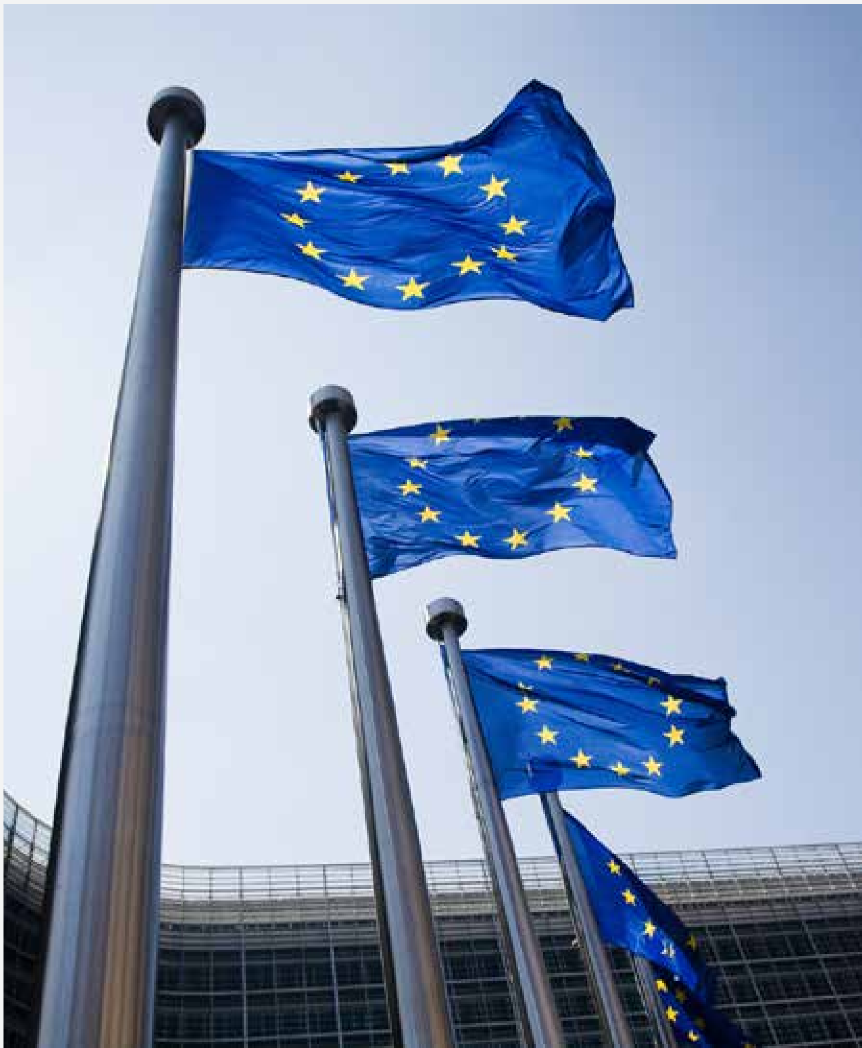
At a practical level, this means that companies will need to engage with third parties in their value chains to obtain data and information to complete their own CSRD reports. It also means that where a company forms part of the value chain of another entity, it will need to provide data and information to help that entity complete its reports. Large firms with complex supply chains may need to engage with a very large number of customers/suppliers, creating timing dependencies as well as logistical challenges.

3. Digitalization

CSRD standards require companies to disclose information in XHTML format in accordance with the European Single Electronic Format (ESEF) Regulation. Reported sustainability information must also be machine-readable for use in the European Single Access Point (ESAP). These measures are expected to improve data quality and accessibility, enabling data aggregation at the EU level and streamlining sustainability information into a single access point across Europe. However, in the short term, this requires companies to draft disclosures and provide data that align with the draft reporting schema and validation rules.

4. External assurance

Lastly, the CSRD introduces a requirement for assurance of sustainability information, to be performed by an accredited, independent auditor. Limited assurance will be accepted in the initial stages, with the aim of establishing reasonable assurance in the long term. Non-European companies are also expected to comply with certification requirements.



PREPARING FOR THE CSRD

Given the extensive scope of the CSRD reporting standards and the accelerated implementation timeline, businesses must act promptly to comply with the new disclosure requirements.

Businesses can begin the CSRD journey by raising awareness of the changes and establishing internal knowledge of what is to come. Companies should seek to consolidate and review prior sustainability reporting efforts, particularly under the NFRD, prior sustainability or ESG reports and corporate carbon footprint calculations, among others, before conducting an ESRS gap analysis. Most essential is the double materiality assessment, which will help identify material topics as well as material elements of a company's value chain. Combining the results of double materiality and gap assessments will help companies set priorities and focus their resources on closing the most relevant gaps. From this point, business leaders can begin to develop resolution strategies and craft a CSRD roadmap in harmony with the company's resources, strategy and long-term vision.

From the start, companies should track all relevant metrics to support the recalibration of targets and refinement of policies as needed. The process will require setting new roles and responsibilities within the organization, restructuring outdated reporting practices and establishing new processes to fully align with the new CSRD and ESRS requirements. The directive's digital requirements and third-party assurance stipulations will require advanced planning.

START YOUR CSRD CLIMATE DISCLOSURE EFFORT

Climate change is considered one of the greatest threats to business and society and will be a material topic for most companies within the scope of the CSRD. Therefore, the ESRS expect that firms will determine that climate change under ESRS E1 is material.

If a company concludes that climate change is *not* material and seeks to omit all ESRS E1 disclosure requirements, then (unlike for other ESRS requirements) it will need to provide a detailed explanation to support this conclusion along with forward-looking analysis. ESRS E2 is one of the few elements of the ESRS that is not underpinned by a materiality assessment, meaning all in-scope firms will need to provide these core general disclosures.

Follow the steps below to start your climate disclosure journey in line with ESRS E1: Climate Change.

1. **Develop a greenhouse gas (GHG) inventory.**

   ESRS E1 defines a clear process for developing a corporate carbon footprint, beginning with screening, the identification of relevant categories and the development of a calculation approach.

2. **Establish a corporate carbon footprint in line with the ESRS.**

   The ESRS E1 mandates specific reporting guidelines for all seven GHGs, calculated using operational control criteria and the latest global warming potential values from the Intergovernmental Panel on Climate Change.

3. **Review methods and alternative procedures for carbon accounting.**

   Companies may independently choose their calculation approach, based on existing standards, sector, structure, data availability and ESRS requirements.

4. **Define a process and choose appropriate tools for data collection.**

   This process should establish a proper structure for GHG reporting, including data collection for Scope 1, Scope 2 and significant Scope 3 categories using high-quality emission factors.

5. **Calculate gross Scope 1, 2, 3 and total GHG emissions.**

   Companies will be required to account for GHG emissions from associates, joint ventures and consolidated subsidiaries.

6. **Develop, communicate and disclose transition plans.**

   Organizations should present climate change mitigation actions by identified decarbonization levels, with the achieved and expected GHG emission reductions.

7. **Outline investment and funding.**

   Reporting should include investment and funding that supports decarbonization plans, including the amount of OpEx and CapEx in the action plan by economic activity, in line with the EU Taxonomy Regulation.

8. **Provide a framework for data and forecasts.**

   At a minimum, companies must disclose absolute GHG emission targets for 2030 and 2050, as well as the basis for those reduction targets.

9. **Conduct a climate risk assessment.**

   ESRS E1 requires organizations to assess climate-related risks, including physical and transition risks, in their operations and along the upstream and downstream value chain. The latter shall be anchored in a climate-related scenario analysis, considering 1.5°C and high-emission climate scenarios.

10. **Illustrate alignment between business strategy and climate efforts.**

    Companies must also disclose whether they apply internal carbon pricing schemes and how these support decision-making and incentivized implementation of any climate-related policies and targets.

11. **Describe climate change mitigation policies.**

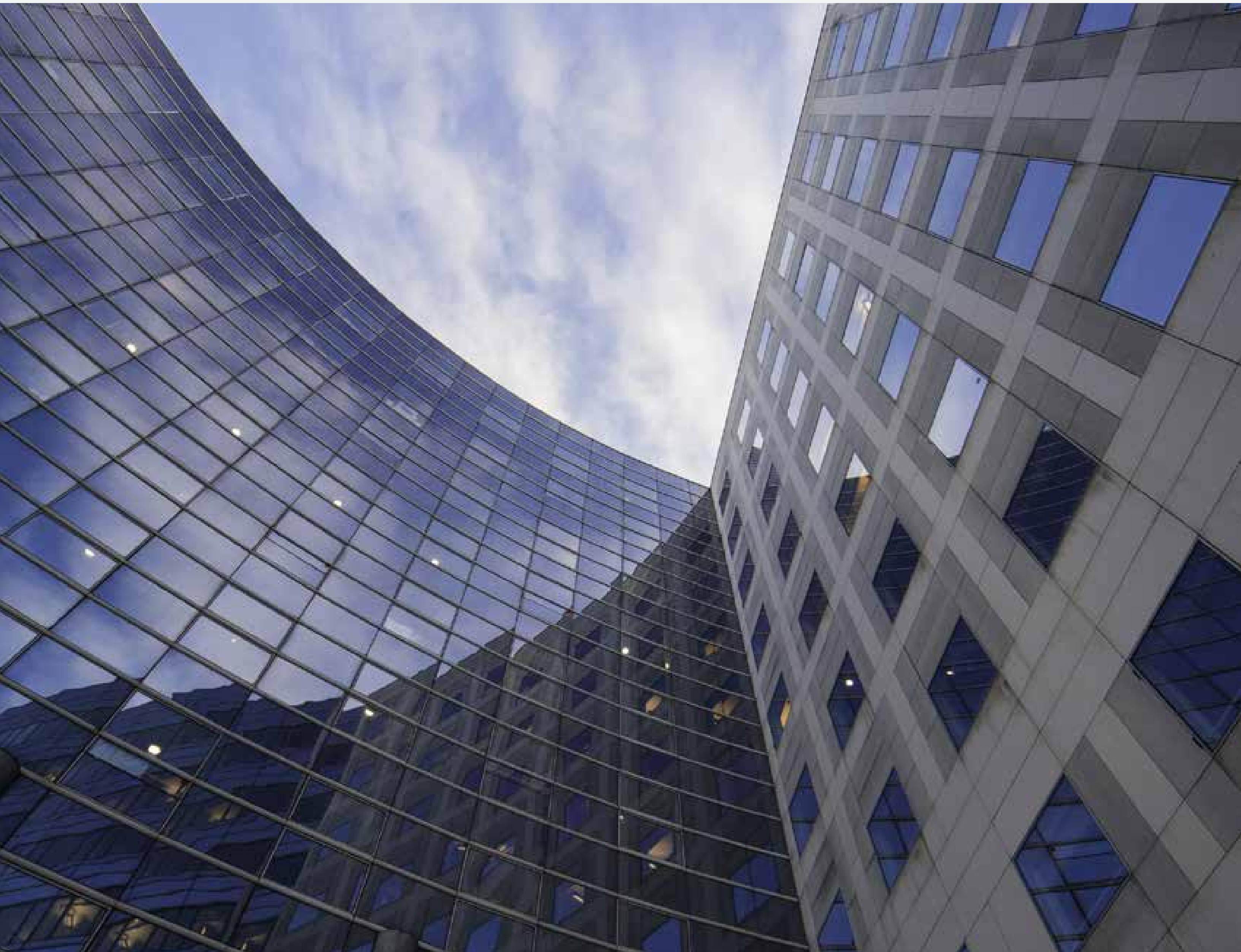
    Reporting may include general climate change mitigation policies or indirect policies supporting these goals, such as training, procurement or supply chain policies or product development policies.

12. **Report on carbon credits and avoided emissions.**

    Finally, companies are expected to report both avoided emissions and the amount of GHG emission removals from climate change mitigation projects outside the value chain, financed with carbon credits.

CONCLUSION

The Corporate Sustainability Reporting Directive and the European Sustainability Reporting Standards officially establish ESG reporting as table stakes for businesses in the European Union and beyond. While this directive creates new challenges for organizations, aligning sustainability efforts with financial and operational strategy empowers them to lay the groundwork for transformation and growth in a resilient, climate-neutral and circular economy.



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HOW JONES DAY CAN HELP

Jones Day has counseled numerous global corporates on the scope and applicability of the CSRD to their operations. We advise on the tactical reporting options that might be available, for example, using the synthetic consolidation transitional regime, as well as helping clients assess the advantages and risks of reporting on a global group basis earlier than mandated by the CSRD.

The CSRD is not an island: global multinationals need to carefully consider the impact of disclosing matters under the CSRD that might not have been disclosed previously and assess how CSRD reporting might interact with reporting obligations in other jurisdictions, for example, under SEC reporting. Jones Day's cross border team is uniquely placed to help clients prepare for the challenges presented by the CSRD, as well as to assess and mitigate the risks it presents, wherever and however such risks may arise around the world.

Contact your Jones Day team for more information.

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HOW SPHERA CAN HELP

Once you know whether you fall within the scope of the CSRD and you understand the timeline for implementation, you need to identify the software, data and expertise you will need for your compliance effort.

Sphera's software, data and consulting services enable you to:

- Establish a foundation of defensible data for reporting and due diligence activities.
- Calculate your organization's carbon footprint and other environmental impacts.
- Conduct supply chain risk assessments from tier 1 to the source level to uncover possible negative environmental or human rights impacts.
- Develop a transition plan for climate change mitigation.
- Identify and act on decarbonization opportunities.
- Gain technical assistance in creating reports for reporting per regulations, voluntary frameworks and for investors and consumers.

Get in touch for more information on how Sphera can help with CSRD compliance.

Jones Day is a global law firm with more than 2,400 lawyers in 40 offices across five continents. The Firm is distinguished by: a singular tradition of client service; the mutual commitment to, and the seamless collaboration of, a true partnership; formidable legal talent across multiple disciplines and jurisdictions; and shared professional values that focus on client needs.

Sphera is the leading provider of Enterprise Sustainability Management (ESM) performance and risk management software, data and consulting services focusing on Environment, Health, Safety & Sustainability (EHS&S), Operational Risk Management (ORM), Product Stewardship and Supply Chain Transparency. For more than 30 years, we have served over 8,400 customers and a million-plus users in 95 countries to optimize workflows and navigate the complex and dynamic global regulatory structure. Our goal at Sphera is to help customers keep their people safe, their products sustainable and their operations productive.

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