UDK 338.2:502.131.1(4-67EU)
Review article

# EXPECTED CONTRIBUTIONS OF THE EUROPEAN CORPORATE SUSTAINABILITY REPORTING DIRECTIVE (CSRD) TO THE SUSTAINABLE DEVELOPMENT OF THE EUROPEAN UNION

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***ABSTRACT***

*In January 2023, the European Corporate Sustainability Reporting Directive (CSRD) came into power, and its application from the fiscal year 2024 becomes mandatory for all large European companies with over 500 employees, as well as for medium and small companies, except for micro-enterprises, whose securities are listed for trading on a regulated market in the European Union. The directive also covers non-European trading companies that generate more than EUR 150 million in net income per year in the Union and have at least one daughter company or subsidiary that exceeds this income threshold. The directive adapts the deadlines, areas and standards of application of the new sustainability reporting rules to the capacities and resources of individual categories of companies. Businesses covered by the directive will have to submit publicly available and detailed non-financial reports on a number of aspects of sustainability in their operations, as well as on the impact of external sustainability factors on current operations, market position and development of companies. The directive represents a strengthening of the existing European rules for the creation and publication of sustainability reports introduced by the Non-Financial Reporting Directive (NFRD) from 2014, which are no longer adequate for the realization of the goals of the European Green Plan and the successful transition of the EU to a sustainable economy and society.*

*This paper analyzes the historical and legal context of the creation of the Directive, goals and the scope of the Directive's application, the indicators of reporting by companies with regard to the economic, social and ecological dimensions of sustainability covering also limitations bonded with theoretical and empirical circular economy perspective and the expected benefits* *of standardized reporting on aspects of sustainability of important stakeholders of the society. Besides, the possible burdens and costs are going to be presented, ocuuring when preparing sustainability reports and during practical application of the Directive.*

*The purpose of the paper is to point out possible contributions of the Directive to strengthening the responsibility of companies for an accelerated and easier transition to a sustainable economy and society as a key development goal of the Union, and the potential positive impacts of a broader reduction of the negative environmental and social footprint on the sustainable operations of companies and the economy as a whole. Historical, legal normative and political economic methods are most often used in the analysis of the provisions and effects of the new legislative solution regarding the quantification of the effects of business operations on the sustainability of the European environment and society and the feedback effects of progress in wider sustainability on the operations and market position of businesses.*

***Keywords***: *contributions to the sustainability of the economic and financial system, Corporate Sustainability Reporting Directive, European Green Plan, quantification of business effects on sustainability, sustainability information standards,*

## 1. INTRODUCTORY NOTES

In the globally dynamic economic, environmental and security conditions, at the beginning of 2023, the European Corporate Sustainability Reporting Directive (CSRD), which regulates the future framework and rules of mandatory, regular and public non-financial reporting of European and non-European companies operating in a more comprehensive and thorough manner than previous European regulations was introduced on the European market. The directive provides that these reports contain relevant, reliable, comparable and verifiable information about risks and opportunities in all aspects of sustainability. The new regulatory framework envisages the rapid creation of standards for information on the environmental, social and management dimensions of sustainability (ESG information), expands the circle of those obliged to submit reports and introduces studio audits of reports. The sustainability reports will be freely available to the public through the central registers, the registers of companies of the Member States or on the websites of the companies. It is the intention of the Union that through a solid framework of reports, coherent standards of information on sustainability and reliable quantification of effects, companies gain a thorough insight into the impact of their own business on the sustainability of nature and society, but also on the impact of all aspects of sustainability in the wider environment on their own business risks and opportunities. Sustainability reports will also be very useful for investors, consumers, non-governmental organizations and public policy makers, as well as for the Union and Member States. The companies' periodic reports on sustainability will enable everyone to see the results achieved in solving sustainability problems within the economy more realistically and progress in achieving the goals outlined in the Paris Agreement, the UN Agenda for sustainable development, the European Green Deal, the Action Plan on Financing Sustainable Growth and other delegated acts that regulate social just transition to a sustainable economy and society.

Regardless of the extremely short period of application of CSRD, the purpose of this work is to determine and point out the possible contributions of the newly established legal framework, an organized set of reporting rules and standards of information on sustainability to the strengthening of responsibility and the creation of new corporate policies for a faster and more efficient transition to a sustainable economy and society as key development goals of the Union. Through an early analysis of the solutions foreseen in the CSRD, an attempt is made to determine the circle of otherwise increasingly numerous users of information on sustainability, as well as the benefits they can expect from information on socially responsible and sustainable business operations of companies. It also lists some burdens and costs for companies that may arise during the preparation of sustainability reports and their practical application.

The research was conducted through several separate units and separate parts of the work.

After the Introductory Remarks, the second part of the paper analyzes the socio-economic context of the creation of the CSRD, the features of the current European regulation of non-financial corporate reporting, the reasons and goals of the new regulation, the circle of taxpayers and other important changes introduced by the CSRD in sustainability reporting. The third part of the paper analyzes the standards according to which the reports should be compiled and the standards of ESG information on sustainability that the reports should contain. The fourth part of the paper is devoted to the analysis of the expected contributions of CSRD to a stronger and faster sustainable development of the economy and society, as well as the potential challenges associated with the implementation of CSRD. In the concluding remarks, the synthesized results of previously conducted research point to the initial evaluation of CSRD as an indispensable legal tool for strengthening the sustainable way of operating companies and accelerating the transition to a sustainable European economy and society.

During the analysis of the new European regulation of reporting on the sustainability of companies and standards for quantifying the effects of companies on the sustainability of the European environment and society, comparisons and analysis of legal regulation is the most often used, with sociological, economic and historical approach as a certain auxiliary methods of analysis.

## 2. PURPOSE, GOALS, NORMATIVE SOLUTIONS AND OBLIGEES OF THE APPLICATION OF THE EUROPEAN CORPORATE SUSTAINABILITY REPORTING DIRECTIVE (CSRD)[1]

Based on the Paris Climate Agreement and the 2030 UN Agenda for sustainable development from 2015, the European Green Deal 2019, the EU Climate Law from 2021 and the EU Biodiversity Strategy 2030 from 2020, the Commission's program outlines the Union's green transition towards a resource-efficient and competitive economy without net greenhouse gas emissions until 2050. In addition to the effective protection, preservation and increase of natural capital, the transition to a model of sustainable development in all sectors of the economy and society should enable inclusive and socially just economic and social development that protects and increases the health and well-being of current and future generations that will not endanger social and environmental risks. The success of the transition to development that balances the economic, environmental and social dimensions depends to a considerable extent on the establishment of a comprehensive and mandatory European framework for non-financial reporting by companies and the standardization of information on sustainability in all three dimensions of sustainability. According to the new CSRD, commercial companies will be required to include relevant, reliable, comparable and verifiable ESG (Environmental, Social, Governance) information[2] about their own adaptation

1 The full name is Directive (EU) 2022/2464 of the European parliament and of the Council of 14 December 2022 amending Regulation (EU) No 537/2014, Directive 2004/109/EC, Directive 2006/43/EC and Directive 2013/34/EU, as regards corporate sustainability reporting (OJ L 322, 16.12.2022, p. 15–80).

2 At the meeting of the parties to the UNFCCC (United Nations Framework Convention on Climate Change) in 2015, the Paris Climate Agreement was adopted, which, within the framework of sustainable development of the economy and society, defines three basic groups of goals that will be sought to be achieved at the global level. These are environmental, social and governmental goals, for which the abbreviation ESG is used in practice. Following the Paris Agreement, the European Commission published its European Green Deal (EGD) which directs European sources of funding towards encouraging the development of a sustainable economy and society, recovery and strengthening resilience to crises, green and digital transition and balanced regional development. As a component of EGD, the 2020 Sustainable Europe Investment Plan (European Green Deal Investment Plan) was adopted, and sustainable development financing measures based on the EU Taxonomy for sustainable activities encourage investments in green and sustainable projects. In addition to financial assistance, the EGD envisages expanding the scope and elaboration of information related to the environment and climate that should be published by companies and financial institutions as guidelines for sustainable investments. European Commission, Communication from the Commission to the European Parliament, the European Council, the Council, the European Economic and Social Committee and the Committee of the Regions - European Green Plan, 2019, p. 17, [https://eur-lex.europa.eu/legal-content/HR/ALL/?uri=CELEX:52019DC0640], Accessed 14 November 2022, Odobaša, R., *Refleksije Europskog zelenog plana i strategije „Od polja do stola" na nacionalne strateške planove održivog razvoja poljoprivred-*

to the model of sustainable development in all its dimensions (the "inside-out" aspect), in their annual sustainability reports as well as about the impact of sustainable development issues from the company's environment on its organization, management and business policy ("outside-in" aspect). The obligation of double assessment is very significant because it expands the scope and complexity of reporting. In addition to information on the state and policies, reports should contain goals and an assessment of progress towards these goals (retrospectively and in the future).

As a way of encouraging the business sector in the direction of strengthening sustainability, the Union has already made a significant step forward in sustainability reporting in 2014 with the introduction of the Non-Financial Reporting Directive (NFRD) in 2014.[3] Despite some progress in the transparency of sustainability reporting, expert analyzes and consultations in the Union's bodies determined its inadequacy as a tool for realizing the goals of the transition of the Union to a sustainable economy and society. Gaps were identified in all major topics related to sustainability, including information on greenhouse gas emissions and negative impacts on biodiversity. Deficiencies were also found in information about intangible assets within society, although in developed economies investments in these assets are predominant in the private sector (eg. in human capital, brand, intellectual property and assets related to research and development). A number of companies did not publish sustainability reports at all, and the published information was limited in terms of relevance, reliability and comparability. Although in 2017 the Commission published non-binding guidelines[4] for reporting non-financial information and in 2019 additional guidelines for improved reporting of climate-related information[5], the quality of sustainability information in the reports of the included categories of companies has not increased.[6]

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*no-prehrambenog sektora i ruralnih prostora – primjer Republike Hrvatske*, u: Duić, D.; Ćemalović, U., Zakonodavstvo zaštite okoliša i održivi ekonomski razvoj u EU, Osijek, Pravni fakultet Osijek, 2022, p. 33-34.

[3] Directive 2014/95/EU of the European Parliament and of the Council of 22 October 2014 amending Directive 2013/34/EU as regards disclosure of non-financial and diversity information by certain large undertakings and groups (OJ L 330, 15.11.2014, p. 1–9).

[4] Communication from the Commission — Guidelines on non-financial reporting (methodology for reporting non-financial information) (OJ C 215, 5.7.2017, p. 1–20).

[5] Communication from the Commission — Guidelines on non-financial reporting: Supplement on reporting climate-related information (OJ C 209, 20.6.2019, p. 1–30).

[6] Hummel, K.; Jobst, D., *The Current State of Corporate Sustainability Reporting Regulation in the European Union*, SSRN, 2022, p. 3-12, [https://papers.ssrn.com/sol3/papers.cfm?abstract_id=3978478], Accessed 10 March 2023; Opferkuch, K., *et al., Circular economy in corporate sustainability reporting: A review of organisational approaches*, Business Strategy and the Environment, 2021, p. 4017-4018, [https://doi.org/10.1002/bse.2854], Accessed 3 March 2023.

In order to strengthen and speed up the transition to sustainable development, the Union adopted the EU Action Plan on Financing Sustainable Growth in 2018, in which measures were determined to redirect the flow of capital towards sustainable investments, sustainable management of financial risks arising from climate change, resource depletion, environmental and social destruction issues and to encourage transparency and long-termism in financial and economic activities[7]. For its accelerated implementation, the European Parliament and the Council adopted the Disclosure Regulation and Taxonomy Regulation[8], which together much more broadly define the new standards of sustainable social and ecological aspects of development, dealing with sustainability risks and sustainable investments, but also encourage credit institutions and other participants in the financial markets to update their reports on sustainability issues. From 2021, the Sustainable Finance Disclosures Regulation (SFDR)[9] will be applied in the Union, which introduces an obligation for the financial services sector to publish transparent information about sustainable financial services and sustainable financing. Sustainability reports will increase the transparency of the financial sector regarding sustainable financial practices, but also redirect their investment capital towards companies with a higher ESG rating[10]. For the achievement of ESG goals of sustainable development at all levels of social organization and the entire economy, the financial industry has a key role to play by redirecting capital flows towards

7 Communication from the Commisssion to the Parliament, the European Council, the Council, the European Central bank, the European economic and social commitee and the Communtee of the Regions, Action Plan: Financing Sustainable Growth (COM/2018/097),Switch2green, *The EU Action Plan on Financing Sustainable Growth*, [https://www.switchtogreen.eu/the-eu-action-plan-on-financing-sustainable-growth/], Accessed 20 March 2023.

8 Regulation (EU) 2019/2088 of the European Parliament and of the Council of 27 November 2019 on sustainability-related disclosures in the financial services sector (OJ L 317, 9.12.2019, p. 1–16), Regulation (EU) 2020 /852 of the European Parliament and of the Council of 18 June 2020 on the establishment of a framework to facilitate sustainable investment, and amending Regulation (OJ L 198, 22.6.2020, p. 13–43). Taxonomy is a classification tool that provides precise information about sustainable activities and investments and is therefore useful for companies and investors when deciding on investments in environmentally and socially acceptable economic activities and investments.

9 By publishing ESG reports, companies open up to greater financing opportunities, since the SFDR obliges large investors to evaluate ESG factors in company reports. Large investors will consequently be able to reduce their exposure to companies that do not publish ESG reports, and ESG rating agencies will be able to reduce the ESG rating of irresponsible companies. Greenly.resources, *What is the Sustainable Finance Disclosure Regulation (SFDR)?*, 2023, [https://greenly.earth/en-us/blog/company-guide/what-is-the-sustainable-finance-disclosure-regulation- sfdr], Accessed 15 March 2023.

10 A high ESG rating also means that companies do not carry out greenwashing as an irresponsible practice of false claims about the acceptability of products for the environment, most often through the presentation of filtered or partial information.

sustainable investments[11]. The scope of the necessary sustainable investments can be seen from the preliminary assessment of the Commission from 2019. In order to reach the goals in the field of climate and energy by 2030, which is only a part of the necessary investments, additional annual investments in the amount of 260 billion euros, or about 1.5 percent, will be required of European GDP in 2018.[12]

Despite the efforts made to improve sustainability reporting, the Commission, in its report that critically reviewed the solutions and from other NFRD-related directives (2013/34/EU and 2013/50/EU), had to determine the inadequacy of the existing framework of rules for non-financial reporting and the necessity of revising the NFRD.[13] Therefore, in April 2021, it presented a proposal for a new directive on corporate sustainability reporting, for which the Union member

[11] The Croatian Financial Services Supervisory Agency (HANFA) adopted the 2021 Guidelines for the creation and publication of ESG-relevant non-financial information of issuers to be published by companies financed through the capital market. It is a document intended for issuers on the regulated market in the Republic of Croatia who are obliged to provide non-financial reporting according to the Accounting Act, but also for those who voluntarily decide to publish a non-financial annual report for the purpose of better future financing, investment and a stronger demonstration of the sustainability of their business and positive impact on the environment, community and protection of human rights. The guidelines also served as a preparation for companies for mandatory reports on sustainability in the period before the entry into force of new rules and standards from CSRD. From March 2021, all financial institutions (banks, pension funds, investment companies) in Croatia and the EU must also apply the SFDR (Sustainable Finance Disclosures Regulation). After the entry into force of CSRD, HANFA is expected to develop new guidelines for sustainability reporting in accordance with the new rules and standards. Hanfa adopted Guidelines for non-financial reporting of companies according to environmental, management and social (ESG) goals, 2021, [https://www.hanfa.hr/vijesti/hanfa-donijela-smjernice-za-nefinancijsko-izvje%C5%A1tavanje- the company-according-to-its-environment-manages-and-other-esg-goals/#], Accessed 25 January 2023. From Hanfa's annual report on corporate governance for 2021, it can be seen growing trend in the number of companies listed on the Zagreb Stock Exchange that publish ESG reports. When it comes to non-financial reports, issuers on the Leading Market of the Zagreb Stock Exchange lead the way (100 percent), and companies on the Official Market (83 percent) and Regular Market (89 percent) also have a high percentage of ESG reports. Among those who published sustainability information, 60 percent adapted their reports to the Taxonomy Regulation. Žigman, A., *Raste svijest o koristi ESG izvještavanja*, Business outlook 22/23, Jutarnji list, 2022, p. 22.

[12] European Commission, Communication from the Commission to the European Parliament, the European Council, the Council, the European Economic and Social Committee and the Committee of the Regions - European Green Plan, 2019, p. 15, [https://eur-lex.europa.eu/legal-content/HR/ALL/?uri=CELEX:52019DC0640], Accessed 14 November 2022.

[13] It was estimated that by the time the CSRD came into effect, only 20 percent of large companies were fully implementing some sustainability information standards, and only 30 percent required some form of verification. European Commission, Proposal for a Directive of the European Parliament and the Council amending Directive 2013/34/EU, Directive 2004/109/EC, Directive 2006/43/EC and Regulation (EU) no. 537/2014 regarding corporate sustainability reporting, 2021, [https://eur-lex.europa.eu/legal-content/HR/TXT/PDF/?uri=CELEX:52021PC0189&from=EN], p. 10, Accessed 14 March 2023.

states reached a unanimous agreement during the first half of 2022. After that, the Council approved the position of the European Parliament on 16 November 2022, which meant that the legislative act was adopted.

The application of CSRD[14] started in January 2023, and its application is mandatory for all-inclusive companies from fiscal year 2024, according to the prescribed order.[15]

CSRD must be applied by all large European trading companies with over 500 employees, as well as medium and small trading companies (SMEs), except for micro-enterprises whose securities are listed for trading on a regulated market in the Union. Small and medium-sized companies whose securities are not listed for trading can apply proportional standards voluntarily. The directive also covers non-European companies that generate more than EUR 150 million in net income per year in the Union and have at least one subsidiary company that exceeds the income threshold of more than EUR 40 million or a subsidiary that is subject to the thresholds according to which the company is considered large, medium or a small company whose securities are listed for trading on the market in the Union.[16] This expansion of the circle of obligees will lead to a significant increase in the number of companies that will have to publish sustainability reports, approximately 11,700 to approximately 49,000 companies and groups across the Union.

14 CSRD introduced changes in a) Regulation no. 537/2014 on special requirements regarding the legal audit of entities of public interest and the repeal of Commission Decision 2005/909/EC, b) Directive 2004/109/EC on the harmonization of transparency requirements regarding information on issuers whose securities are listed for trading on a regulated market and amending Directive 2001/34/EC, c) Directive 2006/43/EC on statutory audits of annual financial statements and consolidated financial statements, amending Council Directives 78/660/EEC and 83/349/EEC and repeals Council Directive 84/253/EEC and d) Directive on annual financial statements, consolidated financial statements and related reports for certain types of companies, amending Directive 2006/43/EC of the European Parliament and of the Council and repealing Council Directive 78/ 660/EEC and 83/349/EEC.

15 Baumüller, J.; Grbenic, S., *Moving from non-financial to sustainability reporting: analyzing the EU Commission's proposal for a Corporate Sustainability Reporting Directive (CSRD)*, Facta Universitatis, Series: Economics and Organization, 18(4), 2021, p. 370-371, [https://doi.org/10.22190/FUEO210817026B], Accessed 22 February 2023.

16 Reporting is mandatory in 2025 for the financial year 2024 for companies to which the NFRD already applies. Then reporting becomes mandatory in 2026 for the 2025 financial year for large companies not currently subject to the NFRD. In 2027, the reporting for the financial year 2026 must be published by SMEs listed on the stock exchange (except micro-enterprises), small and simple credit institutions and their own insurance companies. Finally, in 2029 for the financial year 2028 reporting becomes mandatory for companies from third countries. Directive (EU) 2022/2464 of the European parliament and of the Council of 14 December 2022 amending Regulation (EU) No 537/2014, Directive 2004/109/EC, Directive 2006/43/EC and Directive 2013/34/EU, as regards corporate sustainability reporting (OJ L 322, 16.12.2022), p. 19–21.

## 3. ENVIRONMENTAL, SOCIAL AND GOVERNANCE STANDARDS (ESG INFORMATION) OF SUSTAINABILITY REPORTING

In addition to the areas and deadlines for the application of the new sustainability reporting rules, the Commission has the mandate to determine sustainability reporting standards and their adaptation to the capacities and resources of individual categories of companies. Although SMEs listed on regulated markets are obliged to apply proportional standards, most of them that are not listed on stock exchanges will be able to apply them voluntarily. Incorporated SMEs will be able to use the opt-out during the transition period and will be exempted from CSRD application until 2028.[17] The Commission will also adopt delegated acts that will complement the CSRD.

Regular annual reports in digital format are compiled by the companies themselves and posted on their own and other websites of certain central registers, and the members of the administrative, management and supervisory bodies of the companies that are responsible for the preparation and publication of the reports of the subsidiary companies. Reports on achieved sustainability should be aligned with the Taxonomy Regulation (EU 2020/852) which establishes a system of environmental objectives, classifications of environmentally sustainable economic activities and a common understanding of what "sustainable"[18] means. The reports will be prepared according to the European Sustainability Reporting Standards (ESRS), the draft of which was prepared by EFRAG[19], and the first set

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17 European Commission, Proposal for a Directive of the European Parliament and the Council amending Directive 2013/34/EU, Directive 2004/109/EC, Directive 2006/43/EC and Regulation (EU) no. 537/2014 regarding corporate sustainability reporting, [https://eur-lex.europa.eu/legal-content/HR/TXT/PDF/?uri=CELEX:52021PC0189&from=EN], Accessed 12 February 2023, p. 1-2.

18 According to Art. 9. Taxonomy Regulation has six environmental goals: mitigation of climate change, adaptation to climate change, sustainable use and protection of water and marine resources, transition to a circular economy, prevention and control of pollution, and protection and restoration of biodiversity and ecosystems. According to Art. 3. there are four comprehensive conditions that an economic activity must meet in order to be qualified as ecologically sustainable: if it significantly contributes to one or more environmental objectives established in Article 9, if it does not significantly harm any environmental objective established in Article 9, if it is carried out in accordance with the minimum protective measures established in Article 18, and if it is harmonized with the technical verification criteria established by the Commission in accordance with Article 10, paragraph 3, Article 11, paragraph 3, Article 12, paragraph 2, Article 13 paragraph 2, article 14 paragraph 2 or article 15 paragraph 2.

19 EFRAG (European Financial Reporting Advisory Group) is a private association founded in 2001 with the encouragement of the European Commission, and after 2022 and the adoption of CSRD as a delegated organization, it provides technical advice to the Commission regarding European sustainability reporting standards. In this regard, EFRAG is a world-renowned center of expertise. EFRAGA's participation at the technical level in the adoption of standards will be coordinated by the Commission with a number of European bodies and member states in order to avoid conflicts of interest, and will hold

of standards should be adopted by the Commission by mid-2023. in which the company operates. These reporting standards will be particularly important in the case of sectors associated with high environmental sustainability risks or impacts on the environment, human rights and governance[20].

Sustainability reporting standards should include environmental, social and governance (ESG) information on sustainability risks and opportunities and in line with applicable guidelines, a wider range of Union acts and internationally undertaken commitments to guide sustainable development. Depending on the specifics of the economic sector, sustainability reporting should contain standardized information on the main environmental factors, including companies' effects on the environment and dependence on climate, air, water, land and biodiversity. Information on the carbon footprint of products, production water pollution, electronic waste, packaging and other types of waste, toxic emissions, etc. will enable an in-depth understanding of companies' effects on sustainability issues and the main risks for companies arising from sustainability issues. Climate information will refer to physical and other risks associated with climate change, but also to society's resilience to different climate scenarios and climate change adaptation plans. Information on the extent of carbon and other greenhouse gas emissions by the company and the extent of their removal, including the extent to which the company applies offsets and the source of these offsets, will also be useful. Among the reporting standards, energy information should be appropriately represented, especially with regard to reducing energy consumption, increasing energy efficiency and consumption of renewable energy sources. Standardized information will also cover the topics of investments in clean technologies and renewable energy, as well as investments in green construction and biodiversity protection.

In the social pillar of sustainability, the standards should include information on working conditions, involvement of social partners in business, works councils and collective bargaining (exchange of relevant information, ways of obtaining and verifying information on sustainability), gender and other forms of equality, non-discrimination in terms of wages, gender diversity at management levels,

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annual consultations with the European Parliament and other expert bodies. ESMA, EBA and EIOPA also participate in the development of reporting standards. More about the EFRAG organization at [https://www.efrag.org/], Accessed 12 February 2023.

20 All economic sectors and branches have their specificities, due to which the same indicators will differ significantly between them. The tourism and energy sectors, for example, will have significantly worse indicators of carbon footprint and greenhouse gas emissions than companies in the service sector. For this reason, the importance of certain environmental and social indicators will be weighted depending on the sector and branch in which the company operates. For recommended weights of indicators, see more in Štriga, T., *Novi regulatorni okvir – Nema više manipulacija i zamagljivanja stvarnosti*, Business outlook 22/23, Jutarnji list, 2022, p. 51.

inclusivity (e.g. on the involvement of workers in management and supervisory boards), on human rights (e.g. including information on forced and child labor) and to include other effects of the company on employees, the community and human health. The information from this pillar of sustainability should be aligned with the principles of the European Pillar of Social Rights Action Plan (The European Pillar of Social Rights Action Plan, 2021) that relate to commercial companies, as well as with other international documents and plans, for example the fundamental conventions of the ILO.

For the governance pillar of sustainability, the standards should include information on the role and contribution of the company's administrative, management and supervisory bodies with regard to sustainability issues, the professional knowledge and skills necessary to fulfill that role or the access of such bodies to the professional knowledge and skills regarding sustainability, the existence of company policies to encourage the members of these bodies to focus on sustainability and information on the company's internal control and risk management systems in relation to the sustainability reporting process. There is a general need for standards that will provide information on the company's corporate culture and business ethics, including information on the fight against corruption and bribery, and on the company's political influence and lobbying activities and efforts. Standards in all three pillars of sustainability should include all established sustainability goals and the progress made in achieving them.[21]

The commission will review progress in the development of reporting standards no later than April 2029, and every three years thereafter.[22] Along with regular annual

[21] Directive (EU) 2022/2464 of the European parliament and of the Council of 14 December 2022 amending Regulation (EU) No 537/2014, Directive 2004/109/EC, Directive 2006/43/EC and Directive 2013/34/EU, as regards corporate sustainability reporting (OJ L 322, 16.12.2022), p. 30-32.

[22] The Commission should submit a report to the European Parliament and to the Council on the implementation of this amending Directive including (...): „an assessment of the achievement of the goals of this amending Directive, including the convergence of reporting practices between Member States; an assessment of the number of small and medium-sized undertakings using sustainability reporting standards voluntarily; an assessment of whether and how the scope of the reporting requirements should be further extended, in particular in relation to small and medium-sized undertakings and to third-country undertakings operating directly on the Union internal market without a subsidiary undertaking or a branch on the territory of the Union; an assessment of the implementation of the reporting requirements on subsidiary undertakings and branches of third-country undertakings introduced by this amending Directive, including an assessment of the number of third-country undertakings which have a subsidiary undertaking or a branch subject to reporting requirements in accordance with Directive 2013/34/EU; an assessment of the enforcement mechanism and of the relevant thresholds set out in Directive 2013/34/EU; an assessment of whether and how to ensure the accessibility for people with disabilities to the sustainability reporting published by undertakings falling under the scope of this amending Directive". Along with the report, the Commission should also attach proposals for legislative changes. Ibid., p. 40.

consultations, this should ensure continuous consideration of relevant changes in standards, including changes to international standards in the process of creation of which the Union participates.[23]

The level of verification of the reliability of information in sustainability reports should be similar to the seriousness of the verification of financial reports, and efficient audit practice depends on the adoption of common standards for verification, which should be in accordance with the reporting requirements from Art. 8. Taxonomy Regulation. Reports will be able to be checked by special authorized auditors or audit companies that already audit financial reports, which would enable the sensitive connection and harmonization of financial and sustainability information, thus avoiding double keeping of different reports and green manipulative marketing. Standardized information on sustainability facilitate their verification and comparison, without which there is no precise ESG rating of companies. In order to ensure a uniform practice of verification of sustainability reporting throughout the Union, the Commission is authorized to adopt standards for verification of information and sustainability reports by delegated acts until October 2026. In the meantime, national standards, procedures or verification requirements will apply. Comprehensive changes from the CSRD, together with future harmonized changes and regulation of sustainability information standards, should ensure that sustainability information in companies' reports is at a significantly higher level of relevance, reliability, verifiability and comparability than under the previous regulation.

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[23] The reporting standards efforts undertaken by the Commission and EFRAG are not alone in terms of convergence and global harmonization of sustainability reporting standards. The G20 and G7 initiatives, the Financial Stability Board, the Sustainability Accounting Standards Board (SASB), the International Integrated Reporting Council (IIRC), the Climate Disclosure Standards Board (CDSB), The Global Reporting Initiative's (GRI) etc. The latter recently presented revised universal standards which, in addition to a slightly changed structure, also introduce in-depth analysis (due diligence). Through this analysis, companies identify their profound negative impacts on the environment, as well as their own responsible business management policies and strengthened human rights reporting components. These changes are consistent with major intergovernmental frameworks related to human rights and sustainability due diligence, including the UN Guiding Principles on Business and Human Rights, the OECD Guidelines for Multinational Enterprises, the OECD Due Diligence Guidelines for responsible business conduct, international labor standards of the ILO, ICGN principles of global management, ISO 26000 norm, etc. It is evident that sustainability reporting is the subject of increasingly strong public interest and regulatory interventions in jurisdictions around the world. More about GRI in de Villiers, Ch., La Torre, M., Molinari, M., The Global Reporting Initiative's (GRI) Past, Present and Future: Critical reflections and a research agenda on sustainability reporting (standard-setting), Pacific Accounting Review, forthcoming., 2022, DOI: 10.1108/PAR-02-2022-0034, accessed 5 March 2023.

## 4. EXPECTED CONTRIBUTIONS TO THE SUSTAINABLE DEVELOPMENT OF THE ECONOMY AND SOCIETY AND POTENTIAL CHALLENGES IN THE PRACTICAL APPLICATION OF CSRD

In accordance with the objectives of the EGD and related international documents, the Union strives to make stronger use of the potential of the European economy's contribution to the transition to a fully sustainable, inclusive and fair economic-financial and soocial system. In order to strengthen environmental, social and managerial sustainability, this system will be obliged to regularly publish reports that will include two groups of sustainability information, those that are important for understanding the effects of this system on sustainability issues and those that are relevant for understanding the impact of sustainability issues in the environment on business results, market position and development of entities in the system.

In the atmosphere of an increasingly pronounced global socio-ecological crisis and the necessity of a transition towards sustainability in all aspects, it is expected that the number of interested users of information on sustainability will grow with a tendency to further increase. The main users of sustainability information are two primary user groups: investors and civil society actors, including non-governmental organizations and social partners (trade unions, workers' representatives). Investors such as credit institutions and insurance companies will be able, based on corporate information on sustainability, to better understand the risks and opportunities for their investments and the impact of these investments on people and the environment, and non-governmental organizations, social partners and all other stakeholders will gain better insight and the possibility of influencing the strengthening of corporate responsibility in terms of their effects on the sustainability of the environment and society.[24] Information on sustainability will be increasingly useful for other social actors who demand greater responsibility of companies for the harmful effects of their operations on human health, environmental quality and the well-being of society - aware citizens as consumers and savers, supervisory state agencies, competent ministries, etc. For example, the reports

[24] The importance of sustainability information for investors and asset managers is also evident from the fact that many of them already purchase sustainability information from third-party data providers, who also collect information from public company reports. With the implementation of the CSRD, the practices of third-party information providers are expected to improve and expertise in the field will increase, providing a good incentive for job creation. Investors' interest in sustainable investments is also growing because such investments reduce their return risks and increase returns on invested capital. Compared to the period twenty years ago, today such investment has increased tenfold, and it is expected that it will increase to 33.9 trillion dollars or more by 2026. HANFA, *Od 2024. tvrtke u svoje izvještaje moraju uključiti i dio o održivosti*, Business outlook 22/23, Jutarnji list, 2022, p. 51.

will be used by citizens who want to consider the opinions of financial advisors and non-governmental organizations about the sustainability of their investments or choose products whose production and consumption do not harm nature or human rights. Holders of public policies and bodies for environmental protection and social cohesion at the European and national levels, as well as certain parts of society (e.g. the scientific and business community) will use the reports to monitor ecological, economic and social trends and include the data obtained in the processes of shaping various public policies. Of course, private and public companies, regardless of the sector or branch in which they operate, can expect growing benefits from ESG reporting and practices: raising the level of awareness of their own risks and opportunities related to climate change and other environmental problems and the degree of responsibility towards nature, employees, other entrepreneurs and the community, productivity and income growth, reduction of business costs, optimization of investment and capital expenditures and minimization of regulatory and legal intervention.[25] ESG reports will expand the social dialogue with new actors within the community, raise the reputation of companies and improve their perception, which will no longer be dominantly based on realized profit, but will also reflect the company's contribution to the sustainability of the economy, nature and society. With more extensive, structured, verifiable and accessible reports, companies will prove that they have directed their business towards green and digital and that they do not have a harmful impact on the environment, social cohesion and people's health. Therefore, standardized and quantified reporting on sustainability will speed up the resolution of environmental and social problems that threaten the achievement of sustainable goals from the Paris Agreement, the EGD and the Action Plan on financing sustainable growth and contribute to a more efficient functioning of the social market economy.[26]

[25] Directive (EU) 2022/2464 of the European parliament and of the Council of 14 December 2022 amending Regulation (EU) No 537/2014, Directive 2004/109/EC, Directive 2006/43/EC and Directive 2013/34/EU, as regards corporate sustainability reporting (OJ L 322, 16.12.2022), p. 3, Štriga, T., *Novi regulatorni okvir – Nema više manipulacija i zamagljivanja stvarnosti*, Business outlook 22/23, Jutarnji list, 2022, p. 52.

[26] Today, non-governmental organizations, social partners, communities affected by the activities of companies and other stakeholders are insufficiently able to influence the transformation of unsustainable business policies of companies, and therefore the trust of citizens in companies and the functioning of the social-market economy is not at a satisfactory level. The earlier lack of generally accepted parameters and thresholds for measuring, evaluating and managing sustainability-related risks not only represented an obstacle to the efforts of companies to ensure the sustainability of their business models and activities, but also limited the ability of all social actors to enter into a dialogue with companies regarding sustainability issues. Directive (EU) 2022/2464 of the European parliament and of the Council of 14 December 2022 amending Regulation (EU) No 537/2014, Directive 2004/109/EC, Directive 2006/43/EC and Directive 2013/34/EU, as regards corporate sustainability reporting (OJ L 322, 16.12.2022, p. 17-18).

Although companies that previously published sustainability reports had associated costs, the new reporting standards are likely to create additional administrative, personnel and other costs for them, particularly burdensome for medium and small businesses. This could lead to an increase in their production costs and product prices, and consequently to a decrease in market competitiveness in the global framework. In order to prevent the growth of reporting costs and the dissatisfaction of companies, the technical assistance of national professional institutions will be very important, as well as the financial participation of national states in the costs of preparing the report, at least in the first years of application of the Directive.[27]

Exposure to a complex network of regulations that regulate sustainability reporting, as well as the gradual elaboration of ESG information standards and their application, which will depend on different categories of companies, will be a another challenge for companies. When adopting ESG standards, it is possible that companies will encounter difficulties in gathering relevant information from actors throughout their value chain, especially from suppliers belonging to the category of small and medium enterprises and suppliers in emerging markets and economies. In the development of reporting rules and standards, care should also be taken to clarify the still insufficiently clear connection between information on sustainability and components in the annual financial reports of companies. Implementation of CSRD will be particularly challenging due to the still insufficiently clearly developed relationship between the aspects of double materiality, i.e. between the effects of the company's activities on people and the environment and the impact of sustainability issues on the company. With all of the above, it would be very useful for companies to have more detailed information on sanctions for not publishing sustainability reports.

[27] The total estimated costs of the option that is more useful for the reporting parties (less detailed reporting requirements, lighter verification requirement and narrower scope) are EUR 1,200 million in one-off costs and EUR 3,600 million in annual reporting costs. The costs could be even higher without the expected new standards and reporting rules, for example the costs of uncoordinated user requests for additional information, the costs caused by the lack of consensus on indicator standards, those that would arise due to the difficulty of obtaining sustainability information from suppliers, clients and companies in which is invested, etc. The future practice of submitting sustainability reports with the application of coherent rules and uniform information standards could bring annual savings of 24,200 to 41,700 EUR per company. This is a total saving of between 280 and 490 million EUR per year for current CSRD taxpayers, or between 1,200 and 2,000 million EUR per year if the standards completely eliminate the need for additional requests for information sent to reporters. European Commission, Proposal for a Directive of the European Parliament and the Council amending Directive 2013/34/EU, Directive 2004/109/EC, Directive 2006/43/EC and Regulation (EU) no. 537/2014 regarding corporate sustainability reporting, 2021, [https://eur-lex.europa.eu/legal-content/HR/TXT/PDF/?uri=CELEX:52021PC0189&from=EN], Accessed 12 February 2023, p. 10-11.

Furthermore, in the process of verifying sustainability reports by authorized auditors or audit firms, there is a risk of further concentration of the audit market, "which could threaten the independence of auditors and increase audit fees or fees related to the verification of sustainability reporting."[28] Therefore, the Commission will need to continuously work to create a more open and diverse trans-European audit market, for example through the inclusion in the verification of authorized, independent and theoretically and practically qualified auditors in the field of sustainability who do not audit the financial reports of companies.

## 5. CONCLUDING CONSIDERATIONS

As a global leader in the regulation and standardization of the reporting process in all dimensions of sustainability, the Union adopted the CSRD in November 2022 with the aim of filling the undoubtedly identified gaps in the previously existing European sustainability reporting rules and standards. The creation and adoption of CSRD was preceded by expert analyzes and political consultations, on the basis of which the Commission concluded that the common European framework for sustainability reporting needs to be strengthened, standardized in more detail and applied to a wider range of business entities. Mandatory reports will include relevant, quantified, comparable and verifiable data on sustainability in all aspects, and will be divided according to dual materiality - "inside out" and "outside in". The professional and technical development of new sets of standards has been entrusted to EFRAG and other related European and international bodies and organizations, and the first set of ESG standards should be completed and adopted by mid-2023, and the additional pillar by mid-2024. Since they differ from each other according to the ecological and social footprint they leave, the new normative solutions of rules and reporting standards adapt to companies of different sizes, sectors and branches of business and thus facilitate the comparison of ESG information and increase the relevance of ESG ranking of companies.

The changes that the application of the Directive should bring to around 50,000 European and non-European companies and groups would accelerate and strengthen the processes of transformation of the European economy and society towards sustainability in all ESG aspects. Positive changes resulting from standardized, comparable and verifiable sustainability reports will take place primarily in the companies themselves, which will implement more sustainable business policies and financial risk management, discover new business opportunities, reduce costs

[28] Directive (EU) 2022/2464 of the European parliament and of the Council of 14 December 2022 amending Regulation (EU) No 537/2014, Directive 2004/109/EC, Directive 2006/43/EC and Directive 2013/34/EU, as regards corporate sustainability reporting (OJ L 322, 16.12.2022), p. 34-38.

and increase revenues, facilitate access to commodity and capital markets, minimize regulatory and legal interventions, and increase business transparency and reputation in the public. Information on sustainability from company reports will be extremely useful for shaping the attitudes and policies of non-governmental associations, trade unions, citizens as consumers and investors, supervisory national and Union agencies, national ministries responsible for sustainable development, public policy holders at the European and national levels, etc. The application of the Directive will have a particularly significant impact on institutional public and private investors and insurers because, based on sustainability reports, they will effectively reduce their exposure to irresponsible companies and business groups, and strongly redirect capital flows towards sustainable investments and highly ESG-ranked business entities. According to the prevailing opinion, the financial industry should play a key role in achieving the goals of European sustainable development, and it will fulfill it through a deeper understanding of sustainable business opportunities associated with their investments as well as harmful consequences for the sustainability of the environment and society.

Challenges in the application of CSRD that could slow down the process of transformation to a sustainable European economy and society are: possible additional financial and personnel costs of business related to the collection of informations and preparation of reports, resistance from the business sector in the event of an assessment of falling profit rates and a decrease in global competitiveness, continuous changes in information standards and auditing standards, an insufficiently elaborated relationship between financial and sustainability reports, an underdeveloped network of auditors, as well as an unclear regime of sanctions in case of publication of low-quality reports or non-publication of reports.

The interest in standardized, relevant, comparable and verifiable reporting on all aspects of sustainability within the business sector at the global level is increasingly pronounced and results in more widespread and tighter legal regulation. This is a reaction to the fact that the concept of sustainable development is recognized today as the only development model that simultaneously ensures economic growth, preservation and protection of nature, and social justice. In the context of an increasingly pronounced socio-ecological crisis, ESG reports are expected to be one of the fundamental instruments in the future for building a higher level of environmental and social awareness, for a deeper understanding of the risks and opportunities associated with climate and other environmental and social problems, and for taking measures and policy to accelerate sustainable development within the business sector and the wider community. All other economic, financial, political, activist and other initiatives for the realization of the goals of sustainable development outlined in the Paris Climate Agreement, the UN Agenda for Sustainable Development 2030, the European Green Deal, the EU Action Plan for Financing Sustainable Growth, the Disclosure Regulation and Taxonomy Regulation would be significantly less effective without the existence of a comprehensive, standardized and solid framework for ESG reporting by business entities.

The analysis carried out showed that the short period of application of the Directive prevents a more thorough understanding and evaluation of its potentially positive effects on the expansion and strengthening of sustainable business projects and the acceleration of the transition to more sustainable business policies of companies, more thorough respect for basic human rights and the rights of nature. Therefore, it is necessary to continuously conduct analyzes and evaluations of the positive effects of the Directive, as well as the challenges that will arise on the way to its application, especially since the rules and standards of reporting will be changed and supplemented through new delegated acts of the Union. A more grounded and relevant assessment of the positive contributions of the Directive to the sustainable development of the EU economy and society and the obstacles on the way to the realization of the Directive's goals will be possible only after the completion and adoption of the ESG information standards on sustainability and the first audits and analyzes of the submitted sustainability reports.

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