Corporate Sustainability Reporting Directive (CSRD): Obligations, Challenges and Requirements for Companies

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Abstract

Today, companies should develop and operate in a sustainable and green society with the least possible negative environmental impact. At the global level, it is necessary to awaken and develop an awareness of the need to accept the concept of sustainable development, thus the application of the Corporate Sustainability Reporting Directive (CSRD) and ESG (environmental, social, and governance) concept. The Corporate Sustainability Reporting Directive (CSRD) is the new EU legislation requiring all large companies to publish regular reports on their environmental and social impact activities. CSRD sets out reporting requirements and obligations for companies and expands existing rules on non-financial reporting. CSRD reporting will help stakeholders (investors, consumers, policymakers, and others) evaluate large companies' non-financial performance. This paper aims to explore the area of sustainability reporting through CSRD reporting and its connection to the ESG concept in today's business world.

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Introduction

The aspiration and idea of achieving a sustainable economy began with the Paris Agreement on Climate Change in 2015 and the adoption of the Sustainable Development Goals (SDGs) by the United Nations (UN) when the European Union created the foundations to fight the challenges posed by climate change and all to develop and ensure sustainable development. The main goal of all regulations and directives passed by the European Union (EU) is to make Europe the first climate-neutral continent by 2050 and to achieve 55% less greenhouse gas emissions by 2030. Companies, their way of doing business, and their impact on the environment and society play a major role in achieving sustainable development and striving for a climate-neutral continent. The Corporate Sustainability Reporting Directive (CSRD) was adopted precisely to regulate the business framework of companies and their impact on the environment and society, so that the company could present unified and standardized data in the form of non-financial reporting, i.e. sustainability report. EU policymakers defined and agreed on The Corporate Sustainability Reporting Directive (CSRD), which entered into force on January 5, 2023. With this directive, for the first time in the history of reporting, sustainability reporting is equalized and brought to the same level as financial reporting, all with the aim of the European Green Plan and the transformation of Europe into the first climate-neutral economy by 2050. The CSRD directive is significant because it replaces the previous Non-Financial Reporting Directive (NFRD) and information on the diversity of certain large companies and groups. The new directive is related to reporting on the social, environmental, and governance impacts of the company itself. The NFRD (Non-Financial Reporting Directive) is somewhat simpler and applied to a narrower circle of obliges. CSRD is a more detailed and demanding reporting than the previously mentioned directive, which will have to be applied by around 50,000 companies, in contrast to the previous 12,000 according to NFRD. To create a sustainability report, businesses will have to publish information by the European Sustainability Reporting Standards (ESRS). The European Sustainability Reporting Standards (ESRS) aim to specify all the information an entrepreneur should report on, i.e. they prescribe the content and format of information related to sustainability. As companies face increasing scrutiny from regulators, investors, and consumers regarding their environmental, social, and governance (ESG) practices, understanding the obligations, challenges, and requirements associated with CSRD is critical for any organization that wants to thrive in this regulatory environment. Investigating the legislation itself in the area of the European Union (EU) and related to sustainability itself, the authors Hummel and Jobst (2022:1) point out that the EU is leading the way in introducing legislation concerning sustainability:"(i) companies' sustainability aspects (Corporate Sustainability Reporting Directive), (ii) the sustainability of economic activities (Taxonomy Regulation), (iii) the sustainability of financial products (Sustainable Finance Disclosure Regulation), and (iv) the environmental, social and governance risks of credit institutions (Pillar 3 disclosures)". This article explores the key features, objectives, and implications of CSRD in today's business environment as one of today's main challenges in terms of sustainable corporate reporting.

Literature Review

ESG criteria and reporting

The result of human actions and behavior has caused and continues to cause global warming and irreversible changes in the environment (ocean currents, rainfall patterns, wind currents, etc.). The environment is changing significantly, and increasingly extreme weather conditions are endangering society itself, as well as entire economies. Climate change is visible through high temperatures, droughts and forest fires, floods, rising sea levels, coastal areas, etc. All this leads to disasters in which, for example, annual losses caused by drought in Europe amount to around 9 billion euros and mostly occur in the agricultural and energy sectors and the public water supply sector,[1] weather conditions and climate-related phenomena caused more than 487 billion euros in financial losses in the EU, etc. Precisely to minimize the mentioned threats to the environment, business, and society, the Paris Agreement on climate change and the European Green Plan are the main drivers towards creating sustainability and promoting Europe as the first climate-neutral continent by 2050. In today's world and a society that strives for sustainability, ESG criteria, i.e. the application of environmental, social, and governance criteria, becomes a key imperative in achieving sustainable business practices, especially in the financial world. In order to be able to achieve sustainability, it is crucial to know how to assess the risks that the concept of ESG criteria carries with it and how they affect business, but also the products, services, and investments themselves (Oliver Yébenes, 2024). The mentioned criteria influence the framework of non-financial information. "Current regulatory developments, such as the European Corporate Sustainability Reporting Directive (CSRD), aim to make ESG indicators (within this triple perspective: social, environmental and governance risks) a key set of information to be used by reporters and information users" (Oliver Yébenes, 2024). ESG criteria are becoming an absolute necessity in the financial world in order to assess all the potential risks that this component entails today. The ESG concept is not new in the business world, but recently it is gaining more and more importance, especially in terms of evaluating the performance of companies in the context of sustainability and further decisions that reflect on responsible and sustainable corporate management. "Environmental, social, and governance (ESG) issues are driving corporate strategy and performance" (Arvidsson and Dumay, 2021:1091). According to the authors of Frade and Froumouth (2022), the reporting that becomes mandatory through CSRD becomes a powerful tool for improving the efficiency of the capital market and promoting the distribution of financing to achieve ESG goals. Reporting on sustainability through the ESG component and showing non-financial performance are necessary criteria and components in addition to financial performance to be able to evaluate the overall performance of the business. "ESG reporting is no longer just a corporate obligation; it is a powerful mechanism driving sustainable development" (Chopra et al., 2024:5). The main goal regarding ESG reporting for companies should be in the context of implementing ESG reporting in corporate strategies and business operations and processes to achieve long-term sustainability. In such an approach to ESG reporting, greater transparency and accountability are achieved, as well as better measurement of effects and stimulation of innovation to create a more sustainable future (Chopra et al., 2024).

[1] https://climate.ec.europa.eu/climate-change/consequences-climate-change_hr

The Corporate Sustainability Reporting Directive (CSRD)

The Corporate Sustainability Reporting Directive (CSRD) represents a major step forward and an upgrade in the process of formal reporting in companies. The changes in EU legislation regarding the new Reporting Directive are a major move towards harmonizing financial reporting with non-financial reporting, i.e. sustainability reporting (CSRD), to achieve the Sustainable Development Goals (Markova-Karpuzova et.al., 2024). The Corporate Sustainability Reporting Directive (CSRD) is a new EU regulation that requires all large companies to publish regular reports on their activities that affect the environment and society. Through this type of reporting, a more responsible and transparent way of doing business is encouraged, and all interested parties can have insight into non-financial performance. Its adoption will increase the circle of those obliged to apply, thus increasing from the previous 12,000 companies to 50,000. In addition to increasing the number of users, CSRD has expanded the content of sustainability reports, carries with it the obligation to verify sustainability reports (external audit), defines the European Sustainability Reporting Standards (ESRS) as well as verification standards and a unique electronic format (ESEF regulation) (digital publication reports). What is important is that through this directive reporting becomes mandatory and a common reporting framework for non-financial data is defined. CSRD aims to properly, thoroughly, and concretely measure and manage risks that affect the environment, society, and governance through the ESG framework (mentioned in the previous chapter). The CSRD is now in force throughout the European Union (EU), and member states should have adopted it in their national legislation by now. The Republic of Croatia had to include this regulation in the Accounting Act, the Audit Act, and the Capital Market Act by July 2024. CSRD requires companies operating in the EU to publicly disclose and report on environmental, social, and governance (ESG) issues. The new directive recognizes the importance of the ESG concept, which is included in everyday business operations and now in the very concept of reporting. CSRD represents a great challenge for today's companies to incorporate it into their operations and ultimately create a sustainability report. However, it is also a great opportunity for companies to be able to increase their transparency and build loyal and long-term relationships with all interested stakeholders, all with the aim of achieving sustainable business and sustainable business practices. CSRD is replacing the NFRD (2014/95/EU)[2] (Non-Financial Reporting Directive) and widens the scope of mandatory sustainability reporting compared to NFRD. The NFRD was introduced in 2014 to increase transparency and publish non-financial information related to ESG issues, but there is no uniform, standardized framework for the same, nor uniform standardized standards that do not allow for comparison. When we talk about NFRD „the sustainability issues falling within the scope of companies' "non-financial statement" must cover, as a minimum, environmental, social and employee matters, respect for human rights, anti-corruption and bribery"(Dolmans et al., 2021). The goal of the new Directive is to make company announcements more comprehensive and mutually comparable, such as financial and accounting reports. The Corporate Sustainability Reporting Directive (CSRD) and the Non-Financial Reporting Directive (NFRD) are frameworks established by the European Union to increase corporate transparency and accountability regarding sustainability. Although the Directives are similar, there are differences between them (Table 1).

[2] https://eur-lex.europa.eu/legal-content/EN/TXT/PDF/?uri=CELEX:32014L0095&from=EN

Table 1
CSRD vs. NFRD

	NFRD	CSRD
Adopted	2014	2021
Applies	From 2017 until companies start to apply CSRD	From 2025 (reporting on 2024 data)
Scope	Large public companies, with more than 500 employees Listed companies, banks, insurance companies Focuses only on EU-based companies The directive applies to 12.000 companies across the EU	Applicable to all large companies operating in the EU Initially, large companies that meet two of these three criteria: - €40 million net turnover - €20 million on the balance sheet - 250 employees Focuses not only on EU–based companies but also subsidiaries of global non-EU-companies that are not incorporated in the EU but have securities on EU markets The directive applies to more than 50.000 organizations
Reporting and format	Reporting is not standardized, companies may choose to use any international, European, or national guidelines to report Reporting online on website of a company (There is no digital reporting).	Reporting is standardized, by ESRS (the mandatory EU Sustainability Reporting Standards) Companies will have to prepare their disclosure in XHTML format, a new digital reporting format (according to European Single Electronic Format (ESEF))
Form	A financial statement is included in the management report (or in a separate report)	A financial statement is included in the management report (or in a separate report)
Audit requirements	Auditing is not mandatory	Auditing is mandatory
Assurance Standard	No specific assurance standards	Limited assurance on the company's sustainability reporting, including compliance with the reporting standards (increasing the reliability and credibility of the reported information)

Materiality	Double materiality – info about how sustainability issues affect their financial performance	Double materiality: - The impact of the activities of entrepreneurs on people and the environment - The impact of sustainability issues on the activities and business itself - entrepreneur
Disclosure matters	Environment, social and employee matters, respect for human rights, and anticorruption and bribery matters	Environmental, social, employee, human rights, corruption, bribery
Disclosure requirements	- Environmental, social, and employee matters - Respect for human rights - Anti-corruption and bribery matters - Diversity policy for boards of directors	- Description of business model and strategy - Description of related targets, their achievement progress, and if they are based on scientific evidence - Role and expertise of administrative, management, and supervisory bodies - Sustainability-related policies - Sustainability-linked incentive schemes - Description of due diligence processes and PAIs (principal adverse impacts) and mitigating actions - Sustainability-related risks and risk management

Source: modified by authors according to Hummel, K., & Jobst, D. (2024:6,12). , https://www.quentic.com/articles/infographic-csrd-vs-nfrd/, https://www.crediblesg.com/blogs/understanding-the-eu-taxonomy-differences-between-nfrd-csrd-and-sfdr/

To date, it has been difficult for companies to compare and measure sustainability reports because the published information differs widely in the multitude of reporting standards and frameworks, but with the development of ESRS standards and the formation of CSRD, this reporting will be largely standardized and unified. Therefore, sustainability reporting is now regulated through mandatory (equal) reporting standards (ESRS), and companies are obliged to report by the ESRS adopted by the European Commission. There are three ESRS categories: cross-cutting, topical standards (environmental, social and human rights, and governance), and sector-specific standards.[3] The directive wants to ensure the publication of quality information on sustainability, and to achieve this, the standards, i.e. ESRS, have a great role and importance. The main purpose of ESRS is to enable a simple and logical structure of sustainability information. The first sustainability reports compiled according to ESRS standards will be published in 2025 for the financial year 2024. The main goal of CSRD is to define a standardized and common language related to sustainability information, bringing sustainability reporting to the same level as financial reporting. Of great importance and great innovation in the new CSRD is the concept of double materiality mentioned previously and through Table 1. Although the concept of double materiality is already mentioned and appears in the NFRD through the CSRD, it appears in the form of "Outside-Inside" and "Inside-Outside" perspectives. „According to the first perspective, the goal will be to look at how sustainability factors affect the company's development, performance, and business position. In the second perspective, the goal will be to observe what is the impact of the company's activity on its surrounding environment and people. This dual, and simultaneous, focus would be able to ensure, from the European legislator's perspective, a completer and more accurate picture of sustainable issues"(Celli et al., 2024:47).

CSRD currently includes and refers to the following business entities that are obliged to apply the new rules, i.e. the new directive:[4]

- All entrepreneurs listed on the regulated EU market (including SMEs listed on the fast track, but excluding micro-entrepreneurs)
- All large entrepreneurs who exceed two of the three following criteria (in accordance with the Accounting Directive 2013/34/EU)
  - 250 employees during the financial year;
  - Total assets EUR 20 million;
  - Net income EUR 40 million(CSRD-2022/2464/EU).

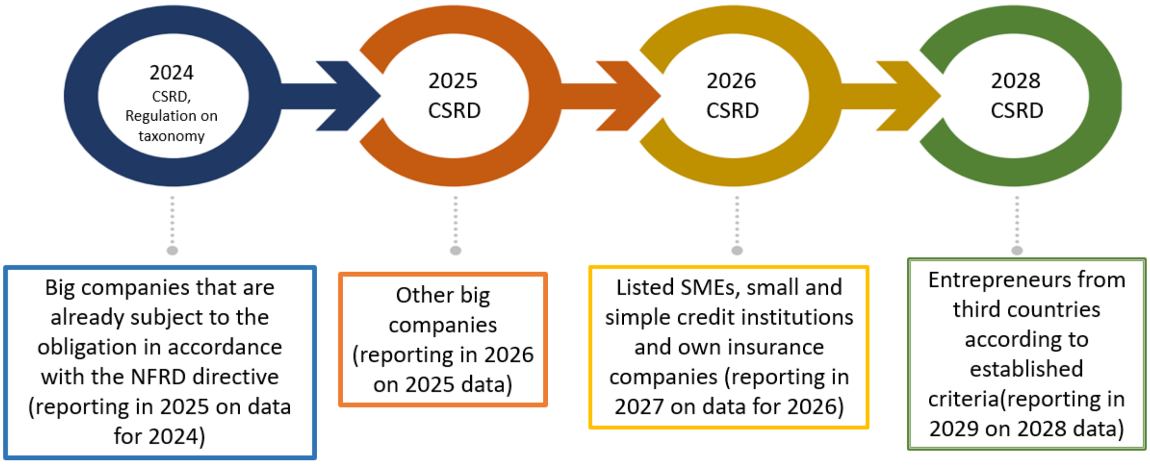
The application of the new rules, i.e. the application of the new Directive, is as follows:

- From January 1, 2024 (first reports in 2025) for entrepreneurs already covered by the scope of The Directive on non-financial reporting (NFRD) 2014/95/EU;
- From January 1, 2025 (first reports in 2026) for other large entrepreneurs;
- From January 1, 2026 (first reports in 2027) for SMEs listed on the stock exchange;
- From January 1, 2028 (first reports in 2029) for non-EU entrepreneurs with branches/subsidiaries (CSRD-2022/2464/EU) (Figure 1).

[3] https://accountancyeurope.eu/publications/faqs-on-corporate-sustainability-reporting-directive/#what-is-the-scope-of-reporting-requirements-?

[4] https://accountancyeurope.eu/publications/faqs-on-corporate-sustainability-reporting-directive/#what-is-the-scope-of-reporting-requirements-?

Figure 1
Timeline of reporting regarding CSRD



Source: Authors according to CSRD (CSRD-2022/2464/EU)

Impact of CSRD on business

CSRD's impact on business will certainly be significant. Influences on companies, both internal and external, will certainly be reasons for companies to start introducing sustainable practices and reporting. Strict EU rules will also demand sustainable clients, sustainable plans, and sustainable investments from companies, so the companies themselves will focus on reaching new and sustainable customers, suppliers, investors, and other stakeholders. Even the authors Odobaša and Marošević (2023) understand the importance of the new Directive in terms of strengthening the responsibility of companies to create a sustainable economy and society as one of the key goals of the EU, all to reduce the negative ecological and social footprint on the sustainable operations of companies and the economy as a whole. What the new Directive brings is an expansion of the information it provides in reporting, which is a focus on business plans and strategies, analysis of double materiality, due diligence, policies related to the development of sustainability, risks, opportunities, etc., all of which are connected to the entire supply chain included in the entire business process of the company (Celli et al., 2024). For companies to successfully implement all the requirements of the Corporate Sustainability Reporting Directive (CSRD), it is necessary to establish a framework for its implementation through the Sustainability Balanced Scorecard (SBSC) (Hristov and Searcy, 2024). The challenge was put before the companies regarding the implementation and further operations by CSRD. Companies must define and establish business processes with a focus on sustainability, where they must use all necessary internal and external information and resources, and include all interested stakeholders to achieve the ultimate goal, which is the achievement of sustainable development through an effectively implemented directive and contribute to positive changes (Staudt et al., 2023). CSRD is certainly an opportunity for companies to achieve and improve their sustainability practice, but as already mentioned there are challenges that companies face in the context of its recognition and implementation itself. Some of the challenges and implications faced by companies are the integration of CSRD into the business strategy, along with the importance of recognizing and functioning according to the ESG concept as a new model of sustainable business. Furthermore, changing the business processes themselves and aligning them with the Directive requires companies to have processes that will collect and analyze sustainability data, as well as trained and professional employees for quality reporting. It is precisely the lack of human resources regarding the current misunderstanding of standards and directives that can have an impact on quality reporting. In addition to fulfilling all internal assumptions, from human resources, to setting business processes to the level necessary for collecting information necessary for reporting, the next step for companies is to satisfy the interests of all interested stakeholders through quality reporting. Given that CSRD is based on unique standards, but also on double materiality, audit, etc., the authors Primec and Belak (2022) expect that the new directive will contribute to corporate governance towards sustainability. The research conducted by the authors Litinska and Oprea (2024) show that CSRD catalyzes organizational changes in all companies, regardless of their previous reporting practices. But "the CSRD will affect many firms and the implementation of the new reporting requirements will be challenging, particularly for firms with no previous sustainability reporting experience (Kosi and Relard, 2024). Likewise, the authors of Krasodomska et al. (2024) believe that the inclusion of government agencies, national accounting and auditing associations and other stakeholders in the implementation of the SDGs can be of great benefit and relief in the reporting implementation approach according to the new CSRD. The key advantages provided by CSRD are certainly an increase in transparency precisely through the standardization of reporting itself. Furthermore, the Directive promotes the responsible practice and responsible sustainable policy and in this way, through responsible and improved data on sustainability, makes it easier for interested parties to make an investment decision. Likewise, the SDGs are realized through the CSRD directive. Companies face great challenges in implementing CSRD well. In addition to CSRD implementation itself, a big challenge is certainly the availability of data for reporting both internal data and external data due to the obligation to report on impacts, risks, and opportunities for sustainability in all their value chains. However, with the establishment of the system itself, CSRD will inevitably ensure a better relationship with all interested parties, influence the reduction of risk, and improve the effect of ESG components on the company's operations.

Conclusion

The CSRD reporting obligation supports the objectives of EU policy, the European Green Plan and EU sustainable financing, and the SDG's. The new CSRD for companies represents increased transparency and responsibility in the reporting process. CSRD ensures the recognition of the importance of ESG factors in business processes with the aim of transparent, responsible, and sustainable reporting. The obligations that the CRSD carries with it represent challenges for companies, mostly in terms of its implementation and integration into the corporate strategy for quality and transparent change. Through CSRD, companies have the opportunity to build stakeholder trust and encourage sustainable business practices. CSRD encourages and increases transparency, responsibility, better information, and better relationship building with all interested stakeholders. CSRD's goal is to promote sustainable practices but also to improve ESG components through business operations and attitudes towards society. The key task and challenge for companies is the incorporation of business sustainability, especially its implementation in the corporate strategy, then business processes and resources. Companies that will recognize and of course implement and operate by the concept and directives of sustainability will have an advantage over the competition and contribute to business growth and profitability. By recognizing the importance and ultimately applying CSRD, companies can achieve a competitive position on the market precisely as carriers and promoters of corporate responsibility and sustainability.

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