

The EU Non-Financial Reporting Directive and the Proposal for Corporate Sustainability Reporting Directive

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There is a global trend to move capital to more sustainable economic activities. To ensure that capital is moved to the desired activities, several questions arise:

- What is sustainable?
- How is “greenwashing” prevented?
- How is materiality of environmental, social, and corporate governance (ESG) issues determined?
- Who must disclose and how?

The European Union (EU) is at the forefront of this movement. The EU is introducing far-reaching legislation addressing the recent adoption of the Taxonomy Regulation ((EU) 2020/852, June 18, 2020, on the establishment of a framework to facilitate sustainable investment ([Regulation \(EU\) 2020/852](#)) and the entry into force on March 10, 2021, of the Sustainable Financial Disclosure Regulation ([Regulation \(EU\) 2019/2088](#)) – please refer to GT Alert “[The EU Sustainable Finance Disclosure Regulation Enters into Force](#).”

The Taxonomy Regulation has recently been supplemented by a delegated regulation of the EU Commission ([Delegated Regulation](#)) which has laid down the technical screening criteria for determining the conditions under which an economic activity qualifies as contributing substantially to climate change mitigation ([Annex I](#)) or climate change adaptation ([Annex II](#)) and for determining whether that economic activity causes no significant harm to any of the other environmental objectives.

Two further important pieces of EU legislation are:

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1. The Non-Financial Reporting Directive (Directive 2014/95/EU, October 22, 2014, amending Directive 2013/34/EU as regards disclosure of non-financial and diversity information by certain large undertakings and groups, as amended by the Taxonomy Regulation – the **NFDR**); and
 2. The proposal for a Corporate Sustainability Reporting Directive (proposal by the European Parliament dated April 21, 2021 – the **CSRD**), which revises and extends the scope of the sustainability reporting requirements introduced by the NFRD.

This GT Alert summarizes the scope of this new and proposed EU legislation.

NFRD

Application

The NFRD requires large (i.e., public interest entities that either have a balance sheet total that exceeds €20,000,000 or a turnover that exceeds €40,000,000) ‘Public Interest Entities’ with more than 500 employees to include non-financial statements as an integral part of their annual public reporting obligations. In the course of 2022 these statements must be made in compliance with the Taxonomy Regulation.

Public Interest Entities are:

- a. Companies governed by the law of a Member State and whose transferable securities are admitted to trading on a regulated market of any Member State;
- b. Credit institutions, other than those referred to in Article 2 of the Credit Institutions Directive;
- c. Insurance companies; or
- d. Designated by Member States as public interest entities, e.g., companies that are of significant public relevance because of the nature of their business, their size or the number of their

employees.

Disclosure

- a. The NFRD requires Public Interest Entities to disclose:
 - i. Information about their business model, policies, outcomes, risks, risk management and key performance; and
 - ii. Key Performance Indicators (KPIs) relating to four key sustainability issues: environment, social and employee issues, human rights, and bribery and corruption.
- b. Public Interest Entities must further disclose how sustainability issues may affect the company, as well as how the company affects society and the environment.

Materiality

The NFRD adopts a “double materiality” principle for matters relating to environmental, social and employee matters, human rights, anti-corruption, and bribery. This requires Public Interest Entities to disclose information to the extent necessary for an understanding of the development, performance, position, and impact of the company’s activities.

Thus, a Public Interest Entity is required to assess and disclose:

- a. Financial materiality (e.g., how climate change impacts a company’s financial position); and
- b. Environmental and social materiality (e.g., how a company impacts the climate).

CSRD

Application

In the current proposal, the CSRD will apply to:

- a. All large companies governed by the law of, or established in, an EU Member State. A company is qualified as large when exceeding two out of three of the

i.	following criteria: A balance sheet total of €20,000,000;
ii.	A net turnover of €40,000,000;
iii.	An average number of employees during the financial year of more than 250.
b.	All publicly listed small- and medium-sized companies, except for listed micro- enterprises, as of Jan. 1, 2026; and
c.	All small- and medium-sized companies, non-listed, who choose to use the standards on a voluntary basis.

Objectives

The CSRD's objectives are:

a.	To improve sustainability reporting in order to better harness the potential of the European single market to contribute to the transition towards a fully sustainable and inclusive economic and financial system in accordance with the European Green Deal and the UN Sustainable Development Goals;
b.	To ensure that there is adequate publicly available information about the risks that sustainability issues present for companies, and the impact of companies themselves on people and the environment;
c.	To reduce systemic risks to the economy and improve the allocation of financial capital to companies and activities that address social, health, and environmental problems and to make companies more accountable for their impact on people and the environment; and
d.	To minimize unnecessary costs

of sustainability reporting for companies, and to enable them to meet the growing demand for sustainability information in an efficient manner.

Disclosure/Due Diligence Strategies

The obligations for in-scope companies are to assess:

- a. Whether the business model and strategy cause any risks to sustainability matters, their impact on those matters, and the way in which stakeholder interests are considered;
- b. The opportunities for the company related to sustainability matters and whether the plans are compatible with the transition to a sustainable economy and with the limiting of global warming to 1.5 °C, in line with the Paris Agreement; and
- c. How the strategy has been implemented regarding sustainability matters.

The CSRD requires companies to provide qualitative and quantitative information, forward-looking and retrospective information, and information that covers short, medium, and long-term time horizons. Where appropriate, report content should also include information about the company's value chain, including the company's own operations, products and services, business relationships, and supply chain, proportionate to its circumstances and resources.

Finally, companies will also need to disclose information on intangibles, including information on intellectual, human, and social and relationship capital.

Sustainability Reporting Standards

The information referenced above must be disclosed according to so-called sustainability reporting standards.

The European Commission will adopt such sustainability reporting standards that specify the structure in which the sustainability information has to be reported.

It is intended that by Oct. 31, 2022, the European Commission will adopt the first set of reporting standards, which will specify the information regarding all reporting areas and sustainability matters. This first set of standards also aims to ensure that financial market participants receive the information they need from companies to ultimately fulfil their own disclosure obligations laid down in the SFDR and the Taxonomy Regulation.

By Oct. 31, 2023, the second set of reporting standards should be adopted specifying complementary information about sustainability matters and reporting areas where necessary, and information that is specific to the sector in which a company operates.

The standards will be reviewed every three years by the European Financial Reporting Advisory Group, in order to take account of relevant developments, including the development of international standards.

Enforcement

Each Member State must designate a national authority to:

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| a. | Investigate in-scope companies; |
| b. | Supervise the correct implementation of their due diligence obligations; and |
| c. | Impose penalties where these obligations are not met, with repeated infringement constituting a criminal offence. |

Timing and next steps

The next step is for the European Parliament, and the Member States in the EU Council, to negotiate a final legislative text of the CSRD on the basis of the European Commission's proposal. There seems to be general support, so we do not expect any material changes to the current proposal.

The final timetable will depend on how the European Parliament and EU Council progress in their negotiations. If they reach agreement in the first half of 2022, then the Commission should be able to adopt the first set of reporting standards under the new legislation by the end of 2022. That would mean that companies would have to apply the standards for the first time to reports published in 2024, covering financial year 2023. The European Commission seems fairly confident that this timetable will be achieved.

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