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The proposal for the new Corporate Sustainability Reporting Directive (CSRD): towards better environmental data in sustainability reporting

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**Abstract**. On April 21, 2021, the European Commission adopted a proposal for a Corporate Sustainability Reporting Directive (CSRD) to amend the Directive 2014/95/EU, known as Non-Financial Reporting Directive (NFRD), transposed in Italy in 2016. The aim is to make the relevant provisions more consistent with the European Green Deal and The Action Plan on Sustainable Finance. The proposed directive provides new features, including the development of new mandatory European reporting standards and the improvement of data quality. In the new mandatory standards, released over the next two years, there will be a reference to a complete environmental footprint and new environmental aspects to be detected and communicated are introduced. The concept of life cycle and the use of impact categories related to the Life Cycle Assessment are becoming increasingly popular within sustainability reports. Therefore, it might be interesting to understand the role of life cycle-based tools in non-financial reporting concerning environmental performance. This study aims to analyse the innovations expected in the CSRD and understand how the new reporting standards can improve the quality of environmental data, their comparability, and what role life cycle-based tools will play in sustainability reporting.

**Keywords.** Corporate Sustainability Reporting Directive, life cycle, sustainability report

1. **Introduction**

In 2014, the European Commission (EC) introduced the regulation of environmental and social performance reporting approving the Directive 2014/95/EU, known as NFRD (Non-Financial Reporting Directive), which is planned to revise starting from 2021. The revision of the NFRD 2014/95/EU is part of the goals of the European Green Deal (EC, 2020), which aims to reduce net greenhouse gas (GHG) emissions by at least 55% by 2030 compared to 1990 levels and to be climate neutral by 2050 (EC, 2020). The NFRD aims to improve transparency, consistency, comparability, and the disclosure of non-financial information such as environmental information, social and employee-related aspects, respect for human rights, and the fight against active and passive corruption (Dir. 2014/95/EU). The proposal for a Directive adopted by the EC on 21 April 2021, called the CSRD (Corporate Sustainability Reporting Directive), which will be approved by the end of 2022, introduces substantial novelties compared to the NFRD. This paper aims to highlight the main differences between the NFRD and the future CSRD, and investigate how life cycle thinking and related tools will positively contribute to increasing companies' transparency.

1. **Review of the literature**

Adopted in 2014 by the EC and transposed into Italian law in 2016 (Leg. dec. 254/2016), the NFRD was the first measure introducing mandatory disclosure of non-financial risks according to the OECD guidelines (Poma and Saccani, 2022). The target audience of the NFRD are "large undertakings (…) exceeding on their balance sheet dates the criterion of the average number of 500 employees during the financial year". These companies are required to report "environmental matters, social and employee-related matters, respect for human rights, anti-corruption and bribery matters" (Dir. 2014/95/EU). The principle of 'double materiality', the requirement of companies to provide information on how sustainability issues affect the company itself. In addition, their impact on people and the environment must be complied (Dir. 2014/95/EU). However, the information communicated by the companies is not easy to compare, and there is little trust in the information reported (COM/2021/189 final). Venturelli (2020) stated that paradoxically, reports edited following the NFRD are less comparable than reports before the NFRD came into force. Thus, there is a problem with consistency with the requirements of Directive 95/2014/EU. Furthermore, the most important effect of introducing the NFRD is the increased number of published reports (Venturelli et al., 2020). Therefore, to overcome these and other limitations of the NFRD, on 21 April 2021, the European Community adopted the CSRD to amend some articles of the previous NFRD. Among others, the proposed Directive: (i) extends the scope of application to all large and listed on regulated markets companies; (ii) requires mandatory audit (or assurance) of reported information; (iii) introduces specifications on reporting requirements (e.g., "double materiality" is clarified); introduces mandatory EU sustainability reporting standards; (iv) requires companies to provide the information in the report digitally, to create a publicly accessible European database.

Thus, the new CSRD will be applied to all large companies (with more than 250 employees) and to all companies listed on regulated markets (including listed SMEs but not listed micro-companies). Listed SMEs, however, will be allowed to report under more straightforward rules, while unlisted SMEs may choose to use them voluntarily. Another innovation concerns the involvement of the supply chain; thus, large companies will have to include suppliers in their reporting. Finally, the sustainability report must be present within the Management Report; therefore, it will no longer be at the discretion of the company to draw up a single or separate document. The NFRD establishes that "Member States shall provide that the parent undertaking may rely on national, Union-based or international frameworks" specifying "which frameworks it has relied upon". Although the GRI Standard of the Global Reporting is the most widely used, another limitation of the NFRD is the lack of a harmonized reference standard with consequent difficulty in comparing non-financial information (La Torre et al., 2018).

The new Directive aims to overcome this limitation, proposing a single standard. To reach this objective EFRAG (European Financial Reporting Advisory Group) is commissioned to develop EU sustainability reporting standards. EFRAG will consider current international standards and will have to integrate with other standards such as SFDR (Sustainable Finance Disclosure Regulation) (Reg. 2019/2088), European Taxonomy, European Pillars on Social Rights, and the pending Sustainable Governance and Due Diligence Directive. The EU reporting standards will be compatible with the systems already widely used internationally. Furthermore, they will have to contribute to the International Financial Reporting Standard (IFRS) initiative to introduce common standards globally (COM/2021/189 final). Moreover, according to the proportionality principle, an appropriate standard for SMEs is intended to develop. The first set of standards, expected to be released by 31 October 2022, should include guidelines on 'double materiality' and information quality. These are 'basic' standards, such as the most relevant and commonly used information and the information needed to support the sustainable finance agenda (EFRAG, 2021). In addition, the concept of 'double materiality' will be better specified. Environmental and social impact materiality and financial materiality will be discussed. The first includes all issues related to the environment that are affected by the business (such as the supply chain) or affect the business (e.g., GHG emissions, energy efficiency, environmental footprint). Social considerations include, for example, working conditions and equal opportunities, also in the value chain. Another objective of the Directive is to improve the quality of information. The development of standards that ensure relevance, faithful representation, comparability, comprehensibility, and reliability/verifiability could help overcome the limitation of the NRFD. The second set of standards, expected by 31 October 2023, should be related to: (1) connectivity ("anchor" points to help companies link financial to sustainability reporting), levels and boundaries of reporting (considering the value chain), (2) retrospective and forward-looking information (i.e., assessment of sustainability goals and indicators developed by companies and progress towards their achievement), (3) consistency of standards with agreements, targets, and public policy regulations (EFRAG, 2021). The overall goal will be to arrive at 'advanced' standards over time, in accordance with the EU sustainability policy changes. In the proposal of the EFRAG European Standard (2021), the environmental issues to be addressed are mentioned, which are those defined and required in the EU: climate change mitigation and adaptation, water and marine resources, and circular economy (CE), pollution, biodiversity, and ecosystems. Companies will have to use more complex and consolidated tools to build a broader picture of environmental performances. Regarding climate-related information, the EC's guidelines (Comm. from the Commission 2019/C 209/01), which recommend the TCFD (Task Force on Climate-Related Financial Disclosures) and the NFRD, will be considered as reference. Therefore, to assess GHG emissions, the GHG protocol has to be used to estimate the total emissions with a view to the entire supply chain.

1. **Methods**

The following documents were analysed for comparative analysis and to highlight the novelties of the new directive: the Directive of the European Parliament and of the Council n. 2014/95/EU on disclosure of non-financial and diversity information, the Proposal for a Directive of the European Parliament and of the Council as regards corporate sustainability reporting COM/2021/189 final, and the Proposals for a relevant and dynamic EU sustainability reporting standard setting. European Reporting LAB. EFRAG, 2021.

1. **Discussion**

The new mandatory European reporting standards will undoubtedly lead to an increase in the amount of data and information that companies will have to report. However, how the quality of the data will improve? An initial examination of the proposals for the new EFRAG standards (Prop. for a Dir. 6292/22) shows that assessing environmental performance through a wide range of indicators and impacts will be necessary. CSRD is about climate change mitigation and adaptation, water and marine resources, CE, pollution, biodiversity, and ecosystems to assess the complete environmental footprint considering the entire supply chain throughout the life cycle. Thus, Life Cycle-based tools are certainly the most suitable for this purpose. In the CSRD proposal, reference is made to these tools. LCA (Life Cycle Assessment) is the most widespread and consolidated tool for assessing the product, service, or process environmental impacts throughout its life cycle. On the other hand, sustainability reports are intended to inform about a company's overall environmental performance. Carrying out an LCA for just a few products might be a viable route. Different is the case for companies with an extensive product portfolio for which the LCA would entail a significant investment in money, time, and resources. Both O-LCA (Organization Life Cycle Assessment) and OEF (Organisation Environmental Footprint) can be used for providing information in sustainability reporting (Rimano et al., 2019). O-LCA could be a suitable tool but is currently more methodologically complex, and the results cannot be used for comparisons between different companies (Blanco et al., 2015). The OEF aims to analyse the environmental impacts of the entire value chain, from a life cycle perspective and the results can be used to compare performance between organisations in the same sector.

Comparability will be emphasised in the new Directive. Data and information reported must be related to the number of employees, turnover, size of production sites, or using the functional unit parameter. This weight data would allow comparison of the performance of the same organisation over different years and between different organisations. The broadening of the list of environmental indicators to be reported within the future CSRD overcomes a critical issue highlighted by Raucci and Tarquinio (2020). They stated that organisations following the NFRD have restricted the number of environmental indicators compared to those analysed prior to mandatory non-financial reporting. This is because they focus only on the indicators considered most relevant, as required by the NFRD, without further efforts. Furthermore, although GRI standards include some indicators in addition to GHG emissions, the tendency since the introduction of the Directive has been to focus mainly on emissions and energy aspects, generally leaving out aspects such as biodiversity and waste treatment (Posadas and Tarquinio, 2021). Regarding the publication of the non-financial report in the same document as the Management Report, Caputo et al., (2021) state that a single document may undermine transparency and thus the quality of environmental information. A separate report would allow the disclosure of non-financial information in more detail (Kiliç wt al., 2015).

1. **Conclusions and future perspectives**

Throughout the year 2022, the new CSRD will almost certainly be released. Based on the proposal released in 2021, the new provisions on non-financial reporting are expected to introduce some innovations compared to the current NFRD, such as broadening the scope of companies required to report and some improvements to increase the quality of the data. One of the most important innovations concerns the introduction of a broader range of environmental performance indicators in line with the current EU policies. The aim is to demand an assessment of a more comprehensive environmental footprint. Life-cycle-based tools will undoubtedly play an important role in providing information for sustainability reports. O-LCA and OEF present both strengths and weaknesses because they are based on a holistic view of the organisation typical of these tools, and comparability is feasible in the case of OEF.

On the other hand, there is a problem with data availability and difficulty in categorising the company's activity. Better comparability of data would allow a more thorough comparison of companies' performance over time and the performance of different companies in the same sector. The comparison would both help companies internally to make strategic choices in the field of sustainability and allow stakeholders to make functional evaluations for their purposes.

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