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Beyond compliance
Kicking off sustainable value creation with the CSRD

The upcoming Corporate Sustainability Reporting Directive (CSRD) is not simply about disclosure requirements and meeting the expectations of auditors and other stakeholders. It holds the potential for companies to leverage their CSRD compliance efforts by putting sustainability at the business strategy. Embedding sustainability aspects into strategy enables companies to create value by uncovering sustainability and financial opportunities at their core.

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Introduction

The EU Corporate Sustainability Reporting Directive (CSRD) came into force on January 5, 2023, and the associated European Sustainability Reporting Standards (ESRS) were adopted by the European Commission on July 31, 2023. Together, the CSRD and the ESRS create detailed sustainability reporting requirements that apply to a significant number of EU and non-EU companies, and will significantly expand the scope of their sustainability reporting. The CSRD replaces the Non-Financial Reporting Directive (NFRD) in Germany and expands reporting obligations both in terms of content and the number of companies that fall within the scope of the directive. CSRD reporting is audited as part of the annual financial statements.

All companies listed on EU-regulated markets (except for micro-enterprises) are subject to the new reporting requirement. All non-capital market companies fall under the CSRD if they meet two of the following three criteria:

- Number of employees > 250
- Net sales > 50 million euros
- Total assets > 25 million euros

Application of the regulation is now imminent. It is estimated that it will affect around 50,000 companies in the EU, including 15,000 in Germany alone. The CSRD follows a double materiality perspective. This means that, on the one hand, companies must report on the impact of their business activities – from their own operations and entire value chain – on society and the environment. This is the inside-out perspective, i.e., impact materiality. On the other hand, they must report the effects of sustainability aspects on the company's economic situation, i.e., if a sustainability topic is likely to trigger financial effects on the undertaking (on cash flow, access to finance and financial position, and therefore on enterprise value in the short, medium, and long term). This is the outside-in perspective, i.e., financial materiality.

The CSRD as a starting point: creating value and achieving long-term growth by deriving strategic fields of action

While the CSRD is often simply understood as a requirement for comprehensive and more transparent sustainability reporting, the real objective of this EU directive is to stimulate changes in business behavior and work towards more sustainable business practices.

The directive requires companies to analyze sustainability topics such as climate change, biodiversity, and human rights, and relate them to company sustainability and financial impacts, risks and opportunities on planet and society. Companies are also encouraged to move towards more sustainable business practices by reporting on their strategies for sustainable long-term growth, on the upstream and downstream value chain in their business, and on the implementation of strategies, measures, policies and plans for joint management of sustainability and financial performance.

Disclosure alone may well bring far-reaching changes into the ongoing movement of integrating sustainability into companies and into the business environment within the EU, and hopefully to some extent worldwide. The greater and more detailed transparency required by the CSRD gives companies an incentive to improve their efforts to act sustainably in order to gain an advantage over competitors, and to attract and retain customers who emphasize sustainability. More than ever, banks are looking at the CSRD and sustainability-compliant companies when deciding on deals, as well as the entire ESG investor movement in recent years.

Another important lever for value creation anchored in the CSRD is "thinking outside the box" about strategy: Within the CSRD, strategy is the interaction between strategy and the company business model, including its key impacts, risks and opportunities, and how these are addressed. To illustrate this with an example and a deeper level of content, a mandatory data point (the lowest level of granularity in the requirements) looks like this: the undertaking shall disclose the following information about the key elements of its general strategy that relate to, or affect, sustainability matters: (b) a breakdown of total revenue, as included in its financial statement, by significant ESRS sectors. When the undertaking provides segment reporting as required by IFRS 8 Operating segments in its financial statement, this sector revenue information shall be, as far as possible, reconciled with IFRS 8 information.[1]

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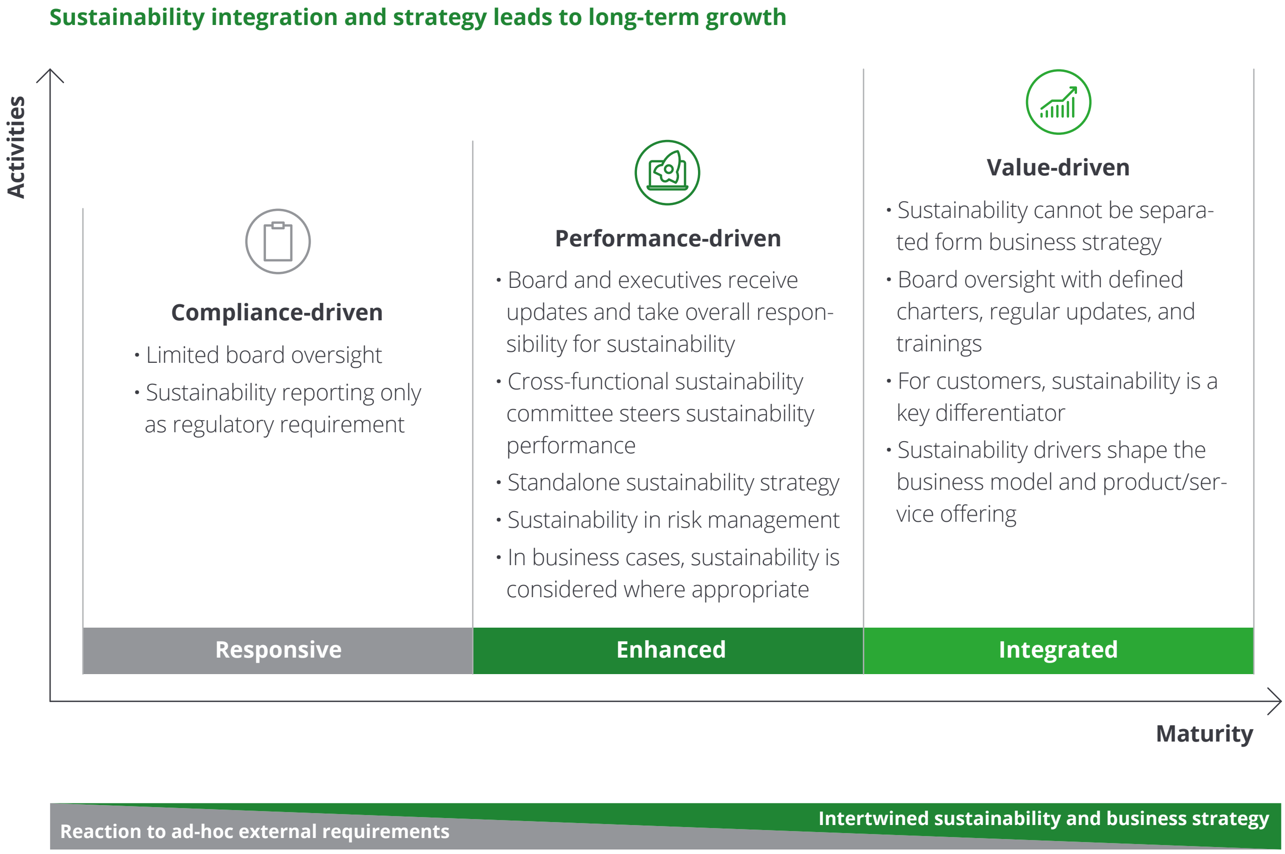
[1] ESRS 2, SBM-1 – Strategy, business model, and value chain

This requirement thus forces – or better yet enables – companies to identify the key elements of their business strategy with a breakdown of their total turnover and by predefined sectors within the CSRD, enabling more transparent and future-proof decisions leading to strategic fields of action.

The example given above reveals another important value lever of the new directive: The ESRS sectors, which are clearly defined within the directive, have a direct link to other common sustainability resources and top tier sustainability frameworks. With regard to industry or sector classification, for instance, the NACE codes (classification system for economic sectors within the EU) are the central point of reference for aggregating individual economic activities into ESRS sectors.[2] This standardization streamlines the identification of company status quo and future risks for distinct sectors, giving greater depth to the assessment and enabling more reachable targets, processes, and measures.

Fig. 1 – Value creation
The further companies progress on their sustainability journey, the greater the impact of sustainability on value creation and the greater the opportunities for long-term growth.



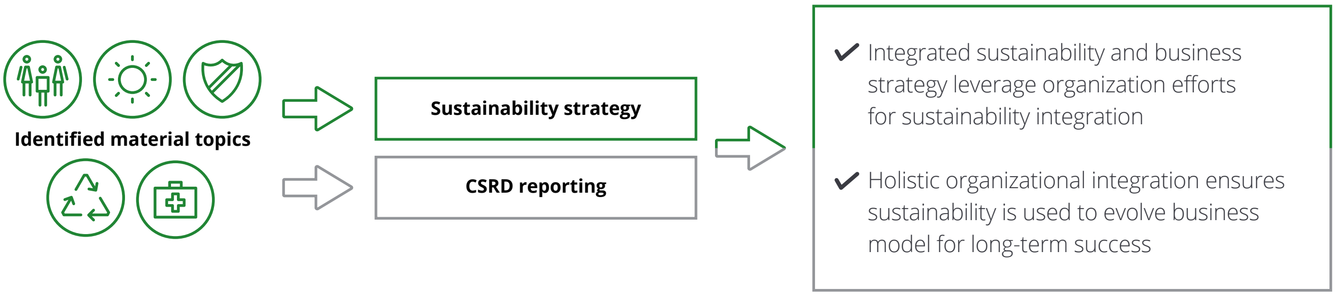
[2] ESRS 2, SBM-1 – Set 2 of sector-specific standards, which describe disclosure requirements that are specific to each different sector, are still under development by EFRAG

Success factors of a CSRD project

We have found that the best outcomes of CRSD projects start with early alignment and implementation of processes, metrics, and governance structures for sustainability reporting. This provides sufficient scope to meet the upcoming mandatory requirements and fulfil compliance ambitions.
The earlier a company engages with the CSRD requirements, the more holistic it can prepare for the reporting year. For example, when subject to CSRD reporting for FY25 (i.e. reporting in 2026 on FY25), it is advisable to start with a pilot project early in 2024 to begin collecting data, setting up processes, governance structures, identify gaps and tackle them in preparation for the "right" reporting.

What's more, a joint approach to sustainability reporting and strategy makes implementation more efficient as synergies can be realized which support a successful project. This includes incorporating sustainability and business strategy efforts, and a holistic organizational integration which ensures sustainability is involved in evolving the business model for long-term success. Measures to achieve this could include a dedicated sustainability team, and the comprehensive and thoughtful empowerment of all employees in all departments through training and their involvement (including management, board, etc.). Another crucial component is the governance concept, which sets the framework for cross-departmental activity and provides the power to actively manage the sustainability transformation. Sustainability thereby evolves from a separate department to a core capability of the business.

Fig. 2 – Combined strategy and reporting approach



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Issue 12/2023