Deloitte.

13th Edition of REal Knowledge Newsletter

Sustainability reporting as part of the obligatory reporting procedure: scope and time horizon

EU is pursuing the Green Deal, which is to achieve the net zero level in line with the Paris Agreement.The programme goal is to define the climate-related challenge and turn it into a new opportunity determining the target to reduce CO2 emission by 55% until 2030 and becoming climate-neutral in 2050. Therefore, intensive regulatory and legislation work has been performed to appropriately adjust EU Directives and Regulations in all economy sectors. Recently, the regulatory changes have helped to define the current real estate sector, and the EU has adopted an action plan to fund the transition to carbon-neutral technologies. Additionally, among others it introduces the following regulations to help achieve the goal:

CSRD will replace **NFRD**, which has been in effect since 2018 and proven to be insufficient in the context of the current challenges faced by business entities. The new Directive will apply to a considerably wider range of enterprises: approximately 50,000 in the EU, including about 3,000 in Poland. CSRD determines general expectations regarding non-financial disclosures. Details shall be determined in a set of standards (ESRS) that will soon come into effect „in form of the delegated acts".

The Directive should be transposed into national law by the middle of 2024, but the first reports will have to be published in 2025 for the financial year starting already in 2024. Initially, the scope will include just entities to whom NFRD applies, i.e. PIE employing more than 500 people and meeting one of the two financial criteria (the balance sheet total above PLN 85m, or net revenue above PLN 170m). A year later, the group of enterprises to whom the Directive applies will be joined by large businesses, i.e. the ones meeting two of the three criteria: employment above 250 people; the balance sheet total above EUR 20 million; and net revenue above EUR 40 million. A year later, the Directive will include listed SME, although the reporting procedure for these entities will be simplified, with an option to depart from the requirements for two years. Non-EU enterprises will be the last to join the list in 2028, provided they generate net revenue above EUR 150m in the EU and have at least one subsidiary subject to CSRD or a branch with a net turnover of more than >EURO 40 million. They will be governed with a separate standard including a specified reporting scope.

Another new legal act that regards ESG and has already came into force is the Regulation of the European Parliament and of the Council of June 2020, which introduces a sustainable business classification system, aka Taxonomy. It applies to financial market participants who fall under SFDR and large companies governed first by NFRD and soon by CSRD. First disclosures determined by Taxonomy were required when preparing non-financial statements for 2021 (identification of Taxonomy-eligible activities). The scope of obligatory disclosures regarding non-financial statements for 2022 is extended by identification of Taxonomy-aligned activities.

The third legal act related to ESG, which came into force in March 2021, is Regulation of the European Parliament and of the Council on sustainability related disclosures in the financial services (SFDR). Its goal is to improve transparency of risk analyses concerning sustainable development carried out by financial market participants and financial advisors.

NFRD:	CSRD:	EU TAXONOMY:	SFDR:
WHO: PIE employing over 500 people and meeting one of the two financial criteria (the balance sheet total above PLN 85 million or net revenue above PLN 170 million) **About 11,000 businesses in the EU** **WHAT:** business model, policies regarding e.g. employee, social, environmental and corruption aspects, key risks and due diligence procedures, KPIs **WHERE:** statement on non-financial information as part of the management board's report or a separate non-financial report **WHEN:** Since 2018 (for the financial year beginning in January 2017)	**WHO**: 1. All large businesses; 2. All SME listed on EU regulated markets; 3. non-European businesses **About 50,000 businesses in the EU, including 3,000 in Poland** **WHAT:** Business model and strategy; role of governance bodies; sustainability due diligence process; material sustainability impacts, risks and opportunities identified through dual materiality process; policies, activities and resources, targets and metrics for identified material topics **WHERE**: annual management board's report, statutory digital ESEF-format reporting system **WHEN**: (for 2024): businesses governed by NFRD; 2026 (for 2025): other large businesses; 2027 (for 2026): listed SME; 2029 (for 2028): non-European entities	**WHO**: Financial market participants (governed by SFDR) and large companies (governed by NFRD/CSRD) **WHAT**: percentage of sustainable business activities based on technical screening criteria for one of the six environmental objectives and minimum safeguards **WHERE**: regular reports, ESG reports, non-financial statements **WHEN**: from 2022 (FY2021) (Taxonomy-eligibility) from 2023 (FY2022) (Taxonomy-alignment reporting by non-financial undertakings) from 2024 (FY2023) (Taxonomy-alignment reporting by financial undertakings)	**WHO**: PIE Financial market participants and financial advisors **WHAT**: how ESG-related risks are included in the process of investment decision making **WHERE**: regular reports, pre-contract disclosures on websites **WHEN**: disclosures from 10 March 2021 from 1 January 2023 (RTS – Regulatory Technical Standards specifying the scope of presented pre-, post- contractual information and website disclosures)

Impact on real estate organisations

Under the CSRD, real estate organisations can no longer report on their financial status without disclosing their environmental and social impact. In order to do so, it is essential to follow the materiality concept when determining which ESG topics to report. When introducing the concept of "**double materiality**", organisations need to consider the impact of both climate-related risks and opportunities on the company's value ("financial materiality" or "inward impact"), and the external impact of their business activities on the environment and social matters („impact materiality"). In addition to mandatory requirements, CSRD will be a major game changer for the industry in terms of transparency and insight into sustainability risks and opportunities. In order to comply with the CSRD, real estate organisations will need to develop a long-term sustainability strategy and extend their sustainability management to include both inward and outward sustainability risks and opportunities. Since the real estate market is stimulated by funds and investments originating from a wide range of investors, clear understanding of sustainability performance and strategy, as well as sustainability-related risks and opportunities for will become increasingly important as a means to attract capital, gain competitive advantage and achieve sustainability goals.

The CSRD will have far-reaching implications for the real estate industry in terms of corporate ESG reporting. Real estate organisations, investors, regulators, auditors and other stakeholders will need to devote significant time and resources to duly prepare for implications of the CSRD. Given the significance of the Directive and the time needed for effective preparation in 2023, **each enterprise should consider the following key topics**:

- Perform a double materiality assessment to determine which ESG issues are material for the organisation from both inward and outward perspective. Perform an ESG baseline assessment for material ESG issues to determine the starting point.
- Set measurable ESG goals in line with the EU Green Deal and UN Sustainable Development Goals.
- Develop a future-proof ESG strategy that includes the purpose, vision, objectives, performance indicators, a strategic roadmap and policies required to comply with EU legislation and mandatory third party limited assurance with effect from 2024.
- Set up reporting and monitoring procedures in order to keep track of the ESG goals over time and to reassess material ESG issues.

Challenges related to reporting

Each company is required to comply with non-financial reporting requirements, taking into account specific employment and financial criteria, and thus disclose information related to sustainable development. Such additional information reflects the rising expectations of investors and the growing public interest in the impact businesses have on the climate.

Below please find possible business and accounting risks that may arise from ESG requirements i.e.

- Impairment of assets: they may be impaired as a result of their inability to generate sufficient economic benefits (regards such assets as coal-fired power plants, or gas infrastructure);

- The economic useful life of assets: it may change as a result of strategy modification or other operating decisions caused by climate-related requirements or imposed by legal restrictions;

- Financial ratios in loan agreements / bond issue terms: an entity may be unable to meet the financial ratios required by the concluded loan agreements or related to the issue of bonds;
- Financing costs: an entity may face increased interest rates on bonds/loans resulting from its poor ESG rating;

- Compliance risk: an entity may fail to provide disclosures required by the EU Taxonomy /CSRD and be fined by a regulator.

As we see, ESG has become part of reporting procedures raising considerable interest of investors and of the public. Further, we can clearly see the growing scope of EU non-financial reporting requirements, meaning that achieving compliance with the reporting requirements of the CSRD will be neither easy, nor fast.

If you need assistance in identifying areas to which the reporting requirements apply, in defining reporting tools and regular performance of reporting obligations, our multidisciplinary team is ready to offer solutions.

If you need more information, you are welcome to contact the authors of the article:

Sylwia Toczyska
Partner Associate, Deloitte Tax
Email: stoczyska@deloittece.com

Damian Zwara
Senior Manager, Deloitte Assurance
Email: dzwara@deloittece.com

Marta Górecka
Manager, Deloitte Risk Advisory
Email: mgorecka@deloittece.com

Magdalena Osowiecka
Manager, Deloitte Risk Advisory
Email: mosowiecka@deloittece.com