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Shades of Green: A Tentative Assessment of the CSRD's Potential Effects

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Summary: The introduction of the CSRD represents the largest regulatory intervention in external reporting in decades. Sustainability statements now have to be issued in accordance with the ESRS, which include numerous Disclosure Requirements and datapoints, and prepared in a standardized, machine-readable format. As part of the management report, the sustainability statement has to be audited. The CSRD is expected to enhance transparency (capital market channel) and to strengthen ESG performance (real effects channel), but companies will face significant challenges such as incomplete regulations and high implementation costs. However, the actual impact of the new regulations regarding sustainability reporting has yet to be fully assessed.

Keywords: Accounting Law; Corporate Sustainability Reporting Directive (CSRD); European Sustainability Reporting Standards (ESRS); Regulation; Sustainability Reporting; Sustainability Statement

Schattierungen von Grün: Eine vorläufige Einschätzung der potenziellen Auswirkungen der CSRD

Zusammenfassung: Die Einführung der CSRD stellt den bedeutendsten regulatorischen Eingriff in die externe Berichterstattung der letzten Jahrzehnte dar. Die Nachhaltigkeitserklärung muss nun gemäß ESRS, die zahlreiche Angabepflichten und Datenpunkte enthalten, in einem standardisierten, maschinen-lesbaren Format erstellt werden. Als Teil des Lageberichts muss die Nachhaltigkeitserklärung geprüft werden. Auch wenn erwartet wird, dass die CSRD die Transparenz (Kapitalmarkteffekt) und die ESG-Performance (Realeffekt) erhöht, sehen sich Unternehmen mit Herausforderungen wie unvollständigen Regelungen und hohen Implementierungskosten konfrontiert. Die Auswirkungen der Neuregelungen zur Nachhaltigkeitsberichterstattung können jedoch erst in Zukunft vollständig bewertet werden.

Stichwörter: Bilanzrecht; Corporate Sustainability Reporting Directive (CSRD); European Sustainability Reporting Standards (ESRS); Nachhaltigkeitsberichterstattung; Nachhaltigkeitserklärung; Regulierung

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1 Introduction

The importance of sustainability reporting is growing worldwide.[1] In the EU, the adoption of the *Corporate Sustainability Reporting Directive* (CSRD) (Directive 2022/2464/EU; European Parliament and Council of the European Union, 2022) marks a new era of sustainability reporting. Compared to the previous *Non-Financial Reporting Directive* (NFRD) (Directive 2014/95/EU; European Parliament and Council of the European Union, 2014), the CSRD requires significantly more extensive sustainability reporting:

First, the CSRD has significantly broadened the *personal scope* of sustainability reporting. The number of undertakings required to disclose sustainability information has increased from the previous 11.000 companies in the EU that had to produce a sustainability report under the NFRD to more than 50.000 companies that (will) have to prepare a sustainability statement under the CSRD (European Commission, 2021).

Second, the CSRD has substantially increased the *content and amount* of sustainability information to be reported. Whereas companies under the NFRD could choose their reporting framework,[2] companies under the CSRD have to use the *European Sustainability Reporting Standards* (ESRS) prepared by the European Financial Reporting Advisory Group (EFRAG). The ESRS (European Commission, 2023) address 92 *sustainability matters* in the areas Environment, Social, and Governance (ESG), and define 100 *Disclosure Requirements* (DRs) with more than 1.000 qualitative and quantitative *datapoints*. The majority of this information shall be reported only if the *impacts, risks and/or opportunities* (IROs) connected with the corresponding sustainability matters are classified as material from an *impact materiality perspective* and/or from a *financial materiality perspective* (*double materiality*). The increasing demand for sustainability information from stakeholders is to be met through the disclosure of sustainability information not only in relation to the reporting entity's own operations, but also in relation to its direct and indirect business relationships in the *up-stream* and/or *down-stream value chain* (ESRS 1.63).

Third, the CSRD aims at achieving a more *balanced external corporate reporting* that includes sustainability and financial information on an equal footing. As the (group) sustainability statement is part of the (group) management report (instead of a stand-alone report), sustainability reporting now is considered *accounting law*. Moreover, the information contained in the sustainability statement is connected to the information presented in the financial statements and the other parts of the management report. Sustainability statements are subject to an audit, currently with limited assurance.

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1 Some jurisdictions have adopted (e.g., Brazil, Costa Rica, Sri Lanka, Nigeria and Turkey) or are consulting on the introduction (e.g., Canada, Japan and Singapore) of the IFRS Sustainability Disclosure Standards developed by the International Sustainability Standards Board (ISSB). Other jurisdictions have implemented jurisdictional-specific requirements (e.g., the US, where the SEC Climate Rule requires disclosures on climate-related risks from an outside-in perspective with a phased introduction starting with FYs 2024, or New Zealand, where reporting against the New Zealand Climate Standards is required from FYs 2023).

2 68 % (35 %) of the European companies surveyed by KPMG (2022) applied the Global Reporting Initiative (GRI) standard (the former standards of the Sustainability Accounting Standards Board (SASB)). Respondents in a survey among companies from Germany, Austria, Switzerland and the Netherlands used the following: GRI (51 %); Sustainable Development Goals (SDGs) (26 %); framework of the Task Force on Climate-Related Financial Disclosures (TCFD) (15 %); standards of the Science Based Targets initiative (SBTi) (13 %) (PWC Germany, 2024a).

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The intention behind the CSRD is to contribute to the implementation of the ambitious EU Green Deal project to create a fully sustainable economic and financial system within the European Union. Already in 2018, the European Commission proposed the "Action Plan: Financing Sustainable Growth" with the goals of (1) reorienting capital flows towards sustainable investment in order to achieve sustainable and inclusive growth; (2) managing financial risks stemming from climate change, resource depletion, environmental degradation and social issues; and (3) fostering transparency and long-termism in financial and economic activity (European Commission, 2018). A basic pre-requisite for achieving these objectives is that companies disclose relevant, comparable and reliable sustainability information. Achieving this is the central objective of the CSRD.

The extensive reporting requirements implemented by the CSRD are seen as the largest regulatory intervention in external reporting in decades. Although the CSRD/ESRS do not specify any obligations to implement or enhance a company's ESG performance, they are expected to influence stakeholders' decisions and thus to have *financial* and/or *real effects* on the reporting entity. In the following, we examine the expected effects of the CSRD/ESRS and highlight critical points of the new sustainability reporting regulations.

2 Sustainability reporting according to the CSRD/ESRS

Based on a proposal for a directive published by the European Commission in April 2021, the negotiators from the European Commission, Council and Parliament agreed on a compromise on June 21, 2022. The Corporate Sustainability Reporting Directive (CSRD) was formally adopted on December 14, 2022, and published in the Official Journal of the European Union on December 16, 2022. In accordance with Article 7 of the Directive, it entered into force on January 5, 2023. 18 months later (i.e., by July 6, 2024), the new regulations had to be transposed into the EU member states' national law. Even if this deadline had been met by all member states, the implementation plan would have been ambitious.[3]

2.1 Personal scope of mandatory sustainability reporting

The CSRD has significantly increased the number of undertakings required to prepare a sustainability statement. In Article 5, the CSRD stipulates a phased introduction:

- The NFRD had laid down that public-interest entities (PIEs) with more than 500 employees had to produce a sustainability report on environmental, social, employee, human rights and diversity issues as well as on anti-corruption and bribery matters, starting from FY 2017. Large PIEs and parent companies of large groups exceeding the average number of 500 employees (i.e., those that were subject to the previous NFRD) had to transition to CSRD compliance already for FYs starting on or after January 1, 2024. An analysis of the first ESRS sustainability statements thus is possible only after the first half of 2025.

3 France was the first member state to transpose the CSRD into national law on December 6, 2023. Other countries (Bulgaria, Croatia, the Czech Republic, Denmark, Finland, Hungary, Ireland, Italy, Liechtenstein, Lithuania, Norway, Romania, Slovakia and Sweden) followed. Germany, in contrast, is a prominent example of delays. Although a draft law to implement the CSRD was adopted on July 24, 2024, the legislative process has not yet been completed. As a result, the European Commission initiated infringement proceedings against Germany on September 26, 2024.

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- Companies with limited liability that are large within the meaning of the Accounting Directive (Directive 2013/34/EU; European Parliament and Council of the European Union, 2013) shall begin reporting under the CSRD for FYs starting on or after January 1, 2025. As these companies are not covered by the NFRD, mandatory sustainability reporting poses particular challenges for them.
- Listed small and medium-sized enterprises (SMEs) will begin their CSRD reporting for FYs starting on or after January 1, 2026. However, listed SMEs can waive sustainability reporting for FYs 2026 and 2027 if they provide in their management report a corresponding explanation and justification. Listed SMEs also do not have to comply with the "full version" of the ESRS. EFRAG currently redeliberates the outcomes from the consultation on the exposure draft for the ESRS LSME (EFRAG, 2024e), which will be issued as a delegated act by the European Commission. "Micro-entities" are exempt from the sustainability reporting obligation.
- Non-EU companies with a net turnover of more than 150 million € in the EU that have either at least one EU subsidiary that is itself subject to CRSD reporting or an EU branch that generates a revenue exceeding 40 million € in the EU must comply with the CSRD requirements for FYs starting on or after January 1, 2028. These groups shall use specific ESRS for third-country companies, to be developed by EFRAG by June 30, 2026.

A company falls into the corresponding size category if it exceeds at least two of the three criteria shown in Table 1 in two consecutive financial years:

Size category	Net turnover	Balance sheet total	Average number of employees
Small	> 900.000 €	> 450.000 €	> 10
Medium-sized	> 15.000.000 €	> 7.500.000 €	> 50
Large	> 50.000.000 €	> 25.000.000 €	> 250

Table 1: Definition of size categories

Generally, subsidiaries subject to the reporting obligation are exempt from sustainability reporting at company level if they are included in the parent company's group sustainability statement.[4] The group exemption also applies to EU subsidiaries of non-EU companies if the sustainability statement of the non-EU parent company is prepared in accordance with the ESRS or "equivalent standards". In Switzerland, the Federal Council thus has opened a consultation on amending the Ordinance on Climate Disclosures, which had entered into force on January 1, 2024. The Federal Council proposes that the obligation of large Swiss companies to report on climate-related matters (Art. 964a ff OR) is fulfilled if the ESRS are used.[5] Although 82 % of the 100 largest Swiss companies already have established a sustainability reporting system (KPMG, 2022), the CSRD will have a significant impact on Swiss companies. The Swiss Federal Council estimates the number of companies that are directly or indirectly affected by the CSRD at between 3.000 and 14.000 (PWC Switzerland, 2024).

4 The group exemption does not extend to subsidiaries that are large PIEs and thus have to issue a CSRD/ESRS sustainability statement for FY 2024 onwards.
5 The consultation is scheduled to end on March 21, 2025.

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The fact that the reporting obligations of an undertaking extend to its value chain can create a *trickle-down effect* on non-listed SMEs that are not in the scope of the CSRD. Their role as a supplier to a reporting entity might require them to provide sustainability information as well. Thus, EFRAG currently works on the ESRS VSME for the voluntary sustainability reporting of non-listed SMEs (EFRAG, 2024f).

ESRS 1 contains a list of *transitional provisions* that allow companies to defer full presentation of certain DRs and datapoints, even if they are material (Appendix C).[6] Some of the phase-in provisions grant exemptions only to companies with an average of less than 750 employees.

2.2 Content and amount of sustainability information to be reported

The "full version" of ESRS Set 1 contains *two cross-cutting standards* (ESRS 1 General Requirements and ESRS 2 General Disclosures). Reporting against the 12 DRs of ESRS 2 is always mandatory (ESRS 1.29): After an explanation of the general basis for the preparation of sustainability statements (ESRS 2 BP-1) and disclosures in relation to specific circumstances (ESRS 2 BP-2), the entity shall provide information about its governance (i.e., the role of the administrative, management and supervisory bodies – ESRS 2 GOV-1; information provided to and sustainability matters addressed by the undertaking's administrative, management and supervisory bodies – ESRS 2 GOV-2; integration of sustainability-related performance in incentive schemes – ESRS 2 GOV-3; statement on due diligence – ESRS 2 GOV-4; risk management and internal controls over sustainability reporting – ESRS 2 GOV-5), its strategy (i.e., strategy, business model and value chain – ESRS 2 SBM-1; interests and views of stakeholders – ESRS 2 SBM-2; material IROs and their interaction with strategy and business model – ESRS 2 SBM-3), and its materiality assessment process (i.e., description of the processes to identify and assess material IROs – ESRS 2 IRO-1; DRs in ESRS covered by the undertaking's sustainability statement – ESRS 2 IRO-2).

The ESRS also include *ten topical standards* that are categorized into *Environment* (ESRS E1 Climate Change; ESRS E2 Pollution; ESRS E3 Water and Marine Resources; ESRS E4 Biodiversity and Ecosystems; ESRS E5 Resource Use and Circular Economy), *Social* (ESRS S1 Own Workforce; ESRS S2 Workers in the Value Chain; ESRS S3 Affected Communities; ESRS S4 Consumers and End Users), and *Governance* (ESRS G1 Business Conduct). These topical standards address the 92 sustainability matters listed in ESRS 1.AR 16 (30 for Environment, 55 for Social, and 7 for Governance). However, reporting against the 88 DRs of the topical standards (40 for Environment, 40 for Social, and 8 for Governance) is mandatory only for the "related to ESRS 2 IRO-1" DRs contained in ESRS E1-E5 and G1 (ESRS 1.29). The remaining information needs to be reported only if the IROs linked to the sustainability matters are assessed as material from the impact materiality perspective (*inside-out perspective*), the financial materiality perspective (*outside-in perspective*), or both:[7]

6 The phase-in provisions relate to the disclosure of comparative, entity-specific, and value chain information.

7 Under the NFRD, sustainability matters had to be reported only if both materiality aspects simultaneously applied.

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According to ESRS 1.43, a sustainability matter is material from an *impact materiality perspective* "when it pertains to the undertaking's material actual or potential, positive or negative impacts on people or the environment over the short-, medium- or long-term." A sustainability matter is material from a *financial materiality perspective* "if it triggers or could reasonably be expected to trigger material financial effects on the undertaking. This is the case when a sustainability matter generates risks or opportunities that have a material influence, or could reasonably be expected to have a material influence, on the undertaking's development, financial position, financial performance, cash flows, access to finance or cost of capital over the short-, medium- or long-term" (ESRS 1.49). Impact materiality and financial materiality are often intertwined, because material risks and opportunities generally derive from impacts or from dependencies and other risk factors. The *double-materiality approach* emphasizes the stakeholders' perspective.

As the ESRS do not mandate a specific procedure when performing the *double materiality assessment* (DMA), EFRAG has published a non-authoritative Implementation Guidance (EFRAG, 2024b) that describes the steps necessary to identify the material IROs, the material sustainability matters, and the information to be reported: (1) understanding the context; (2) identification of actual and potential IROs related to the sustainability matters contained in ESRS 1.AR 16 (long list); (3) assessment and determination of the IROs with regards to their materiality (ESRS 1.43 – 46); sustainability matters are classified as material if material IROs arise from them (short list); and (4) reporting (i.e., mapping of material matters to DRs and datapoints in the topical standards).[8] When an undertaking concludes that a material IRO is not (or not sufficiently) covered by an ESRS, it shall provide additional *entity-specific disclosures*.

Stakeholder engagement is pivotal to the DMA, for example to understand which stakeholders are or might be affected by the undertaking's own operations and upstream and downstream value chain or to validate the IROs that are assessed as material. Stakeholder groups considered are internal stakeholders (e.g., own workers, works council), external stakeholders (e.g., suppliers, workers in the value chain, affected communities, consumers and end-users), nature as a silent stakeholder, and the users of the sustainability statement.

2.3 Reporting boundaries

The sustainability statement shall be for the same reporting entity as the financial statements (ESRS 1.62). However, subsidiaries excluded from the financial statements due to immateriality shall be included in the sustainability statement if they are significant from a double materiality perspective (EFRAG, 2024c).

In addition, ESRS E1 (Climate Change) requires including information on greenhouse gas emissions (ESRS E1–6) for joint ventures, joint operations, investment entities and associates that are not financially controlled (i.e., not consolidated), but over which the company has *operational control*, that is, "the ability to direct the operational activities and relationships of the entity, site, operation or asset" (Annex II, Table 2, Glossary to the ESRS).[9] As the ESRS do not yet specify detailed criteria for the existence of operational control, reporting entities need to develop company-specific criteria that are suitable as indicators for the existence of operational control (Deutsches Aktieninstitut, 2024).

8 EFRAG (2024d) provides a nearly complete list of the datapoints.
9 ESRS E2–4 and ESRS E4 SBM-3 also refer to the concept of operational control.

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2.4 Balanced external corporate reporting

The CSRD aims for the equivalence of the sustainability statement and the financial statements. The following requirements work in this direction:

Undertakings under the CSRD are also in the scope of the Environmental Taxonomy Regulation (European Parliament and Council of the European Union, 2020) and thus have to provide information on how and to what extent their economic activities are associated with environmentally sustainable activities (Regulation (EU) 2020/852, Article 8). More precisely, companies shall report the *proportion of turnover*, *capital expenditure* (CapEx), and *operating expenditure* (OpEx) that is associated with taxonomy-aligned activities. Since not all activities that are environmentally sustainable are included in the Taxonomy Regulation (whereas nuclear power and natural gas are classified as sustainable), the percentage of taxonomy-aligned activities is still low (PWC Germany, 2024b). Nevertheless, these KPIs create a direct link between the statements.

In contrast, disjointed reporting, the perception of missing information, and possible double reporting across the financial statements and the sustainability statement lead to a disconnect between the information presented. *Connectivity*, that is, "the attribute of high-quality information that supports the provision of a holistic and coherent set of information within and across the different sections of the annual report" is a concept that leads to a "communication that links an entity's strategy and business model and IROs to its overall financial performance, sustainability performance, financial position, cash flows and other metrics and targets in the short-, medium- and long-term" (EFRAG, 2024a). To achieve connectivity, EFRAG (2024a) proposes the techniques of *cross-referencing* (direct connectivity) and *disclosing reconciliations* (indirect connectivity).[10] Connectivity can further be improved by *consistency* of information across the sections of the annual report (i.e., assumptions, data, units of measurement, and narrative) and *coherence*. Whereas *point-in-time connectivity* connects information across different sections of the annual report at the reporting date, *intertemporal connectivity* links the effects of risks and opportunities on the entity's financial position, financial performance and cash flows over multiple time horizons. As an example, intertemporal connectivity enables users to understand the migration of the anticipated financial effects disclosed in the sustainability statement (as required by ESRS E1–9, ESRS E2–6, ESRS E3–5, ESRS E4–6 and ESRS E5–6) to provisions recognized in the financial statements at a future date.

Emphasizing the importance of the sustainability statement, a *third-party audit* of the sustainability statement as part of the management report is mandatory. The statutory auditor or an audit firm other than the one auditing the financial statements is eligible to serve as the auditor of the sustainability statement.[11] Initially, the audit is carried out with limited assurance. To this end, European standards for limited assurance audits are to be adopted by the European Commission by October 1, 2026. In prospect, the audit of sustainability statements is to be carried out with reasonable assurance. Although a

10 For example, ESRS E1–9 (Anticipated financial effects from material physical and transition risks and potential climate-related opportunities) requires disclosure of reconciliations to the relevant line items or notes in the financial statements of significant amounts of the assets and net revenue at material physical risk and significant amounts of the assets, liabilities, and net revenue at material transition risk (ESRS E1.68).

11 The CSRD allows EU member states to also authorize independent assurance providers to express an opinion on the compliance of the sustainability statement with the requirements of the CSRD/ESRS.

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date for the transition has not yet been set, it is envisaged that the corresponding audit standards will be available by October 1, 2028.

For companies subject to the CSRD, the entire management report and thus the sustainability statement shall be prepared in accordance with the ESEF Regulation (EU) 2018/815, that is, being reported in XHTML (Extensible Hypertext Markup Language) and tagged with XBRL (extensible Business Reporting Language). The machine-readability of sustainability information facilitates its dissemination and use (e.g., by making comparisons across companies easier).

3 Positive effects of sustainability reporting according to the CSRD/ESRS

3.1 Improved firm valuation and access to capital

Studies from South Africa (where integrated reporting is de facto mandatory)[12] confirm a positive association between sustainability reporting quality and *firm valuation* (Lee & Yeo, 2016; Barth et al., 2017; Thompson et al., 2022). Using data from the EU during a voluntary reporting period, De Villiers & Marques (2016) and Li et al. (2018) confirm this finding. However, there is also evidence for no significant (Vishnu Nampoothiri et al., 2024) or even a negative association (Mittelbach-Hörmanseder et al., 2021) when firms shifted from voluntary to mandatory reporting.

The positive association between sustainability reporting quality and firm valuation could be explained with a *capital market effect* that manifests itself in a positive association between report quality and stock liquidity (Barth et al., 2017), analyst earnings forecast accuracy (Zhou et al., 2017; Bernardi & Stark, 2018), or lower costs of capital (Zhou et al., 2017; Eliwa et al., 2021; Cuomo et al., 2024).

Although the transferability of the findings from existing studies[13] to the CSRD/ESRS-setting is limited, the possibility of a positive effect of mandatory sustainability reporting on firm valuation definitely exists, in particular since the new regulations are designed to strengthen the capital market channel:

Information contained in the sustainability statement is *standardized* in content and in the presentation format (ESRS 1.110ff. and Appendix D to ESRS 1) and is *machine-readable*. These characteristics enhance the acquisition, processing, and comparison of sustainability information. Mandatory audits additionally strengthen the quality and *credibility* of the information.

Standardization also is relevant for financial institutions, which have been assigned an important role in the context of sustainable development (Hummel et al., 2021). Since 2022, the Sustainable Finance Disclosure Regulation (SFDR) (Regulation (EU) 2019/2088, European Parliament and Council of the European Union, 2019b) requires financial institutions to report on sustainability issues related to the assets in their portfolio. To provide financial institutions with the information they need, the CSRD/ESRS link the financial institutions' reporting obligations with their clienteles' data.[14] More precisely, the ESRS

12 The percentage of Integrated Reporting Framework adopters is increasing also in the Middle East, Latin America, and the Asia Pacific region (KPMG, 2022).

13 Brooks & Oikonomou (2018), Christensen et al. (2019), Christensen et al. (2021), Korca & Costa (2021), and Dinh et al. (2023) provide extensive literature reviews.

14 PWC Germany (2024a) notes that a data gap exists: Sustainability statements won't be available until 2025, leaving SFDR-regulated financial institutions without the information necessary for their reporting.

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contain a list of datapoints that derive from the SFDR (see Appendix B of ESRS 2). The sustainability statement shall contain a table showing where the SFDR datapoints can be found (ESRS 2.56). If an entity omits information on SFDR datapoints, it shall explicitly state that this information is not material (ESRS 1.35). Since ESG information has become crucial for the capital market, reporting entities should have a strong incentive to comply with the reporting requirements.[15]

3.2 Improved ESG performance

Another explanation for the positive association between sustainability reporting quality and firm valuation could be a *real effect* in the sense that sustainability reporting enhances ESG performance (Al-Tuwaijri et al., 2004; Christensen et al., 2017; Chen et al., 2018; Downar et al., 2021; Fiechter et al., 2022; Aluchna et al., 2023; Cicchiello et al., 2023; Cuomo et al., 2024).[16] ESG performance, in turn, can enhance financial performance (Al-Tuwaijri et al., 2004; Gregory et al., 2014; Chopra & Wu, 2016; Barth et al., 2017; Whelan et al., 2021), for example by increasing energy and resource efficiency, preventing reputational damage, mitigating risks (Whelan et al., 2021), and strengthening relationships with suppliers, consumers (Banerjee et al., 2014), and employees.

The potential for the CSRD/ESRS to generate positive real effects could be large because the sustainability statement includes information on the *supply chain*. While the reporting obligations of both listed SMEs in the scope of the CSRD and victims of the trickle-down effect result in a significant burden for suppliers, high-quality sustainability reporting that reflects high ESG performance could lead to competitive advantages from establishing SMEs' long-term positions in their customers' supply chain.

But there are also advantages on the part of the reporting entities. Although conducting a DMA is effort- and cost-intensive, the potential benefits can outweigh the costs. An effective stakeholder involvement and an in-depth discussion of the company's actual and potential IROs can be used as a basis for the development of a strong *sustainability strategy*.[17] As demand for sustainable products rises, companies can gain competitive advantages by discovering new business opportunities.[18]

Despite the fact that CSRD/ESRS sustainability reporting offers substantial benefits, notable application challenges remain:

15 Providing banks with sustainability information is a precondition for gaining access to green financing (i.e., green bonds or sustainability-linked loans) at potentially favorable conditions (Pohl et al., 2023), and large asset managers have started demanding ESG information for their investment decisions (Dinh et al., 2023).

16 The causality could also run in the opposite direction, so that ESG performance affects disclosure quantity or quality (Al-Tuwaijri et al., 2004; De Villiers & Van Staden, 2006; Cho & Patten, 2007; Clarkson et al., 2008; Hummel & Schlick, 2016).

17 In the survey conducted by PWC Germany (2024a), 72 % (instead of 24 % in 2021) of the respondents have a sustainability strategy, which for most of them is an integral part of the overall corporate strategy.

18 60 % of the respondents in the survey of PWC Germany (2024a) indicate that the CSRD reporting obligations already would influence their operational decisions (e.g., on investments), and 25 % expect that they will affect their business portfolio.

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4 Challenges with the application of the CSRD/ESRS

4.1 Incomplete regulation

On July 31, 2023, the EU Commission had adopted Set 1 of the ESRS in a delegated act, which was published in the EU Official Journal on December 22, 2023. Given that the first user group had to issue sustainability statements for FYs starting on or after January 1, 2024 – even before the CSRD had to be transposed into national law – the time available for implementing the complex requirements was very limited. And the regulations are still incomplete:

- The deadline for the EU Commission to adopt *sector-specific ESRS* has been moved from June 30, 2024, to June 30, 2026. Since sector-specific ESRS are not yet available, a higher number of entity-specific sustainability matters and/or datapoints will temporarily be observed, leading to a lower degree of within-industry comparability.
- The final ESRS LSME for listed SMEs, the ESRS VSME for the voluntary sustainability reporting of SMEs as well as the ESRS for third-country companies have not yet been issued.
- The Environmental Taxonomy Regulation (Regulation (EU) 2020/852, European Parliament and Council of the European Union, 2020) establishes a classification scheme to identify environmentally sustainable activities. A similar regulation for social sustainability matters does not yet exist.
- The public consultation on a Draft *XBRL Taxonomy* for Set 1 of the ESRS and for the disclosures in accordance with Article 8 of the Taxonomy Regulation closed in April 2024. On the basis of the XBRL Taxonomy, the European Securities and Markets Authority (ESMA) will define the tagging rules applicable to sustainability statements, which then have to be adopted by the European Commission by way of a delegated act amending Commission Delegated Regulation (EU) 2019/815 on the European Single Electronic Format (ESEF) (European Parliament and Council of the European Union, 2019a). This process will take considerable time (approximately 12 months), so that the sustainability statements for FY 2026 are most likely the first to be tagged.

4.2 Inconsistent and imprecise definitions

The ESRS contain definitions that may not align with national laws. For example, the ESRS define an employee as "an individual who is in an employment relationship with the undertaking according to national law *or practice*" (Annex II, Table 2, Glossary to the ESRS), but German Commercial Law, for example, excludes management board members, managing directors, supervisory board members, and apprentices. Other examples for information that is defined differently in different jurisdictions are working hour concepts, fair wage, health & safety indicators, and compensation indicators. To enhance comparability, some of the definitions used need to be sharpened.

Other definitions are imprecise. For example, although the Glossary to the ESRS (Annex II, Table 2) defines the term "operational control", specific criteria when the definition is met are not stated.

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4.3 Implementation issues

Sustainability reporting according to the CSRD/ESRS brings with it various practical challenges.

For example, the CSRD basically assumes the same scope of consolidation as financial reporting. However, the CSRD requires disclosures on subsidiaries that are not included in the scope of consolidation used for financial reporting (EFRAG, 2024c). Thus, a reassessment is necessary.

The CSRD/ESRS also have effects on aspects of the company's risk management, internal controls, and corporate governance. For example, DR ESRS 2 GOV-3 and the related DR contained in ESRS E1 might trigger a revaluation of the existing incentive schemes, and ESRS 2 GOV-1 might lead to an up-skilling of the administrative, management and supervisory bodies. Integrating sustainability information into the internal reporting is also considered time-consuming and costly.

In line with these arguments, companies from Germany, Austria, Switzerland, and the Netherlands regard the complexity of the technical implementation and resource constraints (64 %), time pressure (50 %), technical requirements (49 %), and organizational anchoring (49 %) as the most severe CSRD implementation hurdles. The main drivers for this complexity are the consideration of the entire value chain (74 %), the data basis (61 %), scope for interpretation (53 %), and definitional issues (52 %) (PWC Germany, 2024a). The implementation of the new regulations will thus pose major challenges, especially for SMEs.

5 Conclusion

The introduction of the CSRD represents a pivotal shift in the landscape of sustainability reporting, heralding significant changes for a vast number of EU and non-EU companies. As these new regulations begin to unfold, their ultimate effects remain to be fully determined. While the CSRD aims at enhancing the transparency, reliability, and comparability of sustainability information as the basis for effectively allocating capital to sustainable projects and companies, the practical challenges of implementation, including high costs and incomplete regulations, cannot be overlooked. Companies facing a reporting and auditing obligation for the first time as well as SMEs in the value chain are particularly affected. Nevertheless, the potential benefits, such as improved stakeholder engagement and competitive advantages, suggest a promising direction. As companies navigate these changes, the evolution of these regulations will shape the future of accounting. In particular, it remains to be seen what effects the Simplification Omnibus package published by the European Parliament and Council of the European Union (2024) on February 26, 2024 will have. In proposing to remove around 80 % of companies from the scope of the CSRD, to postpone until 2028 the reporting requirements for companies that are required to report as of 2026 or 2027, and to limit the EU Taxonomy reporting obligations to the largest companies, the Simplification Omnibus package clearly shifts the focus to competitiveness – at the expense of the previously propagated sustainability reporting obligations.

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