

Introduction

Directive (EU) 2022/2464 (Corporate Sustainability Reporting Directive – CSRD) has required EU Member States to transpose the directive into national law by 6 July 2024 at the latest for companies classified as large, small or medium-sized and introduce sustainability reporting obligations, which apply the first time as of the fiscal year 2024. The CSRD was adopted as part of the European Green Deal, which is the European Commission's overarching strategy for financing a sustainable economy and replaces the previous EU Non-Financial Reporting Directive (NFRD, Directive 2014/95/EU) by introducing significant changes for companies, as well as an expansion of the scope of application. The amending provisions of the CSRD have adapted the Accounting Directive (Directive 2013/34/EU), the Transparency Directive (Directive 2004/109/EC) and the Auditing Directive (Directive 2014/56/EU).

Apparently, to comply with the EU Sustainable Finance Disclosure Regulation (SFDR, Regulation (EU) 2019/2088), various financial market participants require additional data from the companies in which they invest their investors' capital, beyond that which is currently available. The CSRD shall ensure the availability of a greater quantity of data. This is because it requires a significantly larger number of companies to report on sustainability than was previously the case. Furthermore, companies that are obliged to report on sustainability also fall within the scope of Article 8 of the Taxonomy Regulation (Regulation (EU) 2020/852) and are therefore required to disclose the extent to which their business activities are linked to economic activities that can be classified as environmentally sustainable.

CSRD Reporting Standard

The content of sustainability reporting is defined by the European Sustainability Reporting Standards (ESRS). These standards provide a comprehensive framework for companies to report on their sustainability performance consistently. By adhering to ESRS, businesses can enhance transparency, comparability and credibility in their sustainability disclosures. From carbon emissions to supply chain ethics, ESRS cover a wide array of sustainability indicators and empowering companies to communicate their efforts effectively.



In this context, the criterion of “materiality” is of particular significance in the field of sustainability reporting, given that not all aspects of sustainability are necessarily pertinent to the content of such reports. Consequently, companies must conduct a materiality analysis. It is essential that both the material impacts of the company's activities on people and the environment (materiality of impacts), as well as the material impacts of sustainability aspects on the company (financial materiality) are reported. This entails an examination of how, for instance, climate change affects (or may affect) the development, performance and position of the company. This is referred to as the “principle of double materiality.”

German Law Transposition

All CSRD requirements are to be transposed into German law through revisions of various laws based on the final CSRD transposition act. Accordingly, in addition to the extensive amendments to the German Commercial Code (HGB), the draft CSRD Implementation Act (CSRD-UG-E), which was adopted by the German cabinet on 4 July 2024, proposes corresponding alterations to other laws, including the German Stock Corporation Act (AktG), the German Cooperatives Act (GenG), the German Securities Trading Act (WpHG), the German Auditors Ordinance (WPO) and the German Supply Chain Due Diligence Act (LkSG).

In this regard, the CSRD-UG-E serves the purpose of implementing CSRD in a manner that is in accordance with the relevant provisions of European law. Notably, the CSRD-UG-E provides for the implementation of the new requirements in accordance with the so-called “1:1 principle,” which stipulates that the resulting obligations should not exceed the requirements of European law. It is important that the rules imposed by EU law are not increased by the pursuit of excessive national regulatory ambition, as has frequently occurred through the so-called “gold plating” in other transpositions.

The obligation to report on sustainability extends to both individual companies and (sub)groups. In addition to capital market-oriented companies and securities issuers from a non-EU country, large corporations and commercial partnerships with limited liability are also required to report in accordance with the CSRD provisions. Furthermore, the CSRD-UG-E stipulates that capital market-oriented cooperatives with more than 500 employees are to be included in the scope of application. The size of the company or (sub)group is determined in accordance with the financial reporting criteria set out in Section 267 of the HGB. For a company to be considered large, it must fulfil two of the following criteria: it must have a balance sheet total of more than €25 million, more than €50 million in sales revenue or more than 250 employees.

Board Liability

The preparation of the sustainability report is the responsibility of the executive board or management, while the supervisory board is responsible for monitoring it. In the event of inaccurate representations in the sustainability report, the same penalties will be imposed on the legal representatives and the supervisory board as are applicable to financial reporting.

Notably, in the event of an error in the sustainability report, the board of directors may be subject to a fine in a manner analogous to that of the company itself. In exceptional cases, members of the board of directors may even be subject to imprisonment, for example, in instances of deliberate greenwashing. Further, it is also possible for the supervisory board members to be held liable. The extent of the supervisory board's duty of review remains a point of contention. Nevertheless, the supervisory board is obliged to examine the report for veracity. The supervisory board may be subject to a financial penalty if the report is found to be erroneous. Additionally, the supervisory board is liable to the company if it fails to fulfil its supervisory duties.

Group Reporting

In accordance with the CSRD-UG-E, companies and (sub) groups may be exempted from the sustainability reporting obligation if they are included in the group management report of a higher-level parent company, which has been expanded to include a group sustainability report. Furthermore, the consolidated sustainability report of a parent company based in a non-EU country may also permit exemption under specific circumstances. Nevertheless, the exemption cannot be applied by companies that are both capital market-oriented and classified as large within the meaning of Section 267 of the HGB. Parent companies that supplement a group management report with a group sustainability report are exempt from the obligation to prepare a sustainability report at the company level. Furthermore, the group sustainability report can satisfy the reporting obligations of companies under the LkSG, thereby eliminating the necessity for companies to prepare a separate report on their fulfilment of sustainability due diligence obligations.

Introduction in Germany

The new sustainability reporting obligation is to be introduced in Germany in stages. In the initial financial year of 2024, the obligation to report on sustainability will apply solely to large capital market-oriented companies with a workforce of over 500 employees. Subsequently, other groups of companies will be incorporated on a rolling basis until 2028. It is estimated that approximately 15,000 German companies will be subject to the sustainability reporting obligation (e.g., corporations, limited liability partnerships and cooperatives).

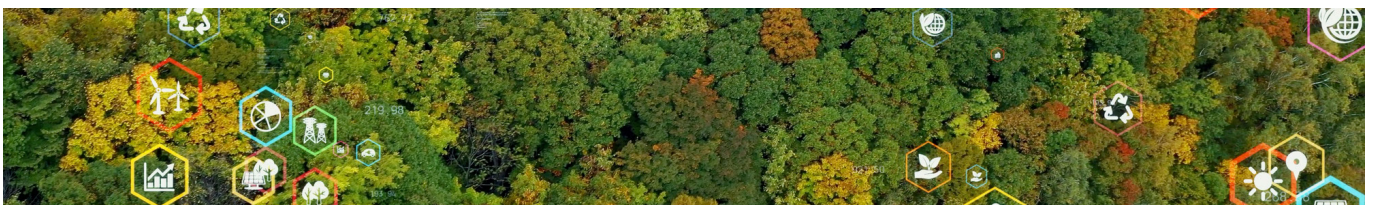
Audit Requirements

Moreover, the sustainability report is subject to an audit by an auditor, initially with limited assurance. Therefore, the EU Commission is developing standards for an audit with reasonable assurance, which will be applied in the future. The provisions on the appointment of the auditor of the sustainability report are to be applied accordingly. For the year of first-time application, the CSRD-UG-E contains a legal fiction that leads to a simplification for affected companies. In the case of companies that are required to prepare a sustainability report for the first time in accordance with the new requirements for the 2024 financial year, the auditor of the corresponding annual financial statements shall be deemed to have been appointed as the auditor of the sustainability report, provided that the annual general meeting or shareholders' meeting was convened before the CSRD-UG will come into force and no separate auditor was appointed for the sustainability report.

Statement made by the German Ministry of Justice

According to the German Ministry of Justice explanations regarding the transposition, the government draft provides for the adaptations to various German laws:

- The CSRD-UG-E renames the “non-financial statement” (currently stated in Section 289b HGB) as “sustainability reporting.” This is intended to demonstrate that the concepts of sustainability and financial reporting are of equal importance. Furthermore, the HGB provisions on the management report, the group management report and the audit are particularly affected. Companies that are subject to the requirements must include a sustainability report in their (group) management reports. Henceforth, this will be subject to audit, either by the auditor of the annual financial statements or by a separate auditor of the sustainability report. The sustainability report must include the information necessary to comprehend the impact of the corporation's activities on sustainability aspects and the impact of sustainability aspects on the corporation's business operations, financial performance and overall situation. The term “sustainability aspects” encompasses environmental, social and human rights factors, in addition to governance factors. The obligation to report on sustainability is extended to more specific subsidiaries and branches of companies based in a third country, provided that these companies (group-wide, if applicable) have a total turnover of more than €150 million in the EU.
- The CSRD-UG-E already contains a right to replace companies subject to LkSG reporting requirements by a sustainability report in accordance with the HGB. In addition, the draft stipulates that LkSG reports on the 2023 financial year do not have to be submitted until 31 December 2025.



- The AktG is to be amended to stipulate that the body of the stock corporation responsible for auditing must also monitor and audit sustainability reporting in future.
- The German Securities Trading Act (WpHG) is to be amended to reflect the changes to the Transparency Directive resulting from the introduction of sustainability reporting for issuers.
- The professional regulations set forth in the German Auditors' Code (Wirtschaftsprüferordnung), which pertain to the training and continued professional development of auditors, the professional principles that guide their practice, quality control and the professional supervision of auditors, are to be revised to align with the auditing of sustainability reports by auditors. Moreover, the German Auditor Examination Ordinance (WiPrPrüfV) will provide greater detail regarding the additional examination to become an auditor for sustainability reports. When auditing sustainability reports, it is essential to ensure that competent, independent auditors, who are qualified for this task and subject to strict professional principles, ongoing quality control and professional supervision are utilized.

Outlook

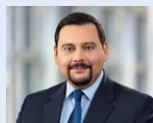
The CSRD had to be transposed into national law by 6 July 2024. Since this was not the case, the question arises whether infringement proceedings will be initiated by the EU Commission. However, for eligible entities the first report on the 2024 financial year is not due until spring 2025. It is anticipated that the legal adjustments should be made by then. It should also be noted, that many EU Member States are also still engaged to implement the complex European directive.

Contacts



Dr. Andreas Fillmann

Partner, Frankfurt
T +49 69 1739 2423
E andreas.fillmann@squirepb.com



Dr. Leo Koltsoff

Rechtsanwalt, Associate
T +49 69 20973 6070
E leo.koltsoff@squirepb.com