Grant Thornton

ADVISORY

Corporate Sustainability Reporting Directive (CSRD) and Due Diligence Directive (CSDDD)

June 2024

Beyond regulatory compliance: a differential vector for companies

The CSRD (Corporate Sustainability Reporting Directive) has its origin in the Non-Financial Reporting Directive (NFRD) published in 2014. However, the CSRD, effective from January 5, 2023, **has increased the requirements for EU companies** (in scope and volume of disclosure requirements) on the information to be presented on their environmental, social and governance impacts, and on the procedures for assessing how these affect the business.

The **CSRD's double materiality assessment** allow companies to identify the topics more relevant to their strategy, risk management and impact on the environment and society, and facilitates dialogue with stakeholders.

The **regulatory landscape** puts the focus on harmonizing sustainability disclosure requirements across the EU. This coordination provides stakeholders with consistent information on the sustainability impacts of companies.

The **recent approval of the CSDDD** (Corporate Sustainability Due Diligence Directive) on April 24 requires companies to assess negative impacts in two areas, environment and human rights, and to take measures to prevent or mitigate them.

Therefore, in the sustainability reports demanded by the CSRDD, it will be needed to report on the processes that are linked to the identification of the negative impacts of this Directive.

Index

Corporate Sustainability Reporting Directive (CSRD)

Main elements of the Directive

The CSRD Directive maintains in the text aspects that were already considered in the NFRD. Additionally, the transposition of this European regulation to the Spanish scope (articulated in Law 11/2018), already included elements such as the mandatory nature of verification by an independent expert.

The Directive considers especially relevant the data collection process to ensure that the reports are complete.

The set ESRS standards requires the assessment of more than 1,000 datapoints related to environmental, social and governance issues to determine their materiality. Accurate and reliable data collection processes are therefore key for reporting material data points.

Therefore, the objectives of the CSRD are focused on creating transparency and obtaining information on sustainability performance through analysis and benchmarking and broadens the scope of sustainability management to include sustainability risks and opportunities, which enables the development and implementation of a strategy to improve sustainability performance.

- Preparation of a reporting **annually**
- **Double materiality assessment** - impact and financial
- **Sustainability management in the value chain**, both in terms of who is present (stakeholders) and their respective IROs (impacts, risks and opportunities)
- Use of new **ESRS standards** and others currently in use **(e.g. GRI, SASB)**
- **Forward-looking information and time horizons** - strategic ambition to improve sustainability performance
- Relevance of the **identification and information gathering process** to capture accurate and comparable ESG data
- Disclosure of information linked to **other EU regulations** (e.g. EU Taxonomy)
- Disclosure of **policies, actions, metrics and governance information** (TCFD, GRI)
- Disclose information on **ESG risks and the Due Diligence process**
- **Digitally tagged** information ESEF/XHTML
- Information to be **included in the Management Report** together with the Financial Statements
- **Mandatory verification** by an independent third party (limited assurance)

Grant Thornton

Is your company in the scope of CSRD?

The timetable for entry into force of the CSRD is as follows: 2024 information to be published in 2025 reports for Public Interest Companies within the scope of application of the current NFRD; by 2025 to be published in 2026 reports for Large Companies meeting at least two requirements (+250 employees, +€50M net turnover, +€25M total assets; for the year 2026 to be published in the 2027 reports for SME companies meeting at least two requirements (+10 employees, +€900k net turnover, +€450k in assets); for the year 2028 to be published in the 2029 reports for non-EU companies active in the EU market with a net turnover of +€150k and at least one subsidiary or branch in the EU.

+50,000 companies within the scope of CSRD

+11,000 within NFRD

Public Interest Entities

All large public interest entities within the scope of the Non-Financial Reporting Directive (NFRD).

FY2024

Large companies

All large companies that meet at least two of the following requirements:

- +250 employees
- +€50M net turnover
- +€25M in total assets

FY2025

SME

SME companies that meet at least two of the following requirements:

- +10 employees
- +€900 thousand net turnover
- +€450 thousand in assets

FY2026

Companies outside the EU

Active in the EU market, with a net turnover of +€150 thousand and at least one subsidiary or branch in the EU.

FY2028

IROs and Double materiality assessment. Concepts

The CSRD proposes the evolution of the concept of materiality towards double materiality, considering impact and financial materiality. Both are closely related, since an impact related to sustainability can have financial effects.

Impact Materiality

- A sustainability issue is of materiality from an impact perspective when it refers to “actual or potential material impacts - positive or negative - of the company on people or the environment over short, medium or long-term time horizons.” (ESRS/NEIS).
- That is, the material impact that the company may have on the population or the environment, including impacts related to the company’s own activities and the upstream and downstream stages of the company’s value chain. Also, through its products and services, as well as its business relationships.

Grant Thornton

Financial Materiality

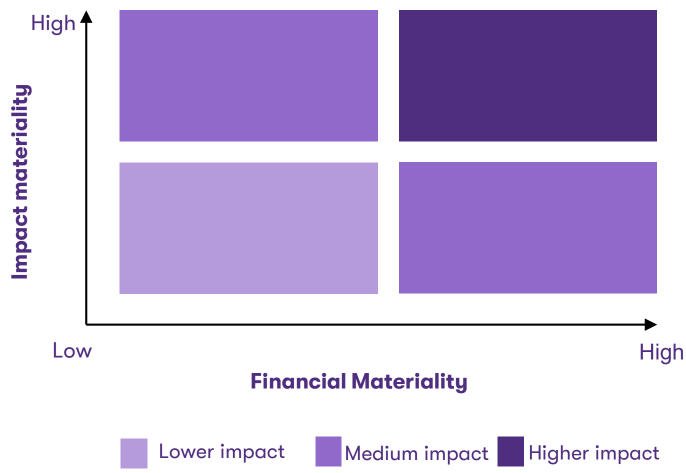
- A sustainability issue is material from a financial perspective if it "creates risks or opportunities that have a material influence or could reasonably be expected to have a material influence, on the development, financial condition, financial performance, cash flows, access to finance or short, medium or long-term cost of capital of the company." (ESRS/NEIS).
- Risks and opportunities may arise from past or future events. The financial materiality of a sustainability issue is not limited to matters within the company's control but includes information about material risks and opportunities attributable to business relationships beyond the scope of consolidation used in the preparation of the financial statements.

IROs and Double materiality assessment: How do we approach this analysis?

As indicated above, articulating a robust double materiality analysis is particularly relevant in CSRD regulation, allowing both financial and non-financial impacts to be identified and disclosure.

The European Financial Reporting Advisory Group (EFRAG) developed a comprehensive guide for the implementation of the double materiality assessment. The Guidance highlights the relevance of assessing impacts along the value chain, from suppliers to customers and other stakeholders, to ensure the full picture of environmental and social impacts. For EFRAG, it is essential to define strategies to incorporate stakeholders (internal and external) in the assessment process, considering their perspectives and expectations. Companies should rely on tools such as risk maps to categorize relevant issues and prioritize them. Our methodology, based on EFRAG guidance, is articulated in three main phases.

On May 31, 2024, EFRAG published three ESRS Implementation Guides (IG), including a Materiality Assessment guide that provides examples and FAQs on the process of disclosing material impacts, risks and opportunities.



Identify stakeholders and issues to evaluate

- Stakeholder identification (internal and external)
- Analysis of material issues in the industry and competitors, and best practices in relation to sustainability practice
- Identification of sustainability trends affecting materiality (short-, medium- and long-terms), and impact assessment

Assess impact materiality

- Assessment of the severity of impacts and their probability of occurrence (for potential impacts)
- Measurement of the impact of the activities on its employees, society and the environment, as well as their magnitude and the amount of goods and/or people affected
- Analysis of the company's capacity to restore the damage caused by its impacts

Evaluate financial materiality and build the matrix

- Evaluation of risks and opportunities associated with material issues, identifying possible risks not contemplated in the risk map, following EFRAG guidelines
- Evaluation of the financial impact in the short, medium and long term, to assess the financial materiality of each topic and subtopic
- Design of the materiality matrix (both axes) and list of material issues*

*Drawing a matrix with the results obtained is not an obligation under CSRD, but an option to present the relevant issues in a visual way.

Grant Thornton

Sustainability Due Diligence Directive (CSDDD or CS3D)

The new CSDDD Directive, approved on April 24, 2024 by the European Parliament, aims to enforce a due diligence process on companies. This Directive complements the CSRD Directive by incorporating an additional obligation for certain companies.

This process will identify, prevent, mitigate or eliminate actual and potential adverse effects on human rights and the environment resulting from the activities of companies, their subsidiaries, their business partners or value chain, demanding responsibilities to companies which are no comply with the requirements.

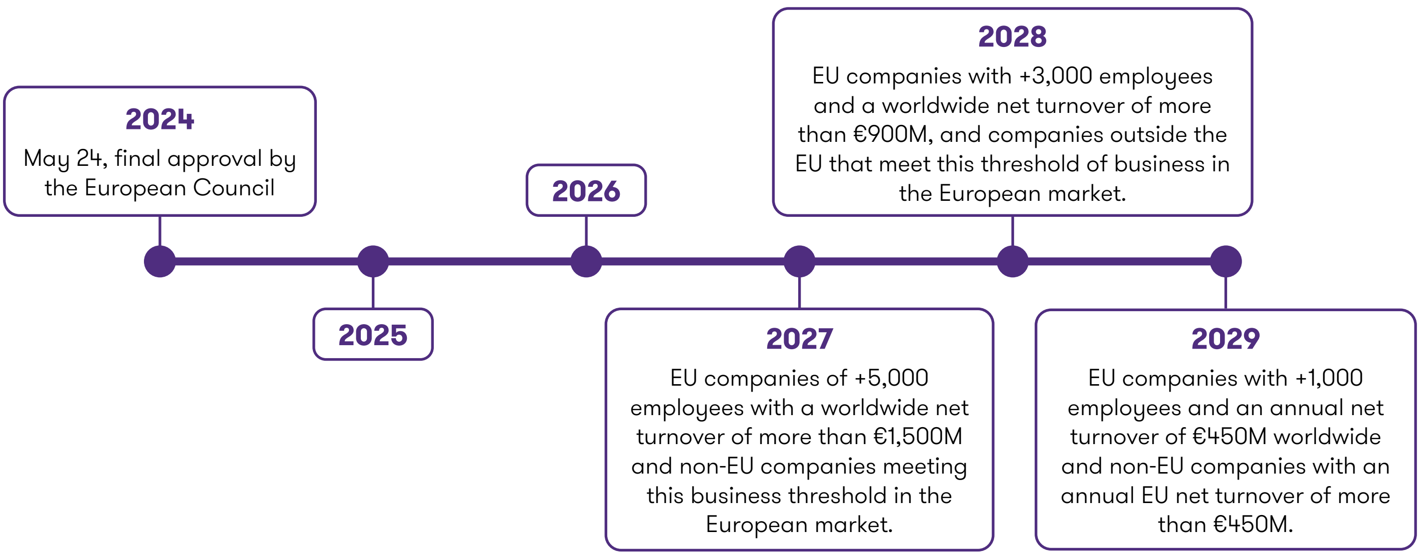
In addition, companies are required to prepare and implement a transition plan aimed of helping to reduce the effects of climate change. This plan must be monitored by the company through different indicators -qualitative and quantitative-, which help to assess the evolution of the plan, and the necessary measures must be taken in the event of identifying possible deviations from the established plan. The Directive seeks to ensure that the business model and strategies of companies help to achieve a sustainable global economy and support the achievement of limiting global warming to 1.5 °C (Paris Agreement).

To achieve these objectives, the Directive establishes a set of common and bounded rules on due diligence, supporting to ensure that companies have an aligned framework, whether they are based within the EU or operate within the EU without being based there.

Additionally, it provides consumers and investors with greater knowledge about the company's operations, knowing whether its value chain follows ethical and sustainable values, and providing information to stakeholders in a transparent and standardized manner. At the same time, with the implementation of this measure, companies will also be strengthened, improving their risk identification and mitigation processes, integrating ESG considerations into their business strategies and risk management systems.

Entry into force - implementation schedule

The timetable for the entry into force of the CS3D is as follows: (1) In 2027 EU companies with +5,000 employees and a worldwide net turnover exceeding €1,500M and companies outside the EU that meet that threshold of business in the European market; (2) In 2028, EU companies with +3,000 employees and have a worldwide net worldwide turnover exceeding €900M, and companies outside the EU meeting that threshold of business in the European market; (3) EU companies with +1,000 employees and an annual worldwide net turnover of €450M and companies outside the EU with an annual EU net turnover exceeding €450M.



7 steps to be adapted to CSDDD

Companies that are affected by the Directive must comply with their due diligence obligations throughout the supply chain and must put in place action plans to mitigate the identified negative effects. The Directive requires a due diligence policy, including a description of the processes and measures implemented by companies to ensure compliance with the Code of Conduct. Companies must also adopt measures to detect, prevent and mitigate (or eliminate) adverse effects, and establish a complaints procedure when a person, trade union or organization has a legitimate concern regarding adverse or potential effects, as well as have a monitoring procedure based on qualitative and quantitative indicators. Finally, they must publicly disclose relevant information. The Directive establishes a set of steps (articles) that companies must ensure to implement in order to consolidate Due Diligence in the company and its value chain.

1 Integration of due diligence into companies' policies (article 5)

- Integration of due diligence into all company policies and risk management, and implement a due diligence policy, containing:
  - Description of the approach to due diligence (including long-term)
  - Code of Conduct
  - Description of due diligence processes in place and measures to verify compliance with the code of conduct.
- Additionally, the due diligence policy must be reviewed and updated annually.

2 Identifying actual and potential adverse impacts (article 6)

- Adoption of measures to identify actual and potential adverse effects on human rights and the environment arising from the activities of the company or its subsidiaries.
- Use of qualitative and quantitative information to detect adverse effects, through the collection of different sources of information, with the possibility of consulting potentially affected groups, for example, workers or interested parties.

3 Preventing potential adverse impacts (article 7)

- Adoption of measures to prevent or mitigate actual and potential adverse effects. These include developing and implementing a preventive action plan that includes deadlines and indicators; seeking contractual guarantees to ensure compliance with the code of conduct; making investments in processes or infrastructure; providing support to SMEs with which there is a business relationship; and collaborating with other entities to eliminate adverse effects.
- Assign responsibilities in order to stop activities that cause negative effects.

4 Bringing actual adverse impacts to an end (article 8)

- Taking measures to eliminate the actual adverse effects that have been detected.
- In the event that these effects cannot be eliminated, their scope must be minimized by establishing action plans. The measures to be adopted by companies are aligned with those to be taken for their prevention (art. 7).

5 Complaints procedure (article 9)

- Establishment of a process for submitting complaints when an individual, union or organization has a legitimate concern regarding potential or actual adverse effects.
- The process established should be transparent and impartial.

6 Monitoring (article 10)

- Conduct periodic evaluations of its own operations and subsidiaries - and their value chain and business relationships - to review the effectiveness in the process of detecting, preventing, mitigating and eliminating/minimizing the extent of adverse human rights and environmental impacts.
- The evaluation will include qualitative and quantitative indicators and will be carried out at least once a year.

7 Communicating (article 11)

- Relevant information on the description of the due diligence, processes, policies and activities followed for the identification of actual and potential adverse effects should be publicly disclosed.

Grant Thornton

How can we help your business?

- Double materiality assessment (DMA) and IROs.
- Diagnosis of your company's current situation and identification of CSRD and CSDDD regulatory compliance maturity (GAP analysis): data, metrics, targets, governance.
- Supporting in reporting and preparation for CSRD assurance.
- Awareness and specialization training for management bodies and employees.

Our team

Our commitment is to be a trusted partner in the pursuit of operational excellence for your business. Let's embark on this journey together

Daniel Fernández

Partner, Risk Advisory Services

E daniel.fernandez@es.gt.com

Daniel is partner in charge of the Risk Advisory practice at Grant Thornton Spain with more than 20 years of experience in regulatory and risk consulting. Daniel provides solutions in the field of regulatory advice, as well as in quantitative risk modeling, where he is developing solutions in the field of climate risk management and solutions based on data analytics for ESG.

Daniel has collaborated with Tier 1 entities in the definition of financial and non-financial risks action plans (ESG, among others) and transformation of assurance functions. Additionally, he has developed quantitative Enterprise Risk Management (ERM) models, including risk appetite and tolerance limits. He has participated in risk and audit committees both in the presentation of results and training.

Alejandro González

Director, Risk Advisory Services

E Alejandro.GonzalezSalcedo@es.gt.com

Alejandro is a director of the Risk Advisory practice with more than 13 years of experience in risk management and regulation. Throughout his career he has worked in different geographies of the EU and UK markets, advising both global financial institutions and large corporations, as well as regulators in reporting processes and supervisory exercises.

In the sustainability area, Alejandro has participated in the EU market in the development and assurance of non-financial disclosure reports, adaptation to frameworks and standards (GRI, SASB), development of sustainability policies, double materiality assessments, quantification of ecological impacts due to process and business functions transformation, as well as ESG compliance assessments, and training.

GrantThornton.es