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What to Expect From the Mandatory Sustainability Disclosure Standards for Non-EU Companies

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The European Financial Reporting Advisory Group (EFRAG) is in the process of finalizing its draft sustainability reporting standards for non-EU parent companies (NESRS), which will shortly be subject to public consultation. Recent drafts for discussion were published on November 18, 2024. These provide a good indication as to the expected direction of CSRD reporting for non-EU parent companies that come in-scope of the CSRD from financial years starting on or after January 1, 2028. The draft NESRS largely mirror the ESRS which have already been adopted by the European Commission (First Set of ESRS) in terms of their format and the sustainability topics covered. Nevertheless, there are some key differences that we discuss below.

CSRD refresher

The CSRD requires EU and non-EU companies with activities in the EU to file annual sustainability reports. These reports must be prepared in accordance with the applicable reporting standards and assured by an independent third-party assurance provider.

On July 31, 2023, the European Commission adopted the First Set of ESRS which apply to EU companies in scope of the CSRD, as well as companies listed on an EU regulated market. EU companies and non-EU companies that plan to report globally from financial year (FY) 2025 are already working towards CSRD compliance based on these ESRS, which have not changed.

Non-EU parent companies subject to the CSRD from FY28 (but who decided not to report on behalf of their EU subsidiaries) have been waiting for the publication of the NESRS for clarity on how their CSRD disclosures will need to be drafted. By contrast, those non-EU parent companies already reporting voluntarily at the global level to the more onerous reporting standards for EU companies will not have to take further steps to comply.

Key takeaways from the draft NESRS

The draft NESRS cover the same topics as the First Set of ESRS

The draft NESRS currently follow the same structure as the First Set of ESRS – i.e., there are two cross-cutting standards and 10 topical standards covering the same sustainability topics. The topical standards are climate change, pollution, water and marine resources, biodiversity, circular economy, own workforce, workers in the value chain, affected communities, consumers and end-users, and business conduct.

Entity-specific disclosures also are required when the reporting company assesses, as part of its materiality assessment, that the matter is not covered by an existing NESRS at all or is covered but with insufficient granularity. Sector-specific standards, once published, also may apply alongside the NESRS but no decision has yet been made on this.

The draft NESRS map exactly on to the First Set of ESRS so that, in theory, companies can use EFRAG's existing Q&A explanations applicable to the ESRS to help navigate the NESRS and leverage existing interoperability guidance to minimize double reporting.

The draft NESRS only focus on impacts – not financial risks and opportunities

One big difference between the draft NESRS and the First Set of ESRS is that the First Set of ESRS focus on impacts, risks and opportunities, whereas the draft NESRS only focus on impacts. The impact-only focus of the NESRS is consistent with the CSRD which for EU companies mandates disclosure on sustainability-related

impacts, risks and opportunities, whereas for non-EU parents, it only requires disclosure on impacts.

This means that, unlike the First Set of ESRS, compliance with the draft NESRS would **not** require businesses to undertake a double materiality assessment. A double materiality assessment requires evaluation of both the financial effects of sustainability matters on the company and the company's impacts on society and the environment. Under the draft NESRS, companies only need to perform an assessment of the impacts of the company – including its upstream and downstream value chain – on society and the environment. The impact materiality test to be applied under each of the First Set of ESRS and the NESRS will be the same; companies must assess whether a sustainability matter is material from an impact perspective based on the severity and (if a potential impact only) the likelihood of that impact.

In terms of disclosures, the impact-only perspective means that non-EU companies reporting under the draft NESRS will not be required to report on the principal financial risks to the company related to sustainability matters, the resilience of the company's business model and strategy in relation to the risks of sustainability matters, or sustainability-related financial opportunities. In practice, this has led to EFRAG stripping out from the First Set of ESRS those data points pertaining to financial-related risks and opportunities.

This does not mean that the draft NESRS require no financial disclosures – e.g., where actions to address a material impact require significant operational and/or capital expenditure, companies will still need to state the amount of current and future financial resources allocated and explain how the current financial resources disclosed relate to the amounts presented in the company's financial statements.

Reporting boundaries

The biggest area of divergence between the First Set of ESRS and the draft NESRS is the range of business and value chain operations (both upstream and downstream) that must be covered by the report.

The default position under the draft NESRS is that, like the ESRS, the company must report on behalf of the entire consolidated group sitting under it and the group's entire upstream and downstream value chain. However, in certain circumstances, the draft NESRS would give non-EU companies a second option: to exclude information about the impacts of sales of goods or provisions of services to natural and legal persons located outside the EU. As drafted, companies would not be able to apply this exclusion to NESRS E1 (climate change) or the general cross-cutting disclosures required under NESRS 2. Therefore, as this second approach cannot be applied wholesale, companies exercising this option would be required to take a mixed approach to reporting boundaries.

This has been criticized by industry for creating a confusing dual-track system and unnecessary complexity for companies – particularly when they operate globally, have integrated global supply chains and may become subject to environmental, social and governance (ESG) reporting requirements in other jurisdictions. There also are serious questions on whether, as proposed, this is in line with the requirements of the CSRD itself.

Phase-ins

A final point non-EU companies should be aware of is the very limited availability of phase-ins for those first in scope, making early preparation even more critical. The use of almost all phase-ins – e.g., on gross Scope 3 greenhouse gas emissions and value chain information – is limited to those non-EU companies who first come into scope of the CSRD **after** January 1, 2029.

Next steps?

These are just the first drafts, and the content of the draft NESRS could still change, both in the lead up to and following the public consultation. We saw significant changes between the exposure drafts of the first set of ESRS and the final version adopted.

Once the current drafts of the NESRS have been agreed upon by EFRAG, they will be subjected to a four-month public consultation which is currently intended for Q1 2025, possibly as early as January 2025. The draft NESRS will then be revised following this consultation and are scheduled to be published by EFRAG before the end of

2025. To enter into law, the NESRS need to be formally adopted by the European Commission in the form of a ‘delegated regulation’. The deadline for formal adoption of the NESRS is June 2026.

If you would like to participate in the public consultation on the drafting of the NESRS, please contact a member of Cooley’s international ESG and sustainability advisory team.

For an overview of the CSRD, check out Cooley’s CSRD FAQ.

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