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Bridging the sustainability information gap: an assessment of the European sustainable finance framework

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3 | Ongoing Disclosures for Issuers How Effective are the Corporate Sustainability Reporting Directive and Article 8 Taxonomy Regulation in Reducing Information Asymmetries?

1 INTRODUCTION

In Chapter 1, I have introduced the EU Sustainable Finance Framework. This framework aims to channel more private capital into sustainable investments, ultimately facilitating the transition to a low-carbon society. To evaluate this framework, I have formulated the research question *To what extent does the European Sustainable Finance Framework enable investors to make better informed investment decisions that integrate sustainability considerations, and how can this framework be improved to facilitate the reorientation of capital flows toward sustainable economic activities?* I approach this evaluation from a Law & Economics perspective (“L&E”). For this, I use a simplified model of financial markets which consists of three actors: issuers, intermediaries, and investors. Together, they represent the investment chain through which capital should be allocated to sustainable investments. This investment chain also encompasses the pathway through which sustainability information must flow from issuer to investor in order to enable the investor to integrate that information into the investment decision.

In Chapter 2, I have set out the normative framework for evaluating the EU SFF based on L&E. L&E identifies several market failures that frustrate the efficiency of the market, including information asymmetries, and the principal-agent problem, which hinder the efficient allocation of capital to sustainable investments. The intervention of the EU SFF aims to address these market failures by regulating the flow of sustainability information in financial markets. This public intervention in the market is justified by the aim to increase overall welfare. ‘Welfare’ means ‘the value of everything in society’. Therefore, all costs and benefits of economic activities must be accounted for, not only those that apply to the parties directly involved with the activity. This is essential because sustainability impacts are typically unaccounted for in traditional pricing mechanisms, yet they significantly affect general welfare.

In this Chapter, I focus on issuers and the market failure that the EU SFF is attempting to remedy at this point in the investment and information chain: information asymmetries between issuers and the market. When investors lack sustainability information about an issuer, they cannot factor sustainability considerations into their investment decisions. As I explained in Chapter 2, this can ultimately inhibit reorienting capital from sustainable investments and thus prevent the maximization of welfare. The primary mechanism to

overcome these information asymmetries is the disclosure of sustainability information by issuers. Issuer disclosure is regulated by two complementary disclosure regimes. On the one hand, the Corporate Sustainability Reporting Directive (“CSRD”) and article 8 of the Taxonomy Regulation (“TR”) require businesses to publish sustainability information about the entire business on an annual basis (Chapter 3). On the other hand, issuers must make initial disclosures when issuing securities that focus on the particular investment which is being offered (Chapter 4). Together, these two disclosure regimes should enable investors to make an informed investment decision. The central question that I aim to answer in this chapter is:

How effective are the ongoing disclosure requirements from the CSRD/ESRS and article 8 TR in reducing information asymmetries regarding sustainability between issuers and investors?

2 REDUCING INFORMATION ASYMMETRIES

As discussed in the previous chapter, this thesis relies on an integrated approach to welfare: all costs and benefits of the potential transaction must be accounted for, not only those that apply to the parties to the transaction.¹ To enable investors to take into account all positive and negative impacts on sustainability matters, and thus to allocate capital efficiently, all relevant information must be available to the investors, i.e. the information asymmetry between the business and the investor must be minimized.² To evaluate how successful the ongoing issuer disclosure rules are in reducing information asymmetries, I rely on three factors. Is the information that is disclosed:

1. Complete, meaning that (a) the qualitative information covers all four aspects of the double materiality principle and (b) quantitative data is included in the disclosures; and
2. Coherent, meaning that core terminology and concepts are defined and used coherently throughout the legislation; and
3. Accurate, meaning that qualifying a financial product as sustainable either (a) is based on the Taxonomy Regulation or (b) is warranted by procedural safeguards that ensure the qualification is supported by scientific evidence.

2.1 Complete

The traditional method that is used to enable investors to make an informed investment decision, is complete disclosure of relevant information by issuers.

1 Paragraph 3 and 4 of Chapter 2.

2 Paragraph 3.4.1 of Chapter 2.

This is reflected in the approach taken in instruments such as the Prospectus Regulation and the Directive on annual financial statements.³ The same logic applies in the context of sustainability information: to empower investors to reorient capital to environmentally sustainable economic activities, it is necessary that they can form a complete picture of how the issuer impacts sustainability. To evaluate how successful the EU SFF is in realizing complete disclosure in relation to sustainability matters, I focus on two aspects: whether the qualitative information covers all four aspects of the double materiality principle and whether the disclosures include quantitative data.

2.1.1 Qualitative Disclosures

Qualitative data are necessary to allow for detailed insight into the business's relation to sustainability. However, such qualitative disclosures create challenges for the completeness of the information, as well as its comparability between businesses.⁴ In the context of sustainability information, the double materiality principle serves as a selection mechanism for determining which information to disclose, with the starting point that 'material' information must be disclosed.⁵ The concept of materiality itself has evolved through various definitions. Consider these three examples: the Prospectus Regulation requires the disclosure of "necessary information which is material to an investor for making an informed assessment of: (a) the assets and liabilities, profits and losses, financial position, and prospects of the issuer and any guarantor, (b) the rights attaching to the securities, and (c) the reasons for the issuance and its impact on the issuer."⁶ The US Securities and Exchange Commission defines materiality as "matters as to which an average prudent investor ought reasonably to be informed before purchasing the security registered"⁷ while the

3 Regulation (EU) 2017/1129 of the European Parliament and of the Council of 14 June 2017 on the prospectus to be published when securities are offered to the public or admitted to trading on a regulated market, and repealing Directive 2003/71/EC; Directive 2013/34/EU of the European Parliament and of the Council of 26 June 2013 on the annual financial statements, consolidated financial statements and related reports of certain types of undertakings, amending Directive 2006/43/EC of the European Parliament and of the Council and repealing Council Directives 78/660/EEC and 83/349/EEC; Armour J., e.a., *Principles of Financial Regulation*, Oxford University Press 2016, Chapter 8.

4 Ott C., "Capital market effects of climate-related disclosure", in: Rimmel G., e.a. (eds.), *Research Handbook on Sustainability Reporting*, Edgar Elgar 2024, p. 252.

5 Bernstein L.A., "The Concept of Materiality", *The Accounting Review* 1967, vol. 42(1), p. 86, 88. See also: Baumüller J. & Schaffhauser-Linzatti M., "In search of materiality for non-financial information – reporting requirements of the Directive 2014/95/EU", *Nachhaltigkeits-ManagementForum | Sustainability Management Forum* 2018, vol. 26, p. 101.

6 Article 6 (1) PR. Serière V. de, "The Contents of the Prospectus: Non-Financial Information and materiality", in: Busch D., Ferrarini G. & Franx J.P. (eds.), *Prospectus Regulation and Prospectus Liability*, Oxford University Press 2020, p. 195.

7 Rule 3-06, Regulation S-X by the Securities and Exchange Commission under the Securities Act (1993).

American Accounting Association considers material “An item [...] if there is reason to believe that knowledge of it would influence the decisions of an informed investor.”⁸ Central to the notion of materiality, is that it has the power to influence an investment decision. However, it remains an elusive concept in practice.⁹

For sustainability disclosures, the double materiality principle provides practical guidance by identifying four key areas for disclosure: (1) financially material positive impacts, (2) financially material negative impacts, (3) impact-material positive effects, and (4) impact-material negative effects.¹⁰ Financial materiality encompasses how sustainability factors influence a business’s financial performance and market position, while impact materiality addresses how the business’s operations affect environmental and social sustainability outcomes.¹¹ Both the financial and the impact dimension are necessary information in the materiality paradigm, as investors who incorporate sustainability considerations into their investment decisions are driven by various motivations, including the effort to reduce financial risk and non-pecuniary motivations such as contributing to climate change action.¹²

Financial materiality in the context of sustainability matters aligns with traditional disclosure practices. However, impact materiality presents new challenges. I, therefore, focus on whether the information that has to be dis-

8 American Accounting Association, *Accounting and Reporting Standards for Corporate Financial Statements and Preceding Statements and Supplements*, American Accounting Association 1957, p. 8.

9 See for the historical development of the concept of materiality: Edgley C., “A genealogy of accounting materiality”, *Critical Perspective on Accounting* 2014, vol. 25(3), p. 255.

10 For example: Communication from the Commission: Guidelines on non-financial reporting: Supplement on reporting climate-related information C/2019/4490; Baumüller J. & Sopp K., “Double materiality and the shift from non-financial to European sustainability reporting: review, outlook and implications”, *Journal of Applied Accounting Research* 2022, vol. 2023(1), p. 8; Mezzanotte F.E., “Examining the Reasons for Impact Materiality in EU Corporate Sustainability Reporting”, *European Business Law Review* 2024, vol. 35(7) p. 925; Bossut M., e.a., “What information is relevant for sustainability reporting? The concept of materiality and the EU Corporate Sustainability Reporting Directive”, *Sustainable Finance Research Platform Policy Brief 7/2021*, available at: https://wpsf.de/wp-content/uploads/2021/09/WPSF_PolicyBrief_7-2021_Materiality.pdf, accessed on: 10 January 2025, p. 5-6.

11 Mezzanotte F.E., “Examining the Reasons for Impact Materiality in EU Corporate Sustainability Reporting”, *European Business Law Review* 2024, vol. 35(7) p. 925, 927-932; Chiu I. H.-Y., “The EU Sustainable Finance Agenda: Developing Governance for Double Materiality in Sustainability Metrics”, *European Business Organization Law Review* 2022, vol. 23(1), p. 87.

12 For example: Heeb F., e.a., “Do Investors Care about Impact?”, *The Review of Financial Studies* 2023, vol. 36(5), p. 1737; Jansson M. & Biel A., “Motives to engage in sustainable investment: a comparison between institutional and private investors”, *Sustainable Development* 2011, vol. 19(2), p. 135; Hartzmark S.M. & Sussman A.B., “Do Investors Value Sustainability? A Natural Experiment Examining Ranking and Fund Flows”, *The Journal of Finance* 2019, vol. 74(6), p. 2789; Bauer R., Ruof T. & Smeets P., “Get Real! Individuals Prefer More Sustainable Investments”, *The Review of Financial Studies* 2021, vol. 34(8), p. 3976.

closed in relation to the business's impact on sustainability meets the following three criteria:

1. The information encompasses both positive and negative impacts. Whilst there may be an incentive for businesses to only disclose positive impacts, the EU SFF should prevent this as it limits the ability of investors to make informed comparisons and restricts their investment strategies.¹³
2. The information extends beyond a binary classification system such as sustainability labels. While labels help investors to interpret information, they can also give rise to two problems. First, the label may be too inclusive or exclusive: activities may not receive the label 'sustainable' even though they are not necessarily unsustainable and vice versa.¹⁴ The second problem of a binary system is that it impairs the ability of investors to compare opportunities within one category.¹⁵
3. The disclosures are guided by specific materiality and disclosure standards. While open-ended impact disclosures might seem ideal in light of the previous two criteria, they can lead to a great variety in the type and content of information that is disclosed, which undermines the ability of investors to compare the impacts between businesses.¹⁶ Therefore, impact materiality should not only contain a range but should also be guided by specific materiality standards.¹⁷

2.1.2 Quantitative Disclosures

Complete disclosure also requires the disclosure of quantitative data. This is essential both because it allows for granular information and because it does

13 Ehlers T., Goa D. & Packer F., "A taxonomy of sustainable finance taxonomies", *Bank for International Settlements Papers* 2021, no 118, available at: <https://www.bis.org/publ/bppdf/bispap118.pdf>, accessed on: 25 January 2025, p. 15-16; Tröger T. & Steuer S., "The Role of Disclosure in Green Finance", *ECGI Law Working Paper* 2021, available at: https://www.ecgi.global/sites/default/files/working_papers/documents/steuertrogerfinal.pdf, accessed on 25 January 2025, p. 17-18. See also: Eurosystem, "Eurosystem reply to the European Commission's public consultations on the Renewed Sustainable Finance Strategy and the revision of the Non-Financial Reporting Directive", *European Central Bank* 2020, p. 20, paragraph 1.13: "Develop a 'brown' taxonomy".

14 Platform on Sustainable Finance, "The Extended Environmental Taxonomy: Final Report on Taxonomy extension options supporting a sustainable transition", *European Commission* March 2022, p. 17.

15 Ehlers T., Goa D. & Packer F., "A taxonomy of sustainable finance taxonomies", *Bank for International Settlements Papers* 2021, no 118, available at: <https://www.bis.org/publ/bppdf/bispap118.pdf>, accessed on: 25 January 2025, p. 15-16.

16 Eccles R.G., e.a., "The Need for Sector-Specific Materiality and Sustainability Reporting Standards", *Journal of Applied Corporate Finance* 2012, vol. 24 (2), p. 65.

17 Eccles R.G., e.a., "The Need for Sector-Specific Materiality and Sustainability Reporting Standards", *Journal of Applied Corporate Finance* 2012, vol. 24 (2), p. 65.

not contain normative values.¹⁸ Moreover, qualitative data is subject to discretion and may be manipulated or misinterpreted.¹⁹ Even when information is disclosed in the form of labels or categories, which are seemingly objective and make cross-sector comparisons easier, they necessarily contain normative judgements on the boundary of sustainable and unsustainable and do not allow for gradual distinctions within a category.²⁰ Therefore, quantitative data is necessary, ideally in standardised formats, as this is easy to analyse and incorporate into decision-making processes.²¹ To further the example used above, if both the nursery school and the coal power plant would qualify as unsustainable in a gradual classification system, there still may be significant differences between the sustainability profile of the two investments. However, if no quantitative raw data is provided to the investors, they will not be able to compare the sustainability profiles of these two investments, which impedes an informed investment decision.

2.2 Coherent

One of the central characteristics of good law is that it is coherent, i.e. principles and propositions must be logically consistent.²² I primarily focus on the following aspects of coherence in my evaluation: whether the terminology and concepts used throughout the different pieces of legislation (CSRD, Taxonomy Regulation, and ESRS) are consistently and precisely defined.²³ If so, the legislation can enhance legal certainty by avoiding disagreements on questions of interpretation.²⁴ After all, when the meaning of terms is vague, the sustainability information disclosed to the investor is at the risk of becoming meaningless. Hence, definitions are necessary to minimize ambiguity and ensure legal certainty.²⁵ Moreover, the legislation should be structured in a coherent and therefore accessible manner.

18 Tröger T. & Steuer S., "The Role of Disclosure in Green Finance", *ECGI Law Working Paper* 2021, available at: https://www.ecgi.global/sites/default/files/working_papers/documents/steuertrogerfinal.pdf, accessed on 25 January 2025, p. 17-18.

19 Ott C., "Capital market effects of climate-related disclosure", in: Rimmel G., e.a. (eds.), *Research Handbook on Sustainability Reporting*, Edgar Elgar 2024, p. 252.

20 Tröger T. & Steuer S., "The Role of Disclosure in Green Finance", *ECGI Law Working Paper* 2021, available at: https://www.ecgi.global/sites/default/files/working_papers/documents/steuertrogerfinal.pdf, accessed on 25 January 2025, p. 17-18.

21 Ott C., "Capital market effects of climate-related disclosure", in: Rimmel G., e.a. (eds.), *Research Handbook on Sustainability Reporting*, Edgar Elgar 2024, p. 252.

22 Kress K., "Coherence", in: Patterson D. (ed.), *A Companion to Philosophy of Law and Legal Theory* (2nd edition), Wiley-Blackwell 2010, p. 521.

23 Balkin J.M., "Understanding Legal Understanding: The Legal Subject and the Problem of Legal Coherence", *The Yale Law Journal* 1993, vol. 103(1), p. 105, 114.

24 Endicott T., "Law is Necessarily Vague", *Legal Theory* 2001, vol. 7(4), p. 379-380.

25 See: Roznai Y., "A Bird is Known by its Feathers' – On the Importance and Complexities of Definitions in Legislation", *Theory and practice of legislation* 2014, vol. 2(2) p. 145.

Another fundamental aspect of coherence is whether uniform indicators are used throughout the information provided.²⁶ This is necessary to enable investors to make meaningful comparisons between investment opportunities.²⁷ I examine whether businesses must use mandatory methodologies in their disclosures or whether they retain discretion to use their own methodologies, which can undermine the ability of investors to compare information between businesses. Moreover, I address the availability of one specific indicator: whether sustainability effects on the business and impacts by the business on sustainability matters are expressed in financial terms.²⁸ By assigning a monetary value to environmental impacts, investors can better weigh impacts and effects against each other and compare them to other firms.²⁹

2.3 Accurate

The absence of information asymmetries implies that the issuer and investor have access to the same information.³⁰ It is implied that this information is materially correct. When an investment is categorized as sustainable under the EU SFF, this qualification should therefore only be made based on scientific evidence.³¹ After all, if the label ‘sustainable’ can be used for unsustainable activities, capital may be allocated to projects that do not contribute to the transition.

Assessing the scientific accuracy of the categorization made under the EU SFF is beyond the scope of this research. For this research, the scientific correctness of the categorisation of ‘environmentally sustainable economic activity’ under the Taxonomy Regulation will be assumed. After all, the Taxonomy Regulation is based on scientific evidence that has been evaluated by experts and relevant stakeholders.³² Nonetheless, it should be noted that the scientific basis for certain classifications in the EU SFF is not uncontroversial. For example, labelling the production of electricity through burning fossil gas as

26 See also: recital 33 CSRD.

27 Chiu I. H.-Y., “The EU Sustainable Finance Agenda: Developing Governance for Double Materiality in Sustainability Metrics”, *European Business Organization Law Review* 2022, vol. 23(1), p. 87.

28 See also: Partiti E., “From disclosures to classification regime and sustainability due diligence. Tackling the flaws of the Sustainable Finance Disclosure Regulation”, *TILEC Discussion Paper* 2023-05, available at: https://papers.ssrn.com/sol3/papers.cfm?abstract_id=4387626, accessed on 25 January 2025, p. 8.

29 Recital 44 CSRD; see also: Natural Capital Coalition, *Natural Capital Protocol*, 2016, available at: https://capitalscoalition.org/capitals-approach/natural-capital-protocol/?fwp_filter_tabs=guide_supplement, accessed on 25 January 2025.

30 See paragraph 3.4.1 of Chapter 2.

31 See also: Financial Stability Board, “Report on Promoting Climate-Related Disclosures”, *Financial Stability Board* 7 July 2021, p. 39-40.

32 Recital 38 TR; article 19 (1) (f) and 19 (5) TR.

an environmentally sustainable economic activity, has been met with criticism from the scientific and political community.³³

Whenever financial products can be promoted as sustainable without having to comply with the criteria of the Taxonomy regulation, scientific accuracy will in principle not be assumed. If such a situation arises under the EU SFF, there should be other procedural safeguards to ensure that the statement is scientifically accurate. I thus review whether any such safeguards are in place.

3 THE CORPORATE SUSTAINABILITY REPORTING DIRECTIVE

3.1 Introduction

In this paragraph, I analyse the disclosure requirements for issuers that have been introduced by the CSRD. As a general rule, article 19a of the CSRD obligates certain businesses to publish a so-called sustainability report that accompanies its annual financial statement.³⁴ In this report, information “necessary to understand the undertaking’s impacts on sustainability matters, and information necessary to understand how sustainability matters affect the undertaking’s development, performance and position” must be made available. The subject matters that should be covered by the sustainability report are contained in article 19a (2) CSRD and will be examined in this paragraph.

The reporting requirements from the CSRD are further elaborated in the European Sustainability Reporting Standards (“ESRS”), discussed in paragraph 4 of this Chapter.³⁵ Whenever a business is subject to article 19a CSRD, article 8 of the TR will apply to that business as well.³⁶ According to that article, the business must include in its sustainability reporting information on how and to what extent the business activities qualify as environmentally

33 For example: CJEU, Action brought on 7 October 2022, T-625/22, (Austria v European Commission); Letter from Minister for Climate and Energy for the Netherlands, Federal Minister for Climate Action, Environment, Energy, Mobility, Innovation and Technology for Austria, Minister for Energy and Digital Development for Sweden, Minister for Climate, Energy and Utilities for Denmark, “Statement fossil gas-based activities in the EU Taxonomy”, 31 January 2022, available at: <https://www.government.nl/documents/letters/2022/01/31/statement-fossil-gas-based-activities-in-the-eu-taxonomy>, accessed on 25 January 2025; Nicolás E.S., “EU gas and nuclear rules derided as ‘biggest greenwash ever’”, *euobserver* (newspaper), 14 January 2022, available at: <https://euobserver.com/green-economy/ard798d6c5>, accessed on: 25 January 2025.

34 Article 19a (1) Directive 2013/34/EU (Accounting Directive) as amended by article 1 (4) CSRD. NB.: the legislation refers to a “management report”, which should *inter alia* include sustainability-related information.

35 Article 19a (1) Directive 2013/34/EU as amended by article 1 (4) CSRD.

36 Article 1 (2) (c) TR.

sustainable in the sense of the TR, as discussed in paragraph 5 of this Chapter.³⁷

3.2 Background and Aims

The CSRD is integrated into the decade-old framework that harmonises annual accounts and reports throughout the EU and that finds its origins in the Fourth Directive, published in 1978, with the aim to coordinate the fragmented landscape of annual accounting throughout the Union, together with the Seventh Directive on consolidated reporting and the Eight Directive on audits.³⁸ The objective of these Directives was to provide an accurate overview of the current economic situation of (groups of) companies.³⁹ The Fourth Directive applied to all limited liability companies in the Union and ensured general access to the core economic data of those companies.⁴⁰ In essence, this data was comprised of the balance sheet, the profit and loss accounts, and the notes on the accounts, which together formed the annual accounts.⁴¹ The information was intended for both creditors as well as investors and shareholders – two groups with notably different interests.⁴² Although the Directives contained some substantive rules, they mainly regulated the format of the annual accounts.⁴³ This left a relatively wide margin of discretion to the Member States regarding the substantive requirements for annual reporting, leading to a somewhat fragmented reporting landscape.⁴⁴

³⁷ Article 8 TR.

³⁸ Fourth Council Directive 78/660/EEC of 25 July 1978 based on Article 54 (3) (g) of the Treaty on the annual accounts of certain types of companies; Seventh Council Directive 83/349/EEC of 13 June 1983 based on the Article 54 (3) (g) of the Treaty on consolidated accounts; Eighth Council Directive 84/253/EEC of 10 April 1984 based on Article 54 (3) (g) of the Treaty on the approval of persons responsible for carrying out the statutory audits of accounting documents; Dorresteijn A.F.M., e.a., *European Corporate Law* (2nd edition), Kluwer Law International 2009, p. 64.

³⁹ See e.g. preamble to the Fourth Council Directive 78/660/EEC of 25 July 1978 based on Article 54 (3) (g) of the Treaty on the annual accounts of certain types of companies.

⁴⁰ Article 1 Fourth Council Directive 78/660/EEC of 25 July 1978 based on Article 54 (3) (g) of the Treaty on the annual accounts of certain types of companies; Grundman S., *European Company Law: Organization, Finance and Capital Markets* (2nd edition), Intersentia 2012, p. 361.

⁴¹ Article 2 Fourth Council Directive 78/660/EEC of 25 July 1978 based on Article 54 (3) (g) of the Treaty on the annual accounts of certain types of companies.

⁴² Grundman S., *European Company Law: Organization, Finance and Capital Markets* (2nd edition), Intersentia 2012, p. 357-358.

⁴³ For example, article 7 Fourth Council Directive 78/660/EEC of 25 July 1978 based on Article 54 (3) (g) of the Treaty on the annual accounts of certain types of companies, prohibiting the set-off between assets and liabilities within the balance sheet.

⁴⁴ Grundman S., *European Company Law: Organization, Finance and Capital Markets* (2nd edition), Intersentia 2012, p. 358.

The regime was replaced in 2013 by the Accounting Directive.⁴⁵ Two important aims of this Directive are to reduce the regulatory burden on small- and medium-sized enterprises (“SMEs”)⁴⁶ and to harmonize financial statements more strictly throughout the EU, enabling easier cross-border comparison and increasing transparency.⁴⁷ In light of the former aim, the Directive categorizes companies into micro-, small-, medium-sized, and large undertakings, to which the reporting requirements apply in increasing levels of intensity.⁴⁸

The Accounting Directive continues the work of the Fourth and Seventh Directive, stipulating the content and format of the annual financial statement.⁴⁹ The annual financial statement must include: the balance sheet, the profit and loss account, and the notes to the financial statements.⁵⁰ If the reporting business is a listed company, then it must prepare its financial statements in accordance with the International Financial Reporting Standards (previously known as International Accounting Standards).⁵¹

Article 19 of the Accounting Directive contains the obligation to make public a management report.⁵² This management report must include “a fair review of the development and performance of the undertaking’s business and of its position, together with a description of the principal risks and uncertainties that it faces” and should comprise a “balanced and comprehensive analysis of the development and performance of the undertaking’s business and of its position, consistent with the size and complexity of the business.”⁵³ The preamble to the Accounting Directive mentions that the information in the management report should include an analysis of *inter alia* environmental matters that are important to the performance or position of the business.⁵⁴ This is reflected in article 19, which states that the management report should

45 Directive 2013/34/EU of the European Parliament and of the Council of 26 June 2013 on the annual financial statements, consolidated financial statements and related reports of certain types of undertakings, amending Directive 2006/43/EC of the European Parliament and of the Council and repealing Council Directives 78/660/EEC and 83/349/EEC (Accounting Directive).

46 Recitals 1-2, 11-13 Accounting Directive.

47 For example, recitals 3, 4, 19, 21 Accounting Directive.

48 Article 3 Accounting Directive.

49 Beckman H., “The New EU-Directive on Annual and Consolidated Financial Statements and Related Management Reports”, *European Company Law* 2013, vol. 10(6), p. 199.

50 Article 4 Accounting Directive. See also: Vicari A., *European Company Law*, De Gruyter 2021, Chapter 8: Accounting and financial statements, p. 195.

51 By virtue of Regulation (EC) No 1606/2002 of the European Parliament and of the Council of 19 July 2002 on the application of international accounting standards.

52 Article 22 and 29 Accounting Directive contain the obligation to publish a management report in the context of consolidated reporting, which will further be omitted from this chapter.

53 Article 19 (1) Accounting Directive.

54 Preamble 26 Accounting Directive.

include, where appropriate, information on environmental matters (an obligation from which SMEs may be exempted at Member State discretion).⁵⁵

To enhance Corporate Social Responsibility, the Accounting Directive was amended in 2014 by the Non-Financial Reporting Directive (“NFRD”), which expanded the extent of information to be included in the management report for certain companies.⁵⁶ For this, the NFRD introduced a new article 19a to the Accounting Directive (as well as a new article 29a on consolidated management reports, further omitted). The scope of article 19a was limited to businesses that fulfil three cumulative criteria: that they are a large undertaking in the sense of article 3 (4) of the Accounting Directive;⁵⁷ that they are a public-interest entity in the sense of article 2 (1) of the Accounting Directive;⁵⁸ and that they have more than 500 employees during the financial year.⁵⁹ Regarding environmental, social, employee, anti-corruption and bribery matters, as well as respect for human rights, these businesses should include in their management report information that is necessary for an understanding of the business’s “development, position and impact”.⁶⁰ For this, the business should publish a description of its business model; its policies and the outcome of those policies relating to *inter alia* environmental matters; principal risks that the business is exposed to and how these risks are being managed; and relevant non-financial key performance indicators.⁶¹ Alternatively, businesses could publish a reasoned explanation for not releasing a non-financial statement.⁶² It is important to note that the NFRD, other than Accounting Directive does for the financial statements, did not determine a specific reporting standard: it merely directed Member States to allow for the use of “national, Union-based or international frameworks.”⁶³

The NFRD had three significant drawbacks. First, the scope of application was relatively limited. Based on the criteria in the Directive itself, only around 2000 businesses would fall within the scope of the NFRD. However, taking into account how the NFRD has been transposed into national law, a total

55 Article 19 (1) and (4) Accounting Directive.

56 Directive 2014/95/EU of the European Parliament and of the Council of 22 October 2014 amending Directive 2013/34/EU as regards disclosure of non-financial and diversity information by certain large undertakings and groups (“NFRD”); Preambles 2 and 3 NFRD.

57 Large undertakings shall be undertakings which on their balance sheet dates exceed at least two of the three following criteria: (a) balance sheet total: EUR 25 000 000; (b) net turnover: EUR 50 000 000; (c) average number of employees during the financial year: 250.

58 More importantly, issuers of transferable securities, credit institutions, insurance undertakings and firms designated by Member States as public-interest entities.

59 Article 19a (1) NFRD.

60 Article 19a (1) NFRD.

61 Article 19a (1) NFRD.

62 Article 19a (1) NFRD.

63 Article 19a (1) NFRD.

of around 11 700 companies were obliged to publish a non-financial report.⁶⁴ Second, the reporting topics were formulated in a generic manner, which could result in insufficiently reliable and incomparable information, a problem exacerbated by the absence of a mandatory reporting standard.⁶⁵ Third, in an attempt to fix this problem, the Commission published Guidelines specifying the information to be published, which however were non-binding.⁶⁶ Consequently, the information disclosed in the non-financial reports did not sufficiently meet the needs of investors. To overcome these information asymmetries between issuers and investors, the CSRD was introduced in 2022. As discussed in Chapter 1, the CSRD reflects the three main aims that resonate throughout the EU SFF: to protect investors and enable well-informed investment decisions;⁶⁷ to enhance market efficiency and economic growth,⁶⁸ and to realize more sustainable investments to transition to a climate-neutral society.⁶⁹ More specifically, the CSRD aims to overcome the problems that have been identified under the NFRD and provide for a disclosure framework on par with financial reporting, including an EU-wide standard for reporting.⁷⁰ This is especially necessary in light of the growing amount of sustainability reporting standards that businesses can use for sustainability reporting and the absence of a mandatory framework under the NFRD, which results in divergent sustainability disclosures, undermining the comparative value of such reporting. The aim of the CSRD therefore not only is to enhance sustainability reporting in general but also to harmonise the content of the disclosures so that the users of the information are better enabled to compare businesses.⁷¹ Accordingly, the CSRD amends the Accounting Directive and

64 Proposal for a DIRECTIVE OF THE EUROPEAN PARLIAMENT AND OF THE COUNCIL amending Directive 2013/34/EU, Directive 2004/109/EC, Directive 2006/43/EC and Regulation (EU) No 537/2014, as regards corporate sustainability reporting COM/2021/189 final, Explanatory Memorandum, p. 1.

65 European Commission, Proposal for a Regulation as regards disclosure of non-financial information by certain undertakings and groups, Inception Impact Assessment, Ares(2020)580716, p. 2. See also: Ohnesorge L.G.L. & Rogge E., "Europe's Green Policy: Towards a Climate Neutral Economy by Way of Investors' Choice", *European Company Law* 2021, vol.18(1), p. 34, 35-36.

66 Communication from the Commission: Guidelines on non-financial reporting (methodology for reporting non-financial information) C/2017/4234; Communication from the Commission: Guidelines on non-financial reporting: Supplement on reporting climate-related information C/2019/4490.

67 Recitals 8, 12, 18, 28, 46, 50 CSRD.

68 Recital 1, 2, 12 CSRD.

69 Recital 1, 2, 3, etc. CSRD.

70 *Inter alia* recitals 13, 14, 38 CSRD.

71 La Torre M., e.a., "Harmonising non-financial reporting regulation in Europe: Practical forces and projections for future research" *Meditari Accountancy Research* 2018, vol. 26(4), p. 598; Breijer R. & Orij R.P., "The Comparability of Non-Financial Information: An Exploration of the Impact of the Non-Financial Reporting Directive(NFRD, 2014/95/EU)", *Accounting in Europe* 2022, vol. 19(2), p. 332.

effectively replaces the NFRD.⁷² The information that is generated under the CSRD is aimed at investors, as well as civil society, NGOs and other stakeholders.⁷³ This can be seen as a shift away from the traditional shareholder-focused approach that was dominant in the Accounting Directive.⁷⁴ Moreover, by including sustainability information in the annual accounts, the legislator recognizes that investors, too, find this information relevant, for example, because they regard climate change as an important issue for risk management or because they face pressure from their clients.⁷⁵

In the next paragraphs, I outline the legal obligations that are contained in the CSRD. The substantive reporting obligations in the CSRD are relatively abstract as they primarily serve as a basis for the ESRS, which will be discussed in para. 4.

3.3 Scope

Article 1 (1) CSRD amends article 1 of the Accounting Directive, which sets out the scope of that Directive.⁷⁶ According to article 1 (1) CSRD, businesses that have to comply with article 19a CSRD are: “undertakings regardless of their legal form, provided that those undertakings are large undertakings, or

72 The CSRD amends three more pieces of legislation: Regulation (EU) No 537/2014 of the European Parliament and of the Council of 16 April 2014 on specific requirements regarding statutory audit of public-interest entities and repealing Commission Decision 2005/909/EC; Directive 2004/109/EC of the European Parliament and of the Council of 15 December 2004 on the harmonisation of transparency requirements in relation to information about issuers whose securities are admitted to trading on a regulated market and amending Directive 2001/34/EC; Directive 2006/43/EC of the European Parliament and of the Council of 17 May 2006 on statutory audits of annual accounts and consolidated accounts, amending Council Directives 78/660/EEC and 83/349/EEC and repealing Council Directive 84/253/EEC.

73 Recital 9 CSRD.

74 Aluchna M., “Sustainability reporting in light of the European Union regulations: integrating theory and policy”, in: Rimmel G., e.a. (eds.), *Research Handbook on Sustainability Reporting*, Edgar Elgar 2024, p. 489. See also: Baumüller J. & Sopp K., “Double materiality and the shift from non-financial to European sustainability reporting: review, outlook and implications”, *Journal of Applied Accounting Research* 2022, vol. 2023(1), p. 8.

75 Ott C., “Capital market effects of climate-related disclosure”, in: Rimmel G., e.a. (eds.), *Research Handbook on Sustainability Reporting*, Edgar Elgar 2024, p. 254-255. On the different motives of investors to use sustainability information, see also: Heeb F., e.a., “Do Investors Care about Impact?”, *The Review of Financial Studies* 2023, vol. 36(5), p. 1737; Jansson M. & Biel A., “Motives to engage in sustainable investment: a comparison between institutional and private investors”, *Sustainable Development* 2011, vol. 19(2), p. 135; Hartzmark S.M. & Sussman A.B., “Do Investors Value Sustainability? A Natural Experiment Examining Ranking and Fund Flows”, *The Journal of Finance* 2019, vol. 74(6), p. 2789.

76 Groot C. de, Koster H. & Oostrum C.H.A van, “Corporate Sustainability Reporting Directive: naar herziening van de Europese duurzaamheidsverslaggeving”, *Maandblad voor Accountancy en Bedrijfseconomie* 2022, vol. 96(3/4), p. 61, 62-64.

small and medium-sized undertakings, except micro undertakings, which are public-interest entities as defined in point (a) of point (1) of Article 2 of this Directive.”⁷⁷ Article 2 (1) of the Accounting Directive defines public-interest entities as companies whose transferable securities are admitted to trading on a regulated market, credit institutions, insurance companies, and entities designated as public-interest entities by a Member State. In addition, article 19a (1) CSRD defines the scope for sustainability reporting as: “[l]arge undertakings, and small and medium-sized undertakings, except micro undertakings, which are public-interest entities as defined in point (a) of point (1) of Article 2[.]” From this, it follows that the sustainability reporting rules of article 19a apply to:

1. Credit institutions and insurance undertakings;
2. Designated public-interest enterprises;
3. Large undertakings⁷⁸ that exceed at least two of the following three criteria on their balance sheet dates:
 - a. balance sheet total: EUR 25 000 000;
 - b. net turnover: EUR 50 000 000;
 - c. average number of employees during the financial year: 250;
4. Medium undertakings⁷⁹ that are no small undertakings and that do not exceed two or more of the following limits:
 - a. balance sheet total: EUR 25 000 000;
 - b. net turnover: EUR 50 000 000;
 - c. average number of employees during the financial year: 250
and that are governed by the law of a Member State and whose transferable securities are admitted to trading on an EU-regulated market, i.e.: European listed companies or that otherwise qualify as a public-interest entity;
5. Small undertakings⁸⁰ that do not exceed two or more of the following limits:
 - a. balance sheet total: EUR 5 000 000 – 7 500 000;
 - b. net turnover: EUR 10 000 000 – 15 000 000;

77 Article 1 (1) CSRD, amending article 1 AD under paragraph 3. The scope is repeated in article 19a CSRD.

78 Article 3 (4) Directive 2013/34/EU, amended by Commission Delegated Directive (EU) 2023/2775 as regards the adjustments of the size criteria for micro, small, medium-sized and large undertakings or groups.

79 Article 3 (3) Directive 2013/34/EU, amended by Commission Delegated Directive (EU) 2023/2775 as regards the adjustments of the size criteria for micro, small, medium-sized and large undertakings or groups.

80 Article 3 (2) Directive 2013/34/EU, amended by Commission Delegated Directive (EU) 2023/2775 as regards the adjustments of the size criteria for micro, small, medium-sized and large undertakings or groups.

- c. average number of employees during the financial year: 50.
and that are governed by the law of a Member State and whose transferable securities are admitted to trading on an EU-regulated market, i.e.: European listed companies or that otherwise qualify as a public-interest entity.

In summary, the sustainability reporting requirements apply to: (i) credit institutions; (ii) insurance companies; (iii) all large companies; and (iv) all listed companies regardless of their size. The scope applies regardless of the legal form of the company.⁸¹ Note that the Commission proposed to reduce the scope of the CSRD/ESRS to large businesses with over 1,000 employees and a turnover exceeding EUR 50 million or a balance sheet exceeding EUR 25 million.⁸² The Council proposed a net turnover threshold of over EUR 450 million in addition to the 1,000 employee threshold.⁸³ With the European Parliament voting against the proposal in October 2025, the future scope of the CSRD is unclear during the finalisation of this manuscript, although a dramatic reduction may be expected.⁸⁴

3.4 Definitions

The CSRD adds two new definitions to article 2 Accounting Directive that are directly relevant to sustainability reporting: sustainability matters and sustainability reporting. The term sustainability matters is defined as “environmental, social and human rights, and governance factors, including sustainability factors defined in point (24) of Article 2 [SFDR]”.⁸⁵ The sustainability factors in the SFDR are: “environmental, social and employee matters, respect for human rights, anti-corruption and anti-bribery matters”.⁸⁶ Combining the list from the CSRD and the SFDR, sustainability matters thus entail: environmental factors and matters, social and human rights factors and matters, governance factors and matters, employee matters, respect for human rights, anti-corruption and anti-bribery matters.

Notably, sustainability factors as defined in the SFDR closely resemble the original article 19a as first introduced in the NFRD, which required reporting on: “environmental, social and employee matters, respect for human rights,

81 Article 1 (3) Directive 2013/34/EU as amended by article 1 (1) CSRD.

82 Omnibus-I COM(2025)80, p. 3-4; Omnibus-II COM(2025)81.

83 Council of the European Union, Press Release: Simplification: Council agrees position on sustainability reporting and due diligence requirements to boost EU competitiveness, 23 Juni 2025, 523/23.

84 European Parliament, Press Release, MEPs to vote on simplified sustainability and due diligence rules in November, 22 October 2025, available at: <https://www.europarl.europa.eu/news/en/press-room/20251016IPR30956/meps-to-vote-on-simplified-sustainability-and-due-diligence-rules-in-november>, accessed on: 23 October 2025.

85 Article 1 (2) CSRD, amending article 2 (17) Directive 2013/34/EU.

86 Article 2 (24) SFDR.

anti-corruption and bribery matters.” The fact that the subject matter of reporting under the NFRD has first been copied into the definition of sustainability factors under the SFDR, which now has been copied into the definition of sustainability matters under the CSRD, indicates how closely interwoven these instruments are.⁸⁷ Working with the same definition framework had also been an explicit aim according to preamble 28 CSRD: reference to the same terms should prevent a mismatch between the needs of the users of sustainability information and the data that is disclosed by businesses reporting under the CSRD.⁸⁸ On the one hand, that aim is fulfilled by including the SFDR definition of sustainability factors in the CSRD definition of sustainability matters. On the other hand, it would have been a more elegant solution to simply use the same definition in both instruments without the distinction between matters and factors, a distinction that is not explained in the first place.

Another important term defined in the CSRD is sustainability reporting, which means reporting information related to sustainability matters in accordance with Articles 19a, 29a and 29d.⁸⁹ Next to describing the action of reporting, this phrase is also used to indicate the part of the management report that has to be drawn up according to article 19a.⁹⁰

3.5 Sustainability Reporting: Article 19a (1) – (4)

3.5.1 Introduction

Article 19a CSRD contains elaborate general instructions for sustainability reporting, spanning well over three pages in the Official Journal.⁹¹ Article 19a (1) contains the primary obligation to draw up a sustainability report, which must be identifiable within the management report. Moreover, this report must be drawn up in accordance with the principle of double materiality (19a (1)). The topics of sustainability reporting are set out in article 19a (2) (a) – (h). The information to be disclosed should relate to the relevant short-, medium-, and long-term horizons and should include information not only about the business itself but also about its value chain and supply chain.⁹² Next to the reporting topics, exemptions and derogations can be found in

87 See also: Zukas T., *Regulating Sustainable Finance in Europe*, Duncker & Humblot 2024, p. 73-74

88 Recital 28 CSRD.

89 Article 1 (2) CSRD, amending article 2 (18) Directive 2013/34/EU.

90 In this thesis, I use the term sustainability report to indicate that part of the management report.

91 The Official Journal of the European Union is the official publication for EU legal acts, other acts and official information from EU institutions, bodies, offices and agencies, online available via: <https://eur-lex.europa.eu/oj/direct-access.html>.

92 Article 19a (2) last paragraph and (3) first paragraph CSRD.

article 19a (3), (6)-(10), and article 19a (4) specifies the applicable reporting standards. In the following sections, I discuss the reporting topics set out in articles 19a (2) (a) – (h).

3.5.2 Reporting Topics

3.5.2.1 Article 19a (2) (a) CSRD: Business Model and Strategy

Article 19a (2) (a) under (i) and (ii) CSRD mandates a description of the undertaking's business model, including "the resilience of the undertaking's business model and strategy in relation to risks related to sustainability matters" and "the opportunities for the undertaking related to sustainability matters." These two requirements thus focus on the financial risks and opportunities of the business in relation to sustainability. Article 19a (2) (a) under (iii) – (v) contains the requirement to disclose the business model and strategy in relation to plans to ensure that the business model and strategy are aligned to limiting global warming to 1.5 degrees and climate neutrality, including the business' coal-, oil-, and gas-related activities; how the business takes account of both the interests of its stakeholders and its impact on sustainability matters; and how strategies on sustainability have been implemented.⁹³

3.5.2.2 Article 19a (2) (b) CSRD: Time-Bound Targets

The business must describe any time-bound targets relating to sustainability matters that it has set.⁹⁴ This should include targets for the absolute reductions in greenhouse gas ("GHG") emissions for 2030 and 2050, the progress being made on those targets, and the scientific evidence on which these targets are based.⁹⁵

3.5.2.3 Article 19a (2) (c) CSRD: Governance

According to article 19a (2) (c) CSRD, the business should describe the position of the administrative bodies, the management, and the supervisory bodies in relation to sustainability matters. This description should include information about (access to) expertise and skill in sustainability matters. This disclosure requirement has been introduced to meet the needs of the users of the information on the corporate culture of the business.⁹⁶

3.5.2.4 Article 19a (2) (d) CSRD: Policies

Article 19a (2) (d) CSRD requires: "a description of the undertaking's policies in relation to sustainability matters." This point is not further explicated in the Directive. Recital 30 merely states that article 19a comprises five reporting

93 See also: recital 30 CSRD.

94 Article 19a (2) (b) CSRD.

95 On this reporting topic, no rationale or explanation is provided in the recitals.

96 Recital 50 CSRD.

areas: “business model; policies, including due diligence processes implemented; the outcome of those policies; risks and risk management; and key performance indicators relevant to the business”.

3.5.2.5 Article 19a (2) (e) CSRD: Incentive Schemes

Article 19a (2) (e) CSRD requires the disclosure of information on the existence of incentive schemes that reward members of the administrative, management and supervisory bodies for sustainability performance must be included in the sustainability reporting.⁹⁷

3.5.2.6 Article 19a (2) (f) CSRD: Due Diligence Processes

Under article 19a (2) (f) CSRD, three due diligence matters need to be described: (i) due diligence process; (ii) actual or potential adverse impacts; and (iii) actions taken to prevent those impacts. Due diligence is a broad concept, defined in recital 31 as the business’s processes to “identify, monitor, prevent, mitigate, remediate or bring an end to the principal actual and potential adverse impacts connected with their activities and identifies how undertakings address those adverse impacts”. According to the recital, these processes encompass the entire value chain of the business.⁹⁸ ‘Impacts’ is equally defined in a broad manner, including those that are “directly caused” by the firm, those to which the business contributes, and those which are “otherwise linked” to the value chain of the business.⁹⁹

Recital 31 aligns this reporting requirement with the UN Guiding Principles on Business and Human Rights, a framework for preventing and addressing human rights violations committed by commercial enterprises.¹⁰⁰ Guiding Principles 17-22 of this framework address human rights due diligence, stressing that businesses should conduct due diligence processes throughout their value chains.¹⁰¹ Principle 18 prescribes that businesses should identify and assess actual and potential human rights impacts. This is somewhat similar to the text in article 19a (2) (f) and recital 31 of the CSRD, but it should be kept in mind that the subject matter of the CSRD is altogether much broader and different to the UN Principles, which are limited to the topic of human rights. Hence, only a little guidance can be deducted from these principles. The obligation to describe due diligence processes can also be seen in con-

97 On this reporting topic, no rationale or explanation is provided in the recitals.

98 Recital 31 CSRD.

99 Recital 31 CSRD.

100 See also: United National Guiding Principles on Business and Human Rights, “Implementing the United Nationals “Protect, Respect, and Remedy” Framework”, [ST/]HR/PUB/11/4 (2011).

101 United National Guiding Principles on Business and Human Rights, “Implementing the United Nationals “Protect, Respect, and Remedy” Framework”, [ST/]HR/PUB/11/4 (2011), Commentary to Principle 17, p. 17-19.

nection to the Corporate Sustainability Due Diligence Directive (“CSDDD”).¹⁰² Whereas the CSRD does not (and cannot) refer to this proposal, the proposed CSDDD does refer to the CSRD.¹⁰³ In the Explanatory Memorandum of the proposal for the CSDDD, the Commission reveals its intent that the CSDDD should complement the CSRD by construing a “substantive corporate duty for some companies to perform due diligence to identify, prevent, mitigate and account for external harm resulting from adverse human rights and environmental impacts in the company’s own operations, its subsidiaries and in the value chain.”¹⁰⁴ As the CSDDD is not a disclosure framework but a directive that requires businesses to identify and address harmful impacts on human rights and the environment that occur in their business activities, including their business chains, it is omitted from this research.¹⁰⁵

3.5.2.7 Article 19a (2) (g) CSRD: Risks

Article 19a (2) (g) CSRD mandates a description of the principal risks related to sustainability matters that the business is exposed to. This reporting requirement seems, at first glance, similar to the one under (a) point (i) – the business’s resilience and strategy regarding risks related to sustainability matters. (f) specifies that the description of principal risks should include a description of the dependencies on those matters and how the business manages those risks. This could imply – in combination with recital 46, which refers to principal risks and the need to specify geographical and other contextual information – that article 19a (2) (g) requires a more thorough description of risks than (a).

3.5.2.8 Article 19a (2) (h) CSRD: Indicators

Article 19a (2) (h) requires that for the disclosures made under (a) – (g), relevant indicators are included. Without explicit elaboration, it is not entirely clear what the requirement entails. However, recital 30 CSRD mentions that reporting should include key performance indicators, which could mean that the disclosures under (a) – (g) must be accompanied by quantifiable metrics that track the progress in light of the sustainability goals, policies and risks of the business. Alternatively, this could be an attempt to harmonize information between businesses by mandating the use of uniform indicators and/or

102 Directive (EU) 2024/1760 of the European Parliament and of the Council of 13 June 2024 on corporate sustainability due diligence and amending Directive (EU) 2019/1937 and Regulation (EU) 2023/2859.

103 Proposal for a DIRECTIVE OF THE EUROPEAN PARLIAMENT AND OF THE COUNCIL on Corporate Sustainability Due Diligence and amending Directive (EU) 2019/1937 COM/2022/71 final, Explanatory Memorandum, p. 4.

104 Proposal for a DIRECTIVE OF THE EUROPEAN PARLIAMENT AND OF THE COUNCIL on Corporate Sustainability Due Diligence and amending Directive (EU) 2019/1937 COM/2022/71 final, Explanatory Memorandum, p. 4.

105 Recital 16 CSRD.

aligning indicators in sustainability reporting with those used in other Union laws.¹⁰⁶

3.6 Value chain

Article 19a CSRD not only requires businesses to disclose information about themselves but also requires disclosure of information on the business's value chain. Firstly, this is included in article 19a (2) (f) point (ii) in relation to principal actual or potential adverse impacts. Secondly, article 19a (3) prescribes that the information to be revealed under 19a (1) and (2) should refer – where applicable – to the business's own operations and its value chain. The value chain consists of products and services, business relationships and the supply chain.¹⁰⁷ The obligation to disclose this information encompasses both the value chain within the EU and the business's value chain in third countries.¹⁰⁸

3.7 Double Materiality

Article 19a (1) CSRD prescribes that the management report must include information necessary to understand how the business impacts sustainability matters, and information necessary to understand how sustainability matters affect the development, performance, and position of the business, referred to as the concept of double materiality. This concept, originally implied in the NFRD, requires businesses to disclose two perspectives of sustainability impacts:¹⁰⁹ (1) how the business impacts sustainability matters, and (2) how sustainability matters affect the business.¹¹⁰

To illustrate the double materiality principle, consider a steel factory located in an estuary. Under the double materiality principle, the business would need to disclose: (1) how it impacts sustainability matters by reporting *inter alia* on how its production processes cause the emission of GHG gases and other waste, and (2) how sustainability matters impact the business, for example

106 Recital 33 CSRD, recital 41 CSRD. It is argued by *inter alia* La Torre that the CSRD is primarily aimed at harmonizing the content of disclosures rather than to provide a stricter framework for disclosures. La Torre M., e.a., "Harmonising non-financial reporting regulation in Europe: Practical forces and projections for future research" *Meditari Accountancy Research* 2018, vol. 26(4), p. 598. See also: Pizzi S., Venturelli A. & Caputo F., "Regulating Sustainability Reporting in Europe: De Jure Harmonisation or De Facto Standardisation?", *Accounting in Europe* 2025, vol. 22(1), p. 51.

107 Recital 33 CSRD.

108 Recital 33 CSRD.

109 Recital 29 CSRD. Communication from the Commission: Guidelines on non-financial reporting: Supplement on reporting climate-related information C/2019/4490, p. 6.

110 Recital 29 CSRD.

how rising sea levels threaten the factory's physical infrastructure and operational continuity.

While the double materiality principle is central to the CSRD, the Directive does not provide a precise definition of the concept.¹¹¹ Instead, the double materiality principle and its application is worked out in detail in the ESRS.¹¹² As the CSRD itself is silent on the application of the double materiality principle, this paragraph only provides a brief overview, with a more comprehensive discussion in the context of the ESRS in paragraph 4 of this Chapter. According to the ESRS, the starting point for sustainability reporting is the identification of impacts, risks, and opportunities that are material to the relevant stakeholders.¹¹³ Relevant stakeholders are divided into two groups: the affected stakeholders (such as (in)direct business relationships across the value chain) and other users (such as investors and creditors, as well as social partners, NGOs, and civil society).¹¹⁴

For impact materiality, the business must report the material actual or potential, positive and negative impacts on sustainability matters, on a short-, medium-, and long-term basis, including those of its value chain.¹¹⁵ To determine whether something is material, the business should take into account how severe the impact is and additionally, in the case of potential impacts, the likelihood of the impact materializing.¹¹⁶ The severity should be determined on the basis of the scale, scope, and irremediability of the impact.¹¹⁷ According to recital 44 CSRD, it may be useful to express the impact of the business on sustainability matters in monetary terms, for example, the estimated value of the damage caused by the GHG emissions.¹¹⁸ However, impact materiality primarily is a qualitative disclosure concept.

The obligation to report on financial materiality focuses on sustainability matters that (could) trigger financial effects for the business, both positive and negative.¹¹⁹ These include effects on the business' "development, financial position, financial performance, cash flows, access to finance or cost of capital

111 It is merely mentioned in recitals 29, 37, 39 CSRD.

112 ESRS 1, para. 3 Commission Delegated Regulation (EU) 2023/2772 of 31 July 2023 supplementing Directive 2013/34/EU of the European Parliament and of the Council as regards sustainability reporting standards ("CDR 2023/2772"); Baumüller J. & Sopp K., "Double materiality and the shift from non-financial to European sustainability reporting: review, outlook and implications", *Journal of Applied Accounting Research* 2022, vol. 2023(1), p. 8, 20.

113 ESRS 1, para. 3.2 point 25 CDR 2023/2772.

114 ESRS 1, para. 3.1 CDR 2023/2772.

115 ESRS 1, para. 3.4 CDR 2023/2772.

116 ESRS 1, para. 3.4 CDR 2023/2772.

117 ESRS 1, para. 3.4 CDR 2023/2772.

118 This idea is also reflected in the work of the Natural Capital Coalition, *Natural Capital Protocol*, 2016, available at: https://capitalscoalition.org/capitals-approach/natural-capital-protocol/?fwp_filter_tabs=guide_supplement, accessed on 25 January 2025.

119 ESRS 1, para. 3.5 CDR 2023/2772.

over the short-, medium- or long-term.¹²⁰ To determine whether an impact is material, the business should take into account the likelihood of occurrence in combination with the potential severity of the effects.¹²¹

Note that the two dimensions of the double materiality concept in the CSRD are both interconnected and distinct from each other. The interconnectedness can be observed in the following example: a business that is heavily polluting by discharging waste toxins into the air should disclose this first and foremost under impact materiality. At the same time, this behaviour becomes financially material due to potential financial consequences, such as civil liability risks.¹²² At an abstract level, the interconnectedness may be even more obvious, for example, the emission of GHG increases climate change risks, which may have negative financial impacts on the businesses that cause the emissions in the first place.¹²³ However, impact materiality and financial materiality may often not align for individual businesses. For example, a business that does not cause any environmental impact may still be located in an area prone to flooding, which must be reported on under financial materiality. Moreover, the focus of the two concepts of materiality is fundamentally different: impact materiality focuses on outgoing effects regardless of their financial implications whereas financial materiality is explicitly limited to financial effects on the business.

3.8 Exemptions

Article 19a CSRD contains five types of exemptions. The most important exemption is the lighter disclosure regime of article 19a (6) for small- and medium-sized undertakings that do fall within the scope of article 19a because they are public-interest companies.¹²⁴ This exemption thus applies to small- and medium-sized issuers, Member-State designated public-interest entities, credit institutions, and insurance companies.¹²⁵ In line with the idea that

120 ESRS 1, para. 3.5 CDR 2023/2772.

121 ESRS 1, para. 3.5 CDR 2023/2772.

122 Example based on Rb. Rotterdam, 27 September 2023, ECLI:NL:RBROT:2023:8987 (Gemeente Dordrecht e.a. v Chemours Netherlands e.a.). This case provides a concrete example of how environmental impact can translate into financial materiality. The Rotterdam court ruled that Chemours' emission of PFOA (Per- and Polyfluoroalkyl Substances) was unlawful, establishing the defendants liability for damages caused to the municipality.

123 The interconnectedness of impact and financial materiality is illustrated in Gourdel R., e.a., "The double materiality of climate physical and transition risks in the euro area", *Journal of Financial Stability* 2024, vol. 71, 101233, p. 3.

124 Article 19a (1) CSRD, referring to article 2 (1) (a), which defines public interest companies.

125 Small- and medium sized credit institutions must fall within the definition of small and non-complex institutions defined in point (145) of article 4 (1) of Regulation (EU) No 575/2013. Small- and medium sized (re)insurance companies must fall within the definition of captive insurance undertakings defined in point (2) of article 13 of Directive 2009/138/EC of the European Parliament and of the Council and captive reinsurance undertakings defined in point (5) of Article 13 of that Directive.

businesses should not be burdened excessively,¹²⁶ the reporting requirements have been limited to:

1. a brief description of the undertaking's business model and strategy;
2. a description of the undertaking's policies in relation to sustainability matters;
3. the principal actual or potential adverse impacts of the undertaking on sustainability matters, and any actions taken to identify, monitor, prevent, mitigate or remediate such actual or potential adverse impacts;
4. the principal risks to the undertaking related to sustainability matters and how the undertaking manages those risks;
5. key indicators necessary for the disclosures referred to in points (a) to (d).

The second type of exemption can be found in the fourth paragraph of article 19a (3), which contains an exemption for information that could endanger the commercial position of the business.¹²⁷ This exemption can be linked to recital 34, according to which the disclosure requirements should not require a business to make public intellectual capital, intellectual property, know-how, or trade secrets. The exemption may only be invoked in "exceptional cases" – when the bodies of the business are of the justified opinion that an omission of "impeding developments" or "matters in the course of negotiation" is necessary to safeguard the business's commercial position.¹²⁸ Moreover, omitting such information from the sustainability report should not prejudice the ability of the users of the information to form a balanced understanding of the business.¹²⁹

Third, in groups, certain entities may be exempted.¹³⁰ In particular, subsidiaries need not publish a sustainability report if the parent undertaking draws up a consolidated management report in accordance with articles 29 and 29a CSRD in which the subsidiary is included.¹³¹

Fourth, there are exemptions that apply only in the first few years after the CSRD has entered into force. Firstly, for the first three years after the national implementation measures entered into force (ranging from 2024 to 2029, depending on the type of firm), a business that does not have access to all necessary information on its value chain may explain the efforts that it made to obtain this information, the reasons for not obtaining the information, and its plans for obtaining the information.¹³² Secondly, for financial

126 Recital 21 CSRD.

127 Recital 33 CSRD.

128 Article 19a (3) fourth paragraph CSRD.

129 Article 19a (3) fourth paragraph CSRD.

130 Article 19a (9) CSRD.

131 Article 19a (9) CSRD, recitals 25-26 CSRD. See also: Roozen C.M. & Vereijken-Van den Bosch S.F.W., "Vrijstellingen in de CSRD", *Verslaggeving, accountancy en toezicht* 2023, nr. 5/6, p. 163.

132 Article 19a (3) second paragraph CSRD.

years starting before 1 January 2028, small- and medium-sized public-interest entities – who would have to comply with the reporting regime from the financial year 2026 – may decide not to include the information mandated under 19a (1) and (2) CSRD in their management report but instead explain why the sustainability reporting was not provided.¹³³ Effectively, this entails a postponement of 2 years for the application of the sustainability reporting requirements for small- and medium-sized businesses that fall within the scope of the Directive.

Lastly, article 19a CSRD does not apply to financial products listed in points (b) and (f) of point (12) of Article 2 of the SFRD.¹³⁴ Those ‘products’ are an alternative investment fund (AIF) and a UCITS. However, the undertakings that manage these funds may fall under the obligation to draw up a sustainability report if they fulfil the scope requirements of the CSRD.¹³⁵

3.9 Single Electronic Format

The information that had to be disclosed on the basis of the national transposition of the Accounting Directive did not have to be made available in any electronic format on the basis of Union law.¹³⁶ This has resulted in a fragmented disclosure system, which hinders access to that information. To empower investors to easily access and compare the information disclosed under the CSRD, article 29d CSRD has been introduced.¹³⁷ The article mandates that the management report must be prepared in the ‘electronic reporting format’ that has been specified through the CDR 2019/815.¹³⁸ Article 3 CDR 2019/815 mandates that issuers prepare their annual financial statements in XHTML format – one of the languages in which web pages are formulated.¹³⁹ Thus, all sustainability reporting under the CSRD will be in

133 Article 19a (7) and article 5 CSRD.

134 Article 1 (1) CSRD, amending article 1 (4) AD.

135 Answer to question 12, Commission Notice on the interpretation of certain legal provisions in Directive 2013/34/EU (Accounting Directive), Directive 2006/43/EC (Audit Directive), Regulation (EU) No 537/2014 (Audit Regulation), Directive 2004/109/EC (Transparency Directive), Delegated Regulation (EU) 2023/2772 (first set of European Sustainability Reporting Standards, first ESRS delegated act), and Regulation (EU) 2019/2088 (Sustainable Finance Disclosures Regulation, SFDR) as regards sustainability reporting.

136 Recital 55 CSRD.

137 Recital 55 CSRD.

138 Article 1 Commission Delegated Regulation (EU) 2018/815 of 17 December 2018 supplementing Directive 2004/109/EC of the European Parliament and of the Council with regard to regulatory technical standards on the specification of a single electronic reporting format.

139 XHTML stands for Extensible HyperText Markup Language. Files in this markup are well suited to be viewed online.

the same electronic format, greatly increasing access to sustainability information.¹⁴⁰

The CSRD mandates centralized information disclosure across the European Union through the European Single Access Point (“ESAP”), established by Regulation (EU) 2023/2859 and set to become operational by 10 July 2027.¹⁴¹ The ESAP aims to facilitate easy access to information, enabling sound, informed, and environmentally responsible investment decisions that support efficient market functioning.¹⁴² Disclosing sustainability reporting via the ESAP should increase the availability of sustainability reporting throughout the Union.

3.10 Transposition and Entry Into Force

The CSRD has been transposed into the national law of Member States. Article 5 CSRD contains rules on when businesses will have to comply with the national rules implementing the CSRD.

Large businesses that are public-interest entities and employ more than 500 employees, will have to comply with the sustainability reporting rules for the financial year starting on or after 1 January 2024.¹⁴³ This date remained unchanged under the so-called Stop the Clock Directive. However, the original schedule for reporting has been postponed by two years for other businesses that fall under the scope of the CSRD: other large undertakings that would have to start reporting from the financial year starting on 1 January 2025 onward now have to start reporting for the financial year starting on or 1 January 2027.¹⁴⁴ The remaining firms only have to start reporting for the financial year starting on or after 1 January 2028 (instead of 1 January 2026).¹⁴⁵ Member States should have implemented the first three articles of

140 See also: Dinant J., “Een uniform elektronisch verslaggevingsformaat voor de jaarlijkse financiële verslaggeving”, *Tijdschrift voor Jaarrekeningenrecht* 2022, nr. 1, p. 12.

141 Recital 55 and 56 CSRD. Article 1 Regulation (EU) 2023/2859 of the European Parliament and of the Council of 13 December 2023 establishing a European single access point providing centralised access to publicly available information of relevance to financial services, capital markets and sustainability (“ESAP Regulation”).

142 Recital 1 ESAP Regulation. See also: Heldring M. & Horck M.F., “Een Wondermiddel in de Zoektocht naar ESG-Data?”, in: Loopik M.J. van & Palm-Steyerberg I.P. (eds.), *The Twin Transition: Digital & Sustainable Finance*, Wolters Kluwer 2022, p. 329-345.

143 Article 5 (2) (a) point (1) CSRD.

144 Article 1 (a) sub (i) Directive (EU) 2025/794 of the European Parliament and of the Council of 14 April 2025 amending Directives (EU) 2022/2464 and (EU) 2024/1760 as regards the dates from which Member States are to apply certain corporate sustainability reporting and due diligence requirements.

145 Article 1 (a) sub (ii) Directive (EU) 2025/794 of the European Parliament and of the Council of 14 April 2025 amending Directives (EU) 2022/2464 and (EU) 2024/1760 as regards the dates from which Member States are to apply certain corporate sustainability reporting and due diligence requirements.

the CSRD (which contain *inter alia* articles 19a and 29a CSRD) by 6 July 2024.¹⁴⁶

3.11 Auditing and Assurance

The CSRD introduces new auditing and assurance rules to ensure that sustainability reporting complies with the Directive (and the ESRS).¹⁴⁷ Although non-financial reporting had already been more regulated under the NFRD, that Directive did not require any assurance of the information disclosed: auditors merely needed to confirm that a separate report had been published that contained non-financial information.¹⁴⁸ Clearly, a lack of assurance of the contents of the sustainability report undermines its credibility, which is why the CSRD amends Directive 2006/43/EC on statutory audits of annual accounts and consolidated accounts to include rules on the assurance of sustainability reporting.¹⁴⁹ According to the new article 26a of Directive 2006/43/EC, the Commission will adopt delegated acts setting out limited assurance standards by 1 October 2026.¹⁵⁰ For limited assurance, the auditor merely must declare that no material misstatements have been identified in the sustainability report, which is a less intensive type of assurance.¹⁵¹ By 1 October 2028, the Commission should adopt delegated acts with rules on reasonable assurance, a more extensive type of assurance where the auditor provides a

146 Article 5 (1) CSRD. The Netherlands missed the implementation deadline of 6 July 2024. On the implementation process: Rietveld S., “De implementatie van de CSRD in Nederland: enkele ondernemingsrechtelijke implicaties”, *Tijdschrift Ondernemingsrechtpraktijk* 2024, nr. 8, p. 19, 21-22.

147 Article 3 CSRD. Ruohonen J. & Kullas H., “The Assurance of Corporate Sustainability Reports and the Renewed Role of Certified Auditors”, *European Company and Financial Law Review* 2024, vol. 21(3-4), 2024, p. 442; Bos D.E., “Zekerheid en onzekerheid: Onafhankelijkheid van externe accountants bij de voorbereiding op verplichte duurzaamheidsrapportage”, *Tijdschrift voor Jaarrekeningenrecht* 2023, nr. 5/6, p. 145.

148 Article 19a 5 NFRD: “Member States shall ensure that the statutory auditor or audit business checks whether the non-financial statement referred to in paragraph 1 or the separate report referred to in paragraph 4 has been provided.” The Netherlands has chosen to have the sustainability report assured by accountants (article 8 Implementatiebesluit richtlijn duurzaamheidsrapportering (2024)); Rietveld S., “De implementatie van de CSRD in Nederland: enkele ondernemingsrechtelijke implicaties”, *Tijdschrift Ondernemingsrechtpraktijk* 2024, nr. 8, p. 19, 25-26.

149 Recital 60 CSRD.

150 Article 3 CSRD amending article 26a Directive 2006/43/EC of the European Parliament and of the Council of 17 May 2006 on statutory audits of annual accounts and consolidated accounts, amending Council Directives 78/660/EEC and 83/349/EEC and repealing Council Directive 84/253/EEC.

151 Recital 60 CSRD. Rietveld S., “De implementatie van de CSRD in Nederland: enkele ondernemingsrechtelijke implicaties”, *Tijdschrift Ondernemingsrechtpraktijk* 2024, nr. 8, p. 19, 25-26.

positive statement that the report matches the criteria set out in the legislation.¹⁵² Increasing the level of intensity of assurance over the years should provide the assurance market with time to develop their expertise in this area.¹⁵³ This is important because the level of limited insurance is significantly lower than reasonable assurance, which may affect investors' confidence about the correctness of the information.¹⁵⁴

One concern that is expressed in publications on the new assurance regime, is the combination of the extensive reporting framework under the CSRD/ESRS, the nature of sustainability reporting which is distinct from traditional financial reporting, and the limited time that external auditors have to become acquainted with the CSRD/ESRS.¹⁵⁵ Although the CSRD also provides rules that concern the quality of the auditors providing assurance, including rules on (continued) education, training, professional ethics, confidentiality, and independence, these additional requirements may also increase the regulatory burden of sustainability reporting.¹⁵⁶

Another concern is that auditors fulfil a gatekeeping role, as they effectively assure which businesses sufficiently comply with the sustainability reporting regime.¹⁵⁷ However, this gatekeeping function may be compromised by the fact that the auditors are paid by the businesses whose sustainability reports they audit, creating a conflict of interest: rather than making a fully independent assessment of the firm, auditors may be incentivized to assess their clients' sustainability reports favourably.¹⁵⁸ This is why, in general, the (in)-

152 Article 3 CSRD amending article 26a Directive 2006/43/EC of the European Parliament and of the Council of 17 May 2006 on statutory audits of annual accounts and consolidated accounts, amending Council Directives 78/660/EEC and 83/349/EEC and repealing Council Directive 84/253/EEC. Recital 60-61 CSRD.

153 Recital 60 CSRD.

154 Ruohonen J. & Kullas H., "The Assurance of Corporate Sustainability Reports and the Renewed Role of Certified Auditors", *European Company and Financial Law Review* 2024, vol. 21(3-4), 2024, p. 442.

155 Bos D.E., "Zekerheid en onzekerheid: Onafhankelijkheid van externe accountants bij de voorbereiding op verplichte duurzaamheidsrapportage", *Tijdschrift voor Jaarrekeningenrecht* 2023, nr. 5/6, p. 145; Kamp-Roelands A.E.M., "Assurance bij duurzaamheidsinformatie. Wat betekent dit voor ondernemingen?", *Tijdschrift voor Financieel Recht* 2021, nr. 8/9, p. 286; Velte P., "Prüfung von Nachhaltigkeitsberichten nach der Corporate Sustainability Reporting Directive (CSRD) durch den Wirtschaftsprüfer – Fluch oder Segen?" *Schmalenbach IMPULSE* 2023, vol. 3(1), p. 1.

156 Article 3 CSRD amending articles 6, 7, 12, 14a, and 25b 26a Directive 2006/43/EC of the European Parliament and of the Council of 17 May 2006 on statutory audits of annual accounts and consolidated accounts, amending Council Directives 78/660/EEC and 83/349/EEC and repealing Council Directive 84/253/EEC.

157 Dell'Erba M. & Doronzo M., "Sustainability Gatekeepers: ESG Ratings and Data Providers", *University of Pennsylvania Journal of Business Law* 2023, vol. 25(2), p. 355.

158 Dell'Erba M. & Doronzo M., "Sustainability Gatekeepers: ESG Ratings and Data Providers", *University of Pennsylvania Journal of Business Law* 2023, vol. 25(2), p. 355; Rogge E. & Ohnesorge L., "The Role of ESG Rating Agencies and Market Efficiency in Europe's Climate Policy", *Hastings Environmental Law Journal* 2022, vol. 28(2), p. 113.

dependence of audit firms is strictly regulated both at the national and European level.¹⁵⁹ The gatekeeping discussion is analysed more extensively in Chapter 4 in relation to external reviewers for European Green Bonds, which are explicitly regulated under the EuGBR – unlike the general regulation of the independence of auditors of sustainability reports, which is not part of the CSRD framework.¹⁶⁰ Instead, the general rules on *inter alia* the professional ethics, independence and objectivity of auditors from Directive 2006/43/EC on statutory audits of annual accounts apply *mutatis mutandis* to the assurance of sustainability reporting.¹⁶¹

3.12 Commentary

3.12.1 Complete

In paragraph 2, I outlined the criteria for evaluating completeness: (a) assessing whether qualitative information covers all four aspects of the double materiality principle, and (b) verifying the inclusion of quantitative data. For the first criterion, I evaluate whether the information (i) encompasses both positive and negative impacts, (ii) extends beyond a binary classification, and (iii) is guided by specific materiality and disclosure standards.

The CSRD itself provides insufficient detail to adequately assess these criteria. The Directive primarily establishes the overarching framework for sustainability reporting, delineating procedural boundaries through personal scope, exemptions, and entry into force. The substantive reporting requirements, however, are contained in the ESRS. Regarding the evaluative criterion of qualitative information, the CSRD merely stipulates disclosure of material actual or potential, positive and negative impacts on sustainability matters, spanning short-, medium-, and long-term horizons, including those within the value chain. The directive is even less explicit regarding quantitative

159 See for various manners in which to safeguard the independence of auditors: Gelter M. & Gurrea-Martínez A., “Addressing the Auditor Independence Puzzle: Regulatory Models and Proposal for Reform”, *Vanderbilt Journal of Transnational Law* 2020, vol. 53 (3), p. 787. One example of EU regulation on this is: Regulation (EU) No 537/2014 of the European Parliament and of the Council of 16 April 2014 on specific requirements regarding statutory audit of public-interest entities and repealing Commission Decision 2005/909/EC. This regulation sets out the conditions for carrying out statutory audits of Public interest entities, which includes rules on fee structures, the prohibition of certain non-audit services such as legal advice or the preparation of the accounts, and independence requirements for, *inter alia*, senior management and partners of the audit firm.

160 Paragraph 4.6.1 of Chapter 4.

161 Article 25b CSRD; articles 21-24a Directive 2006/43/EC of the European Parliament and of the Council of 17 May 2006 on statutory audits of annual accounts and consolidated accounts, amending Council Directives 78/660/EEC and 83/349/EEC and repealing Council Directive 84/253/EEC.

disclosures. While it lists topics to be disclosed and mandates the inclusion of relevant indicators, the CSRD remains generic, setting conditions for the ESRS rather than prescribing specific disclosure requirements. To fully comprehend the CSRD's effectiveness in terms of completeness, it is necessary to read the directive in conjunction with the ESRS.

3.12.2 Coherent

In paragraph 2, I set out that I evaluate coherency by assessing whether core terminology and concepts are defined and used coherently throughout the legislation. Moreover, I assess whether sustainability effects on the business and impacts by the business on sustainability matters are both expressed in financial terms.

A handful of observations can be made regarding the first point. Firstly, the CSRD uses the term sustainability matters, defined as “environmental, social and human rights, and governance factors, including sustainability factors defined in point (24) of Article 2 [SFDR]”.¹⁶² The sustainability factors in the SFDR are: “environmental, social and employee matters, respect for human rights, anti-corruption and anti-bribery matters”.¹⁶³ The CSRD definition thus adds “governance factors” but is repetitive for the remaining elements.¹⁶⁴ It would have been more coherent to simply use the same definition in both instruments without the distinction between matters and factors, a distinction that is not explained in the first place.¹⁶⁵ This would be possible without loss of meaning by either defining sustainability matters as “sustainability factors as defined in point (24) of Article 2 [SFDR] and governance factors” or by interpreting sustainability factors to include governance factors. Indeed, interpreting “social and employee matters, respect for human rights, anti-corruption and anti-bribery matters” to include governance does not seem a stretch.

Secondly, it appears that AIFs and UCITSs are excluded from the scope of the CSRD but not from the application of the SFDR or Taxonomy Regulation, which is not explained in the Directive and seems incoherent in light of the entire framework.

Thirdly, the CSRD is written in a somewhat awkward manner that does not always contribute to an easy reading. For example, the scope of the regulation is contained in article 1 and repeated redundantly in article 19a; the reporting topics are relatively elaborate but do not contain any substantive rules (which can be found in the ESRS). Moreover, the order and content of

¹⁶² Article 1 (2) CSRD, amending article 2 (17) AD.

¹⁶³ Article 2 (24) SFDR.

¹⁶⁴ See also: Zukas T., *Regulating Sustainable Finance in Europe*, Duncker & Humblot 2024, p. 73-74.

¹⁶⁵ See paragraph 3.4 of this Chapter.

the topics are not reflected as such in the ESRS, which follow the structure of the Taxonomy Regulation, raising the question of why such an elaborate list of topics needed to be included in the CSRD in the first place.¹⁶⁶ In general, the impression thus arises that the CSRD could have been written more succinctly and coherently without losing any force.

The second criterion I formulated for coherency is that not only financial materiality (how the business is impacted by sustainability matters) but also impact materiality (how the business impacts sustainability matters) is expressed *inter alia* in monetary terms so that investors can make a meaningful assessment of the environmental costs caused by the business and better compare environmental costs between businesses. The idea of financially valuing sustainability impacts is reflected in recital 44 CSRD, which mentions the Commission's support for the sector-led development of standardised natural capital accounting.¹⁶⁷ It is also expressed in article 29b CSRD, which contains the Commission's task to adopt the ESRS. According to that article, the Commission will take into account, to the greatest extent possible, existing standards and frameworks for natural capital accounting and greenhouse gas accounting.¹⁶⁸ However, the CSRD contains no rules that make mandatory any form of financially valuing the (societal) costs of sustainability impacts by the business.

3.12.3 Accurate

In paragraph 2, I set out that I evaluate accuracy by assessing whether the qualification of a financial product as sustainable is either (a) based on the Taxonomy Regulation or (b) warranted by procedural safeguards that ensure the qualification is supported by scientific evidence. These criteria cannot be applied in the context of the CSRD as the purpose of the Directive is not to determine whether a financial product – or a business or an economic activity – is sustainable. Nonetheless, it is obviously still imperative that the information to be disclosed under the CSRD – and the ESRS – be accurate and reliable.¹⁶⁹ For this, the external auditing of the sustainability report plays a central role. As I explained in para. 3.11, this new auditing regime is facing a number of challenges, in particular a current gap in expertise that may close over time.

166 Article 29b CSRD. See paragraph 4.2 of this Chapter.

167 This idea is also reflected in the work of the Natural Capital Coalition, *Natural Capital Protocol*, 2016, available at: https://capitalscoalition.org/capitals-approach/natural-capital-protocol/?fwp_filter_tabs=guide_supplement, accessed on: 25 January 2025.

168 Article 29b (5) (a) CSRD.

169 See also: Financial Stability Board, "Report on Promoting Climate-Related Disclosures", *Financial Stability Board* 7 July 2021, p. 39-40.

3.13 Conclusion

The CSRD is an enormous and bold step forward in diminishing information asymmetries in terms of scope, content, and accessibility of relevant information for investors: all listed companies regardless of their size have to disclose sustainability information, the topics of reporting have been clarified and extended, and through the ESAP this information will be easily accessible. Moreover, by the integration of the materiality principle, the explicit intent is to provide investors with the information that they need to make an informed investment decision. In general terms, the CSRD thus is a successful step toward complete information.

Regarding the content of sustainability reporting, the CSRD is mainly of a procedural nature: it contains indications on what the ESRS should look like rather than prescribing substantive reporting requirements itself. On some points, these procedural rules seem to be formulated in an overly complicated manner, with unnecessary repetitions or elaboration and an obsolete distinction between “sustainability matters” and “sustainability factors”. In terms of coherence, the CSRD thus would have benefited from some sharp final editing.

One thing that could enhance the effectiveness of the CSRD is the obligation to value the costs of sustainability impacts by the business. By assigning a monetary value to environmental impacts, investors can use a standardised metric to weigh impacts and effects against each other and compare them to other businesses.¹⁷⁰ However, the CSRD only mandates monetary indicators for financial materiality, i.e. the impact of sustainability matters on the business, but not vice versa. This may impede a good valuation of the sustainability impacts and effects of the investment opportunity.

Given that the CSRD contains relatively generic rules on the content of sustainability reporting, para. 4 and para. 5 delve into the ESRS and article 8 of the Taxonomy Regulation to come to a deeper analysis of the successfulness of reducing information asymmetries regarding sustainability information in ongoing disclosures.

4 THE EUROPEAN SUSTAINABILITY REPORTING STANDARDS

4.1 Background and Requirements for the Development of the ESRS

Businesses that have to publish a sustainability report on the basis of article 19a CSRD, must do so in accordance with the sustainability reporting standards

¹⁷⁰ Recital 44 CSRD. See also: Natural Capital Coalition, *Natural Capital Protocol*, 2016, available at: https://capitalscoalition.org/capitals-approach/natural-capital-protocol/?fwp_filter_tabs=guide_supplement, accessed on: 25 January 2025.

that have been adopted pursuant to article 29b CSRD.¹⁷¹ Those standards, the ESRS, have been adopted in a Commission Delegated Regulation which entered into force on 3 August 2023 and which follows the CSRD schedule for entry into application.¹⁷² There are several reasons to justify the introduction of mandatory reporting standards. First, the NFRD has shown that generically formulated reporting requirements lead to insufficiently reliable and incomparable information.¹⁷³ Moreover, in that same context, it became clear that voluntary guidelines are insufficient to realize substantive harmonization in the way that businesses disclose information.¹⁷⁴ This is particularly obstructive for investors who cannot compare businesses if the substantive disclosures are too discrepant.

Second, a mandatory standard enables external assurance of the information, for example, by accountants.¹⁷⁵ As already mentioned, external assurance is important because it increases investors' confidence about the correctness of the information.¹⁷⁶ Furthermore, mandatory disclosure standards facilitate supervision and enforcement.¹⁷⁷ Lastly, they are an important condition for effective digitalization of the reported information.¹⁷⁸

It should be noted that a number of popular sustainability reporting standards and frameworks existed before the adoption of the ESRS, such as the GRI Standards and the United Nations Global Compact reporting framework.¹⁷⁹ Nonetheless, the EU has decided to develop its own standards. This

171 Article 19a (4) CSRD.

172 Article 2 CDR 2023/2772.

173 European Commission, Proposal for a Regulation as regards disclosure of non-financial information by certain undertakings and groups, Inception Impact Assessment, Ares(2020)580716. See also: Ohnesorge L.G.L. & Rogge E., "Europe's Green Policy: Towards a Climate Neutral Economy by Way of Investors' Choice", *European Company Law* 2021, vol.18(1), p. 34, 35-36.

174 Communication from the Commission: Guidelines on non-financial reporting (methodology for reporting non-financial information) C/2017/4234; Communication from the Commission: Guidelines on non-financial reporting: Supplement on reporting climate-related information C/2019/4490.

175 Recital 37 CSRD.

176 Ruohonen J. & Kullas H., "The Assurance of Corporate Sustainability Reports and the Renewed Role of Certified Auditors", *European Company and Financial Law Review* 2024, vol. 21(3-4), 2024, p. 442.

177 Recital 37 CSRD. Supervision and enforcement depend on the national implementation of the CSRD. In case of The Netherlands, the Autoriteit Financiële Markten will supervise the sustainability reporting by issuers (article 2-4 Wet toezicht financiële verslaggeving (version 2025)). See also: Dinant J., "De duurzaamheidsverslaggeving van beursgenoteerde ondernemingen en het toezicht van de AFM" *Tijdschrift voor Jaarrekeningenrecht* 2024, nr. 5/6, p. 188.

178 Recital 37, 55 CSRD.

179 The Global Reporting Initiative (GRI) Standards provide for reporting on economic, environmental and social impacts. Available at The Global Reporting Initiative (GRI) Standards, available at: <https://www.globalreporting.org/how-to-use-the-gri-standards/gri-standards-english-language/>, visited on: 25 January 2025. The UN Global Compact reporting frame-

is mainly motivated by the fact that the existing standards do not meet the specific needs that arise in the context of the CSRD. In particular, the reporting standards need to be aligned to other EU sustainable disclosure obligations, most importantly those arising on the basis of the SFDR and the Taxonomy Regulation.¹⁸⁰ Moreover, they should reflect the EU's sustainability ambitions in general.¹⁸¹

The CSRD sets out a number of requirements that the ESRS have to meet. First of all, the information to be disclosed by means of the ESRS must cover the needs of financial market participants who need to comply with the SFDR.¹⁸² Furthermore, article 29b (2) CSRD prescribes that the ESRS must ensure the quality of the information that is disclosed, which must be understandable, relevant, verifiable, comparable and represented in a faithful manner. At the same time, the ESRS should not impose a disproportionate administrative burden on the businesses that have to comply with them.¹⁸³

Second, article 29b (2) CSRD specifies the subject matters of the sustainability reporting standards. These are divided into three main groups: (i) environmental factors, (ii) human rights and social factors, and (iii) governance factors.¹⁸⁴ Within the area of environmental factors, article 29b (2) (a) CSRD specifies six environmental factors on which businesses must disclose information: climate change mitigation; climate change adaptation; water and marine resources; resource use and the circular economy; pollution; biodiversity and ecosystems. These environmental factors coincide with the environmental objectives from article 9 Taxonomy Regulation. Remarkably, the list of topics that can be deduced from article 19a (2) CSRD (reporting on sustainability matters in relation to the business model and strategy, time-bound targets, governance, etc.) is not reflected in article 29b (2) CSRD, which raises the question how the articles relate to each other (the CSRD does not resolve that tension). With respect to the reporting topics from article 29b (2) CSRD, the reporting standards must specify both forward-looking, retrospective, qualitative and quantitative information, and cover the value chain of the business where appropriate.¹⁸⁵ However, article 29b (4) CSRD recognizes that busi-

work provides the disclosure for ESG information in a businesses annual communication on progress. Available at: United Nations Global Compact reporting framework, "The Communication on Progress", available at: <https://unglobalcompact.org/participation/report>, visited on: 25 January 2025.

180 Recital 38 CSRD.

181 Recital 38 CSRD; more specifically, they should reflect the EU's sustainability ambitions formulated in the Green Deal and in Regulation (EU) 2021/1119 of the European Parliament and of the Council of 30 June 2021 establishing the framework for achieving climate neutrality and amending Regulations (EC) No 401/2009 and (EU) 2018/1999 ('European Climate Law').

182 Article 29b (1) second paragraph CSRD.

183 Article 29b (2) CSRD.

184 Article 29b (2) (a), (b), and (c) CSRD respectively.

185 Article 29b (3) and article 19a (3) and 29b (4) CSRD.

nesses might experience difficulties when gathering information about other businesses throughout their value chain. This is especially so when businesses in the value chain are not subject to the CSRD themselves and thus do not generate the kind of information that has to be reported under the Directive, for example, because they are SMEs or because they are located outside the EU's jurisdiction.¹⁸⁶ Therefore, the sustainability reporting standards should not mandate the reporting of information on businesses throughout the value chain that exceeds the information that those businesses have to report themselves.¹⁸⁷

Third, article 29b (5) CSRD specifies that the reporting standards ought to take into account other sustainability accounting frameworks and initiatives as well as relevant European legislation, as listed under (b) – (j) of that article. Other sustainability accounting frameworks include the International Sustainability Standards Board (ISSB), the Global Reporting Initiative, the Sustainability Accounting Standards Board, the International Integrated Reporting Council, the International Accounting Standards Board, and the Task Force on Climate-related Financial Disclosures.¹⁸⁸ This is particularly important for businesses that are active both within and outside of the EU, and which may have to report under multiple frameworks.¹⁸⁹ Interoperability between the ESRS and other frameworks reduces the regulatory burden that is imposed on those businesses.¹⁹⁰ European legislation that the ESRS must take into account include the SFDR and delegated acts adopted pursuant to that Regulation, and the criteria, indicators, and methodologies set out in the delegated acts adopted on the basis of the Taxonomy Regulation.¹⁹¹

In order to draft the ESRS, the European Financial Reporting Advisory Group (EFRAG), a non-profit association based in Belgium, was commissioned to prepare a first draft of the standards (so-called independent technical

186 Recital 53 CSRD.

187 Article 29b (4) CSRD.

188 Recital 39 CSRD also stresses the need to ensure sufficient alignment to global standard-setting initiatives. Listed in recital 43 CSRD are some of the specific standards that should be taken into account, including the work of the International Sustainability Standards Board (ISSB), the Global Reporting Initiative, the Sustainability Accounting Standards Board, the International Integrated Reporting Council, the International Accounting Standards Board, the Task Force on Climate-related Financial Disclosures, the Carbon Disclosure Standards Board.

189 Recital 43 CSRD.

190 For example the ESRS-ISSB Interoperability Guidance which explains the alignment of the respective standards with a specific focus on climate-reporting IFRS Foundation and EFRAG: "ESRS-ISSB Standards Interoperability Guidance", *IFRS Foundation and EFRAG* 2024. See on the ISSB in relation to the CSRD: Baks L.J.M., Dijk L.K. van & Hijink J.B.S., "Reuzenstapen op het terrein van duurzaamheidsverslaggeving: de Europese CSRD en oprichting van de ISSB", *Ondernemingsrecht* 2022/36, afl. 6, p. 219.

191 Article 29b (5) (b) and (c) CSRD respectively.

advice).¹⁹² On these drafts, ESMA, EBA and EIOPA have provided their opinions, *inter alia* to guarantee the coherence between the ESRS and the regulatory technical standards that are drafted pursuant to the SFDR.¹⁹³ Following modifications by the Commission to better reflect *inter alia* the (double) materiality principle, the ESRS have been adopted by means of delegated acts.¹⁹⁴ The ESRS are contained in Annex I Commission Delegated Regulation (EU) 2023/2772, which supplements the Accounting Directive, of which the CSRD is a part.¹⁹⁵

4.2 General Structure

Table 3: Categories of reporting standards in the ESRS. Source: Own image.

Cross-cutting standards	Topical standards			Sector-specific standards
	Environment	Social	Governance	
ESRS 1 General requirements	ESRS E1 Climate change	ESRS S1 Own workforce	ESRS G1 Business conduct	<i>Note that under the Omnibus-I proposal, the plan to design sector-specific standards may be abandoned.</i> ¹⁹⁶
ESRS 2 General disclosures	ESRS E2 Pollution	ESRS S2 Workers in the value chain		
	ESRS E3 Water and marine resources	ESRS S3 Affected communities		
	ESRS E4 Bio-diversity and ecosystems	ESRS S4 Consumers and end-users		
	ESRS E5 Resource use and circular economy			

¹⁹² Article 29b (1) CSRD and recital 3 Commission Delegated Regulation (EU) 2023/2772. As van Dijk & Hijink remark, EFRAG thereby is the de-facto standard-setter for sustainability reporting. Given the relative lack of experience of EFRAG in sustainability reporting in combination with the limited time for drafting the ESRS, the authors express their doubts on the feasibility of the task: Dijk L.K. van & Hijink J.B.S., “‘Corporate Sustainability Reporting’: over de Europese aanzet voor het fundament van duurzaamheidsverslaggeving”, *Tijdschrift voor Financieel Recht* 2021, nr. 8/9, p. 276, 281-283.

¹⁹³ Recital 39 CSRD.

¹⁹⁴ Article 29b (1) and article 49 CSRD.

¹⁹⁵ Commission Delegated Regulation (EU) 2023/2772 of 31 July 2023 supplementing Directive 2013/34/EU of the European Parliament and of the Council as regards sustainability reporting standards (“ESRS”).

¹⁹⁶ Omnibus-II COM(2025)81, p. 4, 15.

The ESRS cover categories of reporting standards: the cross-cutting standards, the topical standards, and the sectors-specific standards, which are systematically represented in the table above.¹⁹⁷

The cross-cutting standards, which consist of ESRS 1 (General requirements) and ESRS 2 (General disclosures), apply to all businesses and across the topical standards and the sector-specific standards.¹⁹⁸ ESRS 1 sets out general principles and requirements that must be respected when disclosing information under the other ESRS.¹⁹⁹ These pertain to issues such as the qualitative characteristics of information, double materiality, due diligence, value chain, time horizons, and the preparation and presentation of information. ESRS 2 contains general disclosures that the business must make in conjunction with the relevant disclosure requirements under the topical standards, including general rules on preparing a sustainability report, governance, strategy, impact risks and opportunity management, and metrics and targets.

The topical standards, of which currently ten exist, are categorised into Environmental, Social, and Governance standards and equally apply to all businesses and in conjunction with ESRS 2.²⁰⁰ These topical standards cover the sustainability matters and are subdivided into sub-topics and sub-sub-topics.²⁰¹ For example, ESRS E3 is on the topic of Water and marine resources, which is subdivided into the sub-topic Water and the sub-topic Marine resources, which are further subdivided into Water consumption, Water withdrawals, etc.²⁰² For the topical standards, the business need not meet all the requirements listed therein. Instead, at a minimum, the business needs to describe for all topical standards its description of the processes that it used to identify and assess material impacts, risks and opportunities. Only if the result of this assessment is that there are material impacts, risks or opportunities in relation to that topical standard, must the standard be further complied with.

The sector-specific standards apply to businesses that are within the same sector, as such businesses often have similar profiles.²⁰³ Sector-specific

197 ESRS 1 para. 4. The structure of the ESRS is also described in: Eijkelenboom E.V.A., "European Sustainability Reporting Standards: Een overzicht van Europese duurzaamheidsrapportageverplichtingen", *Tijdschrift voor Venootschapsrecht, Rechtspersonenrecht en Ondernemingsbestuur* 2022, afl. 5, p. 155, 157-159; Hijink J.B.S., "De betekenis van de corporate sustainability reporting directive voor de bancaire sector", in: Strijbos F.P.C., e.a. (eds.), *Duurzaam bankieren*, Wolters Kluwer 2023.

198 ESRS 1 para. 5. See also: Vereijken-van den Bosch S., "De CSRD: beoogde gedragsverandering of louter transparantie?", *Ondernemingsrecht* 2024, afl. 15, p. 510, 511.

199 On ESRS 1 and ESRS 2: Müller S. & Warnke L. "Entwürfe der allgemeinen Regelungen der Europäischen Nachhaltigkeitsstandards (E-ESRS 1 und 2)", *Zeitschrift für Internationale Rechtslegung* 2022, Heft 6, p. 247.

200 ESRS 1 para. 8.

201 See overview ESRS 1 Appendix A AR 16.

202 See overview ESRS 1 Appendix A AR 16.

203 Recital 53 CSRD.

standards should enable investors to make a meaningful comparison between businesses with a similar profile within a given sector.²⁰⁴ The sector-specific standards, which are currently still in development, contain standards that are specifically aligned to activities classified under specific NACE codes.²⁰⁵ NACE codes are a system of classifying economic activities in the EU and are also the basis for the categorisation of economic activities in the delegated acts to the TR.²⁰⁶ Note that under the Omnibus-I proposal, the plan to design sector-specific standards may be abandoned.²⁰⁷

4.3 Commentary

The Commission Delegated Regulation containing the ESRS on cross-cutting and topical standards comprises 284 pages of text in the Official Journal. Rather than providing a comprehensive overview of its contents, I assess how they relate to the criteria that I set out in paragraph 2 of this chapter: will the information disclosed under the ESRS be complete, coherent, and accurate?

4.3.1 Complete

In paragraph 2, I outlined the criteria for evaluating completeness: (a) assessing whether qualitative information covers all four aspects of the double materiality principle, and (b) verifying the inclusion of quantitative data.

4.3.1.1 Qualitative Disclosures and the Concept of Materiality

The double materiality principle is embedded into the ESRS framework by virtue of ESRS 1 and 2. The ESRS demand the disclosure of “material impacts, risks and opportunities” in relation to sustainability matters.²⁰⁸ The term “impacts, risks and opportunities” (IRO) reflects the double materiality principle that lies at the core of CSRD reporting. The term “impacts” refers to the business’s positive and negative impacts on sustainability (so-called impact

204 Recital 53 CSRD.

205 Article 29b (1) second and third paragraph CSRD. For example EFRAG, Development of the EFRAG ESRS for Oil and Gas sector, available at: <https://www.efrag.org/en/projects/oil-gas-og-standard-setting/research-phase>, accessed on: 13 December 2024. NACE is the acronym of the French term *Nomenclature statistique des activités économiques dans la Communauté européenne*; Statistical classification of economic activities in the European Community.

206 Regulation (EC) No 1893/2006 of the European Parliament and of the Council of 20 December 2006 establishing the statistical classification of economic activities NACE Revision 2 and amending Council Regulation (EEC) No 3037/90 as well as certain EC Regulations on specific statistical domains.

207 Omnibus-II COM(2025)81, p. 4, 15.

208 ESRS 1 para. 2.

materiality).²⁰⁹ The phrase “risks and opportunities” refers to the business’s sustainability related financial risks and opportunities (so-called financial materiality).²¹⁰ As both impact materiality and financial materiality encompass negative and positive impacts, the ESRS in principle provide for the disclosure of a full spectrum of information. Moreover, double materiality can be seen as a method to identify detailed information on the relationship between the business and sustainability matters, both financial and in terms of impact.²¹¹ In principle, the disclosures thus meet the double materiality criterion. To assess whether qualitative disclosures enable investors to integrate sustainability considerations into their investment decisions, I previously outlined three sub-criteria for qualitative information in the context of the double materiality principle.²¹² These criteria are whether the information disclosed (i) encompasses both positive and negative impacts, (ii) extends beyond a binary classification, and (iii) is guided by specific materiality and disclosure standards.

(i) *Positive and Negative Impacts*

By its very nature, the double materiality principle provides businesses with some flexibility on what to include in their sustainability report. The primary reason for this is that double materiality also serves as a selection mechanism when determining what information to include in the sustainability report.²¹³ After all, only material information must be included in the sustainability report. Without sufficient guidance on how to assess whether information is material, the concept can be used to minimize disclosures by applying a high threshold for materiality. Especially in relation to negative impacts, there is a clear incentive for businesses to find that their impacts are non-material, namely to avoid reputational damage.²¹⁴

The ESRS provide some guidance on the materiality threshold to be observed by the reporting business. ESRS 1 prescribes that materiality for actual negative impacts by the business on sustainability matters is based on the severity and the likelihood of the impact, whereby severity is based on the scale, scope and irremediable character of the impact.²¹⁵ Similarly, financial materiality is based on the likelihood of occurrence and the potential mag-

209 ESRS 1 para. 14 (a).

210 ESRS 1 para. 14 (b).

211 Herold C., Grottel G. & Klein L., “Die Wesentlichkeitsanalyse gemäß den European Sustainability Reporting Standards (ESRS)”, *Zeitschrift für Internationale Rechtslegung* 2023, Heft 11, p. 459.

212 See paragraph 2.2.1 of this Chapter.

213 ESRS 1 para. 26. Eijkelenboom E.V.A., “European Sustainability Reporting Standards: Een overzicht van Europese duurzaamheidsrapportageverplichtingen”, *Tijdschrift voor Venmoetschapsrecht, Rechtspersonenrecht en Ondernemingsbestuur* 2022, afl. 5, p. 155158.

214 ESRS 1 para. 5.

215 As well as related forms of financial damage such as litigation risk.

216 ESRS 1 para. 45.

nitude of the financial effects.²¹⁶ Both are elaborated in Appendix A, which however is limited to qualitative descriptions of terms such as “scale” and “scope”.²¹⁷ ESRS 1 thus gives little guidance on the exact limits of what constitutes material information. This is exacerbated by the fact businesses can report on an aggregated basis, which may obscure information: especially tail-risks or risks and impacts that only apply in relation to a specific site or asset of the business may seem immaterial when businesses aggregate information.²¹⁸ To prevent this, ESRS 1 prescribes that businesses must disaggregate the report by country or even by significant site or significant asset if aggregation could lead to obscuring material information or when material impacts, risks and opportunities are highly dependent on a specific location or asset.²¹⁹ The standard, however, fails to specify what “significant” sites, “significant” assets, or even the term “obscure” entails, again leaving room for interpretation.

Another notable weakness of the double materiality concept is the description of stakeholders to whom the information must be relevant. In principle, information that is not material to the stakeholders of the business must be omitted, whereas information that is material must be included – even when that information relates to facts or circumstances that are not listed in the ESRS.²²⁰ Surprisingly, “nature” may be considered a silent stakeholder but businesses are not obligated to take natural environments into account when conducting their materiality assessment.²²¹ As a matter of fact, all types of stakeholders that must be taken into account in order to determine whether an impact, risk or opportunity is material is of an anthropogenic nature.²²² This means that (negative) impacts on sustainability matters that lack any anthropogenic dimension – such as dumping waste in a desert – may be considered immaterial and thus need not be disclosed. This is surprising as limiting the minimum application of materiality to anthropogenic stakeholders is contradictory to the aims of the policy framework that the CSRD and the ESRS are part of, namely to promote a broader perspective on the interaction between mankind and nature.²²³ Moreover, various models for integrating “nature” as a stakeholder have been developed, for example as an inspiration,

216 ESRS 1 para. 51.

217 ESRS 1 Appendix A AR 9 – 15.

218 See: Bressan G., e.a., “Asset-level climate physical risk assessment is key for adaptation finance”, 2 November 2023, available on: https://papers.ssrn.com/sol3/papers.cfm?abstract_id=4062275, accessed on: 26 August 2023.

219 ESRS 1 para. 54.

220 ESRS 1 para. 11.

221 ESRS 1 Appendix A AR 7.

222 ESRS 1 para. 22.

223 One can also argue that the aims ultimate of the Paris Agreement, the EU Green Deal, and the EU SFF to limit global warming, to prevent pollution, to preserve biodiversity, etc., is to serve humans.

an advisor, a director, or a shareholder.²²⁴ This means that businesses can rely on various approaches to include nature as a stakeholder, which raises the question of the necessity of excluding nature as a stakeholder in the ESRS. The exclusion is also surprising in light of the materiality principle as one of the motivations of investors to invest sustainably, is to have a positive sustainability impact. For those investors, the nature perspective may be material.

There is one important exception to the materiality principle that applies throughout the ESRS: regardless of the outcome of the materiality assessment, the business must disclose its process for identifying and assessing material impacts, risks and opportunities (referred to as IRO-1) for all disclosure requirements in the topical ESRS that are jointly applicable with ESRS 2.²²⁵ ESRS 2 para. 53 describes what information must be included under IRO-1. For example, the business must disclose the methodologies and assumptions used in its materiality assessment, as well as a description of how it identifies, assesses and prioritises the business's impacts on people and the environment.²²⁶ The topical ESRS (to be applied in conjunction with IRO-1) contain additional disclosure requirements for the description of the process for the materiality assessment under the respective ESRS. For example, ESRS E1 on climate change requires that the business discloses the process to identify material impacts, risks and opportunities, which must include a description of how the business identifies climate-related physical and transition risks as well as the process of the business to identify the impact on climate change, including the undertaking's GHG emissions.²²⁷ These disclosure requirements are elaborated in Appendix A to ESRS E1, AR 10-16, which provides detailed guidance on what must be included in the process for the materiality assessment.

The materiality principle thus can be seen as a double-edged sword. On the one hand, it requires a high level of disclosure of all relevant information, on the other hand, it serves as a selection mechanism and may create opportunities for materiality-washing – the purposeful omission of information by designating it as immaterial. Whether the materiality principle is used to form a complete picture of the business's impacts, risks and opportunities or whether it is used to minimize disclosures will very much depend on the attitude of the business. The ESRS attempts to prevent the latter by excluding the process of the materiality assessment itself from any materiality rule so that businesses cannot conceal how they decided that certain information need not be dis-

224 An overview can be found in: Lambooy T., e.a., "Nature as a stakeholder: including nature in corporate governance practices to meet the EU corporate sustainability reporting directive", *Mednarodno inovativno poslovanje* 2024, vol. 12(2), p. 1.

225 ESRS 2 para. 2 (a); Herold C., Grottel G. & Klein L., "Die Wesentlichkeitsanalyse gemäß den European Sustainability Reporting Standards (ESRS)", *Zeitschrift für Internationale Rechtslegung* 2023, Heft 11, p. 459.

226 ESRS 2 para. 53.

227 ESRS E1 para. 20.

closed. Therefore, I conclude that the granular regulatory framework for the ESRS contains sufficient constraints to prevent businesses from hiding their negative sustainability impacts.

(ii) *Beyond a Binary Classification and (iii) Specific Materiality and Disclosure Standards*

In general, the ESRS is a qualitative reporting system that transcends a binary nature for determining whether a certain activity is sustainable or not – this would also not be in line with the aim of the CSRS/ESRS to provide comprehensive sustainability information. The topical ESRS contain specific disclosure standards and methodologies. However, as will also be discussed in the next section, the detailedness varies greatly between the topical standards. For example, there are a relatively high number of mandatory standards for the disclosure of GHG emissions in the topical standard on climate change.²²⁸ The standards on pollution and biodiversity are more open-ended and do not contain such a high level of mandatory methodologies. This, however, makes sense given that pollution and biodiversity loss can manifest themselves in much more diverse forms than GHG emissions, which requires a more flexible framework for disclosures. The ESRS thus seeks a balance between harmonized disclosures for areas in which this is possible and adaptive disclosure for more diverse sustainability impacts. Thereby, investors will receive harmonized – and thus comparable – information on topics that are easy to compare, and more individualized information on topics that will likely vary between businesses to start with.

4.3.1.2 *Quantitative Data*

The topical ESRS prescribe metrics to be used in the disclosure of quantitative data. These differ grossly between the topical ESRS. ESRS E1 on climate change contains more than thirty pages of guidance on quantitative data disclosure, including clearly delineated requirements such as to disclose in metric tons of CO₂ its scope 1, 2, and 3 emissions as well as its energy mix.²²⁹ This can be contrasted with the metrics and targets section for ESRS E4 on biodiversity, which covers nine pages with little guidance on what metrics to use exactly. An obvious explanation for the disparity in the level of detail between the different topical standards is that there is much more scientific knowledge and consensus on what metrics should be used to produce reliable quantitative data in relation to climate change than there exists in relation to some of the other reporting areas, such as biodiversity.²³⁰

228 ESRS E1-6; ESRS E1-5.

229 ESRS E1-6; ESRS E1-5.

230 See for example: Watson A.J., “Certainty and Uncertainty in Climate Change Predictions: What Use are Models?”, *Environmental and Resource Economics* 2008, vol. 39, p. 37;

Even where the ESRS do not prescribe what metrics to use, the business must disclose which metrics it chooses to rely on for its assessments.²³¹ The fact that the ESRS does not always prescribe what metrics exactly must be disclosed means that businesses can choose their own metrics. Obviously, this poses a certain risk to the integrity of the information disclosed. Two particular risks are 1) the obfuscation of material impacts and 2) a lack of comparability between businesses.

ESRS 2 para. 5 point 77 prescribes a number of safeguards to prevent the disclosure of meaningless or confounding metrics. A business always has to:

- a) disclose the methodologies and significant assumptions behind the metric, including the limitations of the methodologies used;
- b) disclose whether the measurement of the metric is validated by an external body other than the assurance provider and, if so, which body;
- c) label and define the metric using meaningful, clear and precise names and descriptions;
- e) when currency is specified as the unit of measure, use the presentation currency of its financial statements.²³²

Moreover, if a business is to ascertain certain impacts, it may rely on reasonable assumptions and estimates such as sector averages, as long as the use of assumptions and estimates does not undermine the usefulness of the information.²³³

It can, therefore, be concluded that, in general, the ESRS prescribes the disclosure of impacts through quantitative metrics. These methodologies to establish the metrics are mandatory for areas of high scientific consensus, in other areas, the ESRS allow businesses discretion in selecting methodologies or relying on reasonable assumptions and sector averages. The safeguards contained in ESRS 2 para. 5 point 77 functions as a safeguard against the obfuscation of information, and ensures that the user of the information has enough contextual information to interpret the disclosures. This, however, does not address the comparability problem between businesses. However, given the lack of scientific consensus on methodologies in combination with the wide variety of impacts for certain reporting areas, it is both pragmatic and justified to leave room for the business to employ the methodologies that best fit their specific circumstances.

Thuiller W., e.a., "Uncertainty in ensembles of global biodiversity scenarios", *Nature Communications* 2019, vol. 10, 1446.

231 ESRS 2 para. 75, 77.

232 ESRS 2 para. 5 point 77.

233 ESRS 1, para. 87-89.

4.3.2 Coherent

In paragraph 2, I set out the criterion for coherence: whether the core terminology and concepts are defined and used coherently throughout the legislation. Additionally, I assess whether a monetary metric is assigned to sustainability information that is disclosed under both sides of the double materiality regime.

4.3.2.1 Terminology and Concepts

The ESRS contain two cross-cutting standards: ESRS 1 contains general concepts and principles that apply throughout the ESRS framework, whereas ESRS 2 contains general disclosures that the business must make in conjunction with the relevant disclosure requirements under the topical standards. The use of these two cross-cutting standards that apply in conjunction with the topical and sectoral standards, creates coherency throughout the reporting standards. Moreover, the topical standards are all generally structured along the same lines:

- Objectives
- Interaction with other ESRS
- Disclosure requirements
- ESRS 2 General disclosures
- Impact, risk and opportunity management
- Metrics and targets
- Appendix A
- ESRS 2 General disclosures
- Impact, risk and opportunity management
- Metrics and targets

In addition, terms that are defined are printed in bold italics, signalling to the reader that the term is harmonized throughout the standards and can be found in Annex II (Acronyms and glossary of terms).²³⁴ However, not all definitions that are used in the ESRS are equally meaningful. One important definition for which this may be the case is the definition of the term value chain. As businesses must report data on their value chain, the exact demarcation of the term must be set out clearly. The current definition is:

“The full range of activities, resources and relationships related to the undertaking’s business model and the external environment in which it operates.

A value chain encompasses the activities, resources and relationships the undertaking uses and relies on to create its products or services from conception to delivery, consumption and end-of-life. Relevant activities, resources and relationships include:

- a) those in the undertaking’s own operations, such as human resources;

234 ESRS Annex II.

- b) those along its supply, marketing and distribution channels, such as materials and service sourcing and product and service sale and delivery; and
- c) the financing, geographical, geopolitical and regulatory environments in which the undertaking operates.

Value chain includes actors upstream and downstream from the undertaking. Actors upstream from the undertaking (e.g., suppliers) provide products or services that are used in the development of the undertaking's products or services. Entities downstream from the undertaking (e.g., distributors, customers) receive products or services from the undertaking.²³⁵

Although this definition certainly provides guidance, it does not contain clear demarcations: terms such as “related to the undertaking’s business model” are vague and the use of the word “includes” suggests a non-limitative listing, leaving room for interpretation. Important questions such as how deep or extensive the value chain should be interpreted are simply not addressed.²³⁶ As already discussed in the previous paragraph on completeness, the same problem applies in the context of the definition of materiality, the exact interpretation of which will ultimately depend on the business applying the concept, and the circumstances under which a business is allowed to disclose information on an aggregated basis.²³⁷ That central terms such as “value chain” and “materiality” contain a certain level of ambiguity has also been signalled by numerous respondents to the public consultation on the draft ESRS by the Commission in the feedback period 9 June – 7 July 2023 and has not been resolved in the final rendering of the ESRS.²³⁸ These types of am-

235 ESRS Annex II.

236 Institut der Wirtschaftsprüfer in Deutschland, Feedback on Draft delegated regulation – Ares(2023)4009405 (Draft ESRS), Feedback reference F3429908, submitted on 7 July 2023, p. 5, available at: https://ec.europa.eu/info/law/better-regulation/have-your-say/initiatives/13765-European-sustainability-reporting-standards-first-set/F3429908_en, accessed on: 3 August 2023; KPMG, Feedback on Draft delegated regulation – Ares(2023)4009405 (Draft ESRS), Feedback reference F3429737, submitted on 7 July 2023, p. 6, available at: https://ec.europa.eu/info/law/better-regulation/have-your-say/initiatives/13765-European-sustainability-reporting-standards-first-set/F3429737_en, accessed on: 3 August 2023. See also: French Banking Federation, Feedback on Draft delegated regulation – Ares(2023)4009405 (Draft ESRS), Feedback reference F3430035, submitted on 7 July 2023, p. 4, available at: https://ec.europa.eu/info/law/better-regulation/have-your-say/initiatives/13765-European-sustainability-reporting-standards-first-set/F3430035_en, accessed on: 3 August 2023; European Banking Federation, Feedback on Draft delegated regulation – Ares(2023)4009405 (Draft ESRS), Feedback reference F3429751, submitted on 7 July 2023, p. 6 available at: https://ec.europa.eu/info/law/better-regulation/have-your-say/initiatives/13765-European-sustainability-reporting-standards-first-set/F3429751_en, access on: 3 August 2023.

237 See paragraph 4.3.1 of this Chapter.

238 For comments on “value chain”, see *inter alia*: Institut der Wirtschaftsprüfer in Deutschland, Feedback on Draft delegated regulation – Ares(2023)4009405 (Draft ESRS), Feedback reference F3429908, submitted on 7 July 2023, p. 5, available at: https://ec.europa.eu/info/law/better-regulation/have-your-say/initiatives/13765-European-sustainability-reporting-standards-first-set/F3429908_en, accessed on: 3 August 2023; KPMG, Feedback on Draft delegated regulation – Ares(2023)4009405 (Draft ESRS), Feedback reference F3429737,

biguities can potentially undermine one of the central aims of the CSRD, namely the comparability of sustainability information across and within market sectors.²³⁹ Whereas there thus is a distinct strive for coherency throughout the standards, the ambiguity of some of the definitions potentially weakens the coherency of the ESRS.

The question that arises, is whether it is desirable to formulate a more closed definition of both terms. As discussed in para. 2.1.1, materiality is by its nature an elusive concept, as it requires a business to anticipate the information needs of the user. Not only can these needs never be fully known, but they are also dependent on the context. Similarly, the concept of value chains may not be suitable for clear demarcation lines. Given these issues, the elabor-

submitted on 7 July 2023, p. 6, available at: https://ec.europa.eu/info/law/better-regulation/have-your-say/initiatives/13765-European-sustainability-reporting-standards-first-set/F3429737_en, accessed on: 3 August 2023. See also: French Banking Federation, Feedback on Draft delegated regulation – Ares(2023)4009405 (Draft ESRS), Feedback reference F3430035, submitted on 7 July 2023, p. 4, available at: https://ec.europa.eu/info/law/better-regulation/have-your-say/initiatives/13765-European-sustainability-reporting-standards-first-set/F3430035_en, accessed on: 3 August 2023; European Banking Federation, Feedback on Draft delegated regulation – Ares(2023)4009405 (Draft ESRS), Feedback reference F3429751, submitted on 7 July 2023, p. 6, available at: https://ec.europa.eu/info/law/better-regulation/have-your-say/initiatives/13765-European-sustainability-reporting-standards-first-set/F3429751_en, access on: 3 August 2023.

For comments on “materiality”, see inter alia:

Institut der Wirtschaftsprüfer in Deutschland, Feedback on Draft delegated regulation – Ares(2023)4009405 (Draft ESRS), Feedback reference F3429908, submitted on 7 July 2023, p. 6, available at: https://ec.europa.eu/info/law/better-regulation/have-your-say/initiatives/13765-European-sustainability-reporting-standards-first-set/F3429908_en, accessed on: 3 August 2023; French Banking Federation, Feedback on Draft delegated regulation – Ares(2023)4009405 (Draft ESRS), Feedback reference F3430035, submitted on 7 July 2023, p. 5-6, available at: https://ec.europa.eu/info/law/better-regulation/have-your-say/initiatives/13765-European-sustainability-reporting-standards-first-set/F3430035_en, accessed on: 3 August 2023; European Banking Federation, Feedback on Draft delegated regulation – Ares(2023)4009405 (Draft ESRS), Feedback reference F3429751, submitted on 7 July 2023, p. 6, available at: https://ec.europa.eu/info/law/better-regulation/have-your-say/initiatives/13765-European-sustainability-reporting-standards-first-set/F3429751_en, access on: 3 August 2023. Government of the Netherlands, Feedback on Draft delegated regulation – Ares(2023)4009405 (Draft ESRS), Feedback reference F3430010, submitted on 7 July 2023, p. 1, available at: https://ec.europa.eu/info/law/better-regulation/have-your-say/initiatives/13765-European-sustainability-reporting-standards-first-set/F3430010_en, visited on 3 August 2023; EY Europe LLP, Feedback on Draft delegated regulation – Ares(2023)4009405 (Draft ESRS), Feedback reference F3429805, submitted on 7 July 2023, p. 2-3, available at: https://ec.europa.eu/info/law/better-regulation/have-your-say/initiatives/13765-European-sustainability-reporting-standards-first-set/F3429805_en, visited on 3 August 2023; European Banking Federation, Feedback on Draft delegated regulation – Ares(2023)4009405 (Draft ESRS), Feedback reference F3429751, submitted on 7 July 2023, p. 5, available at: https://ec.europa.eu/info/law/better-regulation/have-your-say/initiatives/13765-European-sustainability-reporting-standards-first-set/F3429751_en, visited on 3 August 2023.

239 Recital 9 CSRD.

ate guidelines in the ESRS should provide guidance but ultimately leave the exact scope of these concepts to the business.

4.3.1.2 *Expressing Impacts, Risks and Opportunities in Monetary Terms*

The ESRS require businesses to report both material sustainability-related impacts of the business (impact materiality) and material sustainability-related risks and opportunities (financial materiality), as previously discussed.²⁴⁰ As the latter concept revolves around the financial effects that sustainability matters may have on the firm, risks and opportunities are expressed in monetary terms: businesses must disclose *inter alia* the influence of material risks and opportunities on the business's cash flow, financial performance, and financial position.²⁴¹

There is no general requirement to value the sustainability-related impacts of the business in monetary terms. ESRS E1 on climate change mitigation and adaptation contains the obligation to disclose whether the business applies a (voluntary) internal carbon pricing scheme.²⁴² If a business applies such a scheme, it should disclose among other things the assumptions to determine the price and how the scheme relates to scope 1, 2, and 3 emissions.²⁴³ It should also disclose how the carbon prices and their use relate to the financial statement of the business.²⁴⁴ This means that the vast majority of impacts of the business on sustainability matters are not priced.

4.3.3 *Accurate*

In paragraph 2, I set out that I evaluate accuracy by assessing whether the qualification of a financial product as sustainable is either (a) based on the Taxonomy Regulation or (b) warranted by procedural safeguards that ensure the qualification is supported by scientific evidence. These criteria cannot be applied in the context of the ESRS as the purpose of those standards is not to determine whether a financial product – or a business or an economic activity – is sustainable. Nonetheless, it is obviously still imperative that the information to be disclosed under the ESRS be accurate and reliable.²⁴⁵ For this, the qualitative safeguards and the external auditing of the sustainability report play a central role.

240 Paragraph 4.3.1 of this Chapter.

241 ESRS 2 para. 48. Also: ESRS E1 para. 64 ff.

242 ESRS E1 para. 62.

243 ESRS E1 para. 63.

244 ESRS E1 Appendix A AR 65.

245 See also: Financial Stability Board, "Report on Promoting Climate-Related Disclosures", *Financial Stability Board* 7 July 2021, p. 39-40.

4.3.3.1 Qualitative Safeguards

ESRS 1 sets out rules on the qualitative baseline that the disclosures must meet.²⁴⁶ These consist of five key characteristics: relevance, faithful representation, comparability, verifiability, and understandability. For each of these characteristics, ESRS 1 formulates guidance in Appendix B. For example, faithful representation means that the information must be complete, neutral, and free from error, whereas verifiability means that external knowledgeable and independent observers should be able to confirm the truthfulness of the information.²⁴⁷ Although defining these characteristics should contribute to safeguarding the integrity of the information disclosed under the ESRS, these rules suffer from a similar problem as discussed above in relation to ‘value chain’ and ‘materiality’. Terms such as ‘neutral’ and ‘relevant’ are not unambiguous and thus can only guarantee the reliability of the information to a certain extent.

4.3.3.2 Verification and Auditing

The ESRS fall under the auditing and assurance regime that is set out in the CSRD, as discussed in para. 3.11.3 of this Chapter. The verification and auditing of the sustainability report may pose a number of challenges. Firstly, there may be logistical challenges for auditors as ESRS require know-how that must be quickly developed within a limited time.²⁴⁸ Secondly, the lack of precise descriptions of some of the key concepts such as ‘materiality’ and ‘value chain’ may be challenging for auditors when determining whether they have been properly complied with.²⁴⁹ Thirdly, the fact that some ESRS leave it to the business to decide by which metric to report means that auditors not only have to check whether the reporting on that metric is accurate but also whether the metric is appropriate in the first place.²⁵⁰ Lastly, the complex and detailed regulation both increases the likelihood of errors by those who must comply with it and can increase regulatory arbitrage.²⁵¹

246 ESRS 1 para. 19-20 and ESRS 1 Appendix B.

247 ESRS 1 Appendix B QC 5 and QC 14.

248 Bos D.E., “Zekerheid en onzekerheid: Onafhankelijkheid van externe accountants bij de voorbereiding op verplichte duurzaamheidsrapportage”, *Tijdschrift voor Jaarrekeningenrecht* 2023, nr. 5/6, p. 145; Kamp-Roelands A.E.M., “Assurance bij duurzaamheidsinformatie. Wat betekent dit voor ondernemingen?”, *Tijdschrift voor Financieel Recht* 2021, nr. 8/9, p. 286; Velte P., “Prüfung von Nachhaltigkeitsberichten nach der Corporate Sustainability Reporting Directive (CSRD) durch den Wirtschaftsprüfer – Fluch oder Segen?” *Schmalenbach IMPULSE* 2023, vol. 3(1), p. 1.

249 Paragraph 4.3.1 under ‘Qualitative disclosures and the concept of materiality’ and paragraph 4.3.2 under ‘Terminology and concepts’ of this Chapter.

250 Paragraph 4.3.1 under ‘Quantitative data’ of this Chapter.

251 See also on complex regulation: Haldane A.G., “The dog and the frisbee”, speech at Jackson Hole Symposium on 31 August 2012, p. 14, available at: <https://www.bis.org/review/r120905a.pdf>, accessed on: 7 July 2023; Fleisher V., “Regulatory Arbitrage”, *Texas Law Review* 2010, vol. 89(2), p. 227.

4.4 Conclusion

The ESRS give substance to the framework for sustainability reporting set out in the CSRD by introducing granular reporting requirements. The standards demand qualitative and quantitative disclosures, as well as disclosure of the methodologies used to measure certain outcomes – and meet the standard of completeness set out at the beginning of this chapter. The structure used throughout the ESRS – with two general standards that apply throughout the topical standards – and the clear signalling of defined terms (in bold italics) make for a coherent framework and accessible reading of the standards, regardless of their extensive size (almost 300 pages). The ESRS thus form an impressive step toward sustainability reporting that is on par with financial reporting and can only be seen as greatly contributing to the reduction of information asymmetries.

A few critical notes must be made. Firstly, the ESRS contain open norms. The most important one is “materiality”, which is decisive for whether or not information must be disclosed, and which is not defined in an absolute manner. This can potentially undermine the comparability of sustainability information and carries the risk of materiality washing – not reporting certain impacts or risks by designating them as immaterial. Whereas these are real risks, it is nonetheless not desirable to formulate an absolute definition: whether a certain matter is material depends heavily on the circumstances, warranting a flexible approach. An open-ended norm thus is pragmatic and justifiable.

The second point of critique is that the ESRS does not make “nature” a mandatory stakeholder in the materiality analysis. Consequently, if a certain impact has no anthropogenic consequences, it need not be considered material even if the consequences for nature are dire. This is directly contradictory to the aim of disclosing impacts on sustainability matters which include environmental factors.²⁵² To fulfil the objective of the CSRD, it thus would make sense to include nature as a mandatory stakeholder.

The third point of critique is that the ESRS, in line with the CSRD, do not make it mandatory to quantify impacts in monetary terms. From an L&E perspective, it is important to gain an understanding of all costs and benefits of actions of a business, not only of the costs and benefits for the business itself. Whereas the CSRD lays down that the Commission, in the adoption of the ESRS, should take into account existing standards and frameworks for natural capital accounting and for greenhouse gas accounting, the ESRS only contain a small section about the disclosure of voluntary internal carbon pricing schemes.²⁵³ This means that the users of sustainability reports are presented with incoherent information: whereas they may get a good picture of the costs and benefits of the business, they are not informed of the costs and benefits

252 Article 2 (17) CSRD.

253 Article 29b (5) (a) CSRD; ESRS E1 para. 62 – 63.

that the business imposes on society in financial terms. This makes it difficult to assess whether an investment is efficient from a societal perspective.

Lastly, it should be noted that the sheer length and complexity of the ESRS may give rise to problems of lack of expertise, especially during the first years after its entry into application. Sustainability reporting and assurance will impose high costs on businesses, especially when the processes for gathering the information have to be designed for the first time. One risk that follows from this is regulatory arbitrage, such as moving to a non-EU jurisdiction or exploiting loopholes such as materiality washing.

5 ARTICLE 8 TAXONOMY REGULATION

5.1 Introduction

Businesses that have to make public an annual sustainability report pursuant to the CSRD, not only must draw up their disclosures in line with the ESRS but also must include in their report how and to what extent their activities relate to the classification system for environmentally sustainable activities under the Taxonomy Regulation.²⁵⁴ Specifically, article 8 TR requires that businesses subject to the CSRD disclose what proportion of their turnover, capital expenditure, and operating expenditure is derived from or related to environmentally sustainable activities in the sense of articles 3 and 9 TR.²⁵⁵ To comply with this obligation, the business must first establish which of its activities qualify as environmentally sustainable in the sense of the Regulation (para. 5.2). Subsequently, the business must communicate this information in accordance with the prescribed standards (para. 5.3).

5.2 Is the activity Taxonomy-aligned?

In order to assess what proportion of its activities is Taxonomy-aligned, a business must determine to what extent its activities meet the criteria set out in article 3 TR.²⁵⁶ Article 3 TR lists the four core criteria for qualifying as 'environmentally sustainable economic activities' (sub a and d overlap):

254 Article 8 TR.

255 Article 8 (2) TR; Kröner-Rosmalen S., "De taxonomieverordening", in: Strijbos F.P.C., e.a. (eds.), *Duurzaam bankieren*, Wolters Kluwer 2023, p. 30; Partiti E., "Green asset ratio and taxonomy disclosures for credit institutions", in: Strijbos F.P.C., e.a. (eds.), *Duurzaam bankieren*, Wolters Kluwer 2023, p. 123.

256 Zukas T., *Regulating Sustainable Finance in Europe*, Duncker & Humblot 2024, p. 52-55; Poulle J.-B., e.a., *EU Banking and Financial Regulation*, Edgar Elgar 2024, p. 634-642; Oliveira Neves

- a) Contribute to one or more environmental objectives set out in article 9 TR in accordance with articles 10-16 TR, including the technical screening criteria (“TSC”) based thereupon;
- b) Do no significant harm (“DNSH”) to any of the environmental objectives;
- c) Respect minimum safeguards on human and workers’ rights (art. 18 TR);
- d) Comply with technical screening criteria that have been established by the Commission in accordance with Article 10(3), 11(3), 12(2), 13(2), 14(2) or 15(2) TR.

5.2.1 Contribute to One or More Environmental Objectives

5.2.1.1 Level 1

Article 9 TR contains six environmental objectives:

- a) climate change mitigation;
- b) climate change adaptation;
- c) the sustainable use and protection of water and marine resources;
- d) transition to a circular economy;
- e) pollution prevention and control;
- f) the protection and restoration of biodiversity and ecosystems.

The objectives of article 9 TR are further specified in the subsequent articles 10-15 TR. All of these articles follow a similar structure. First, a general definition is provided in paragraph 1:

“An economic activity shall qualify as contributing **substantially** to climate change mitigation where that activity contributes substantially to the stabilization of greenhouse gas concentrations in the atmosphere...”; “An economic activity shall qualify as contributing **substantially** to climate change adaptation where that activity: (a) includes adaptation solutions that either **substantially** reduce the risk of the adverse impact of the current climate and the expected future climate on that economic activity or **substantially** reduce that adverse impact, ...”; etcetera [emphasis added].²⁵⁷

These definitions are relatively broadly formulated and do not provide definite criteria to determine whether or not a specific activity qualifies as significantly contributing to the respective environmental objectives from article 9 TR. For this, each of the articles 10-15 TR instruct the Commission to draft technical

R. de, “The EU Taxonomy Regulation and Its Implications for Companies”, in: Câmara P. & Morais F. (eds.), *The Palgrave Handbook of ESG and Corporate Governance*, Palgrave 2022, p. 249-265; Oostrum C.H.A. van, “Groene begripsverwarring: de Taxonomieverordening nader onderzocht”, *Ondernemingsrecht* 2020/131, afl. 13/14, p. 745; Gruijters R.J., “De Europese Taxonomieverordening”, *Maandblad voor Ondernemingsrecht* 2020, nr. 10/11, p. 297.
 257 Article 10 (1) and 11 (1) TR respectively.

screening criteria to determine which economic activity qualifies as contributing substantially to the relevant environmental objectives.²⁵⁸

5.2.1.2 Level 2

The TSC have been divided into two delegated acts:

1. The Climate Delegated Act (CDR (EU) 2021/2139),²⁵⁹ which is complemented by the Complementary Climate Delegated Act (CDR (EU) 2022/1214)²⁶⁰ and amended by CDR 2023/2485.²⁶¹
2. The Environmental Delegated Act (CDR (EU) 2023/2486).²⁶²

The Climate Delegated Act covers the first two objectives of article 9 TR: climate change mitigation and climate change adaptation. The Environmental Delegate Act covers the other four objectives: the sustainable use and protection of water and marine resources, the transition to a circular economy, pollution prevention and control, and the protection and restoration of biodiversity and ecosystems.²⁶³ Within the Delegated Acts, the economic activities are categorized in accordance with the NACE-code system – an EU classification

258 Article 10 (3), 11 (3), 12 (2), 13 (2), 14 (2) and 15(2) TR.

259 Commission Delegated Regulation (EU) 2021/2139 of 4 June 2021 supplementing Regulation (EU) 2020/852 of the European Parliament and of the Council by establishing the technical screening criteria for determining the conditions under which an economic activity qualifies as contributing substantially to climate change mitigation or climate change adaptation and for determining whether that economic activity causes no significant harm to any of the other environmental objectives.

260 Commission Delegated Regulation (EU) 2022/1214 of 9 March 2022 amending Delegated Regulation (EU) 2021/2139 as regards economic activities in certain energy sectors and Delegated Regulation (EU) 2021/2178 as regards specific public disclosures for those economic activities.

261 Commission Delegated Regulation (EU) 2023/2485 of 27 June 2023 amending Delegated Regulation (EU) 2021/2139 establishing additional technical screening criteria for determining the conditions under which certain economic activities qualify as contributing substantially to climate change mitigation or climate change adaptation and for determining whether those activities cause no significant harm to any of the other environmental objectives.

262 Commission Delegated Regulation (EU) 2023/2486 of 27 June 2023 supplementing Regulation (EU) 2020/852 of the European Parliament and of the Council by establishing the technical screening criteria for determining the conditions under which an economic activity qualifies as contributing substantially to the sustainable use and protection of water and marine resources, to the transition to a circular economy, to pollution prevention and control, or to the protection and restoration of biodiversity and ecosystems and for determining whether that economic activity causes no significant harm to any of the other environmental objectives and amending Commission Delegated Regulation (EU) 2021/2178 as regards specific public disclosures for those economic activities.

263 Articles 1-4 CDR (EU) 2021/2139.

system for economic activities, the current version of which was established in 2006.²⁶⁴

Per activity, the TSC contain first a description of the activity including the NACE codes that the activity is associated with. For example, the activity “Acquisition and ownership of buildings” in the Climate Delegated Act is described as “Buying real estate and exercising ownership of that real estate” and can be associated with NACE code L68.²⁶⁵ This is followed by the criteria for substantially contributing to the applicable environmental objective. For “Acquisition and ownership of buildings”, with respect to the objective of climate change mitigation, this includes (but is not limited to) that a building built before 31 December 2020 has an Energy Performance Certificate class A.²⁶⁶ Lastly, the DNSH-criteria are listed for the relevant economic activity. Note that only some activities have specific DNSH-criteria – more often, the ‘generic criteria for DNSH’ listed in Appendices A-E have to be complied with.

Note that according to article 3 (a) TR, the environmental objectives from article 9 TR need to be complied with in accordance with articles 10-16 TR. Whereas articles 10-15 TR, as just discussed, expand on the various environmental objectives of article 9 TR, article 16 TR introduces an altogether different category of Taxonomy-aligned activities: enabling activities. An enabling economic activity qualifies as Taxonomy-aligned in the sense of article 3 (a) TR if it directly enables one of the activities under articles 10-15 TR, and fulfils two additional criteria from article 16 (a) and (b) TR. First, the enabling activity may not lead to a lock-in of assets that undermine long-term environmental goals. Second, the activity must have a positive environmental impact.

5.2.2 *Do No Significant Harm*

Next to qualifying as an activity that significantly contributes to the respective environmental objectives from article 9 TR, the activity may not do significant harm to any of the other environmental objectives.²⁶⁷ Article 17 TR provides general descriptions of significant harm in respect of the six environmental objectives: “**significant** greenhouse gas emissions”; “**increased** adverse impact”; “detrimental to the **good** status”; “**significant** inefficiencies”; “**significant** long-term harm”; etcetera [emphasis added].²⁶⁸ The TR does not define what is

264 Regulation (EC) No 1893/2006 of the European Parliament and of the Council of 20 December 2006 establishing the statistical classification of economic activities NACE Revision 2 and amending Council Regulation (EEC) No 3037/90 as well as certain EC Regulations on specific statistical domains.

265 Point 7.7 of Annex I CDR 2021/2139.

266 Point 7.7 of Annex I CDR 2021/2139.

267 Article 3 and 9 and 17 TR; Kröner-Rosmalen S., “De taxonomieverordening”, in: Strijbos F.P.C., e.a. (eds.), *Duurzaam bankieren*, Wolters Kluwer 2023, p. 42.

268 Article 17 (1) (a)-(d) TR.

meant by the term “significant”. Instead, the Commission is instructed to adopt a delegated act to: “supplement Article 17 by establishing, for each relevant environmental objective, technical screening criteria for determining whether an economic activity in respect of which technical screening criteria have been established pursuant to point (a) of this paragraph causes significant harm to one or more of those objectives.”²⁶⁹ The Commission has given effect to this by including the DNSH criteria along with the specific requirements for activities that qualify as environmentally sustainable in the TSC.²⁷⁰

5.2.3 Example

To illustrate the process of determining whether an activity is Taxonomy-aligned, I analyse the qualification of the production of electricity by burning fossil gas. To qualify as an environmentally sustainable economic activity, article 3 TR must be fulfilled.

First, according to article 3 (a) and (d) TR, electricity production by burning fossil gas must contribute to one of the environmental objectives from article 9 TR. Both (a) climate change mitigation and (b) climate change adaptation seem a potential match. These two objectives are further outlined in articles 10 and 11 TR respectively. As these two articles have a similar structure, I limit myself to article 10 TR. According to article 10 TR, in order to qualify under article 3 and 9 (a) TR, the activity must substantially contribute “to the stabilization of greenhouse gas concentrations in the atmosphere at a level which prevents dangerous anthropogenic interference with the climate system (...) through the avoidance or reduction of greenhouse gas (...)”.²⁷¹ The article goes on to the list activities by which this stabilization of greenhouse gas is to be reached. For the production of electricity by burning fossil gas, that could be (b) “improving energy efficiency, except for power generation activities as referred to in Article 19 (3)”. Article 19 (3) excludes power generation using solid fossil fuels from qualifying as environmentally sustainable economic activities. Fossil gas thus is not excluded. On the basis of the Taxonomy Regulation, producing electricity by burning fossil gas therefore could qualify as a climate change mitigation – and thus as a Taxonomy-aligned activity. Further, the activity must fulfil the requirements that supplement article 10 TR, set out in the Climate Delegated Act CDR 2021/1214.²⁷² Point 4.29 sets

269 Article 10 (3), 11 (3), 12 (2), 13 (2), 14 (2) and 15 (2) TR respectively, under (b).

270 CDR 2021/2139; CDR 2022/1214; CDR 2023/2485; CDR 2023/2486.

271 Article 10 (1) TR.

272 Critique on the choice to include nuclear and fossil gas in the TSC can be found in: Fouquet D., “Taxonomy for Sustainable Finance: A Difficult Topic for Europe, a Worrying Development for Our Democratic Principles”, *Renewable Energy Law and Policy Review* 2022, vol. 11(1), p. 5; Fouquet D., “The Healing Force of Renewables Calls for a Nuclear Free Taxonomy in Times of Aggression.” *Renewable Energy Law and Policy Review* 2022, vol. 10(3/4), 2022, p. 1; CJEU, Action brought on 7 October 2022, T-625/22, (Austria v European Commis-

out the criteria under which burning fossil gas can qualify as Taxonomy-aligned.²⁷³ These include emission thresholds, but also requirements pertaining to the purpose of the firm, for example, that it replaces high electricity production from solid or liquid fossil fuels and that it is designed and constructed to use renewable or low-carbon gaseous fuels to which it will switch in the future.²⁷⁴ Moreover, there are rules on independent verification by a third party.

Second, according to article 3 (b) TR, activity must also meet the DNSH criteria in order to satisfy article 3 (b) TR. The last part of point 4.29 of the CDR 2021/1214 contains a schedule setting out the criteria for the DNHS test that applies to the activity of electricity generation from fossil gaseous fuels – in which reference is made to the standards contained in the appendices of Annex I of CDR 2021/2139, which contain qualitative criteria and threshold values.

Third and last, to satisfy article 3 (c) TR, the activity must meet the minimum safeguards set out in article 18 TR: the activity must be aligned with the OECD Guidelines for Multinational Enterprises and the UN Guiding Principles on Business and Human Rights, the Declaration of the International Labour Organisation on Fundamental Principles and Rights at Work, and the International Bill of Human Rights.

5.3 What Must Be Communicated in the Annual Accounts?

Once the business has established which of its activities are environmentally sustainable economic activities in the sense of article 3 TR, it must disclose this in its annual accounts. These disclosures are primarily regulated by article 8 TR. Article 8 requires disclosure of:

- How the business’s activities are associated with article 3 TR activities;²⁷⁵
- To what extent the business engages in article 3 TR activities,²⁷⁶ which is to be expressed in three key performance indicators (“KPI”):
- The proportion of turnover derived from 3 TR activities (turnover KPI);

sion); Letter from Minister for Climate and Energy for the Netherlands, Federal Minister for Climate Action, Environment, Energy, Mobility, Innovation and Technology for Austria, Minister for Energy and Digital Development for Sweden, Minister for Climate, Energy and Utilities for Denmark, “Statement fossil gas-based activities in the EU Taxonomy”, 31 January 2022, available at: <https://www.government.nl/documents/letters/2022/01/31/statement-fossil-gas-based-activities-in-the-eu-taxonomy>, accessed on: 25 January 2025.

273 Under either 1 (a) or (b) of point 4.29 Technical screening criteria 1 (b) CDR 2021/1214.

274 Point 4.29 Technical screening criteria 1 (b) CDR 2021/1214 amendments.

275 Article 8 (1) TR.

276 Article 8 (1) TR.

- The proportion of capital expenditure related to 3 TR (CapEx KPI);
- The proportion of operating expenditure related to 3 TR (OpEx KPI).²⁷⁷

5.3.1 Commission Delegated Regulation 2021/2178

CDR 2021/2178 further sets out the content and presentation of the disclosures that have to be made pursuant to article 8 TR, including the methodology to generate the information.²⁷⁸ To fulfil the disclosure requirement of article 8 TR a business must identify all its economic activities, and categorize them.²⁷⁹ Based on Annex I point 2 (a) and (d) CDR 2021/2178, the following categorisation seems most sensible: first, identify all economic activities that the business employs along the lines of the NACE-code categorisation. Then divide these activities into two groups: those that are Taxonomy-aligned, and those which are not. The Taxonomy-aligned activities then must be subdivided into: (1) ‘normal’ Taxonomy-aligned activities; (2) enabling activities; and (3) transitional activities. When making this categorisation, businesses must describe how these activities comply with 3 TR.²⁸⁰ For this, the CDR 2021/2178 introduces definitions that are relevant to the Taxonomy Regulation as a whole, though not contained in the TR itself. These include:

- “(2) ‘Taxonomy-aligned economic activity’ means an economic activity that complies with the requirements laid down in Article 3 of Regulation (EU) 2020/852;
- (3) ‘transitional economic activity’ means an economic activity that complies with the requirements laid down in Article 10(2) of Regulation (EU) 2020/852;
- (4) ‘enabling economic activity’ means an economic activity that complies with the requirements laid down in Article 16 of Regulation (EU) 2020/852;
- (5) ‘taxonomy-eligible economic activity’ means an economic activity that is described in the delegated acts adopted pursuant to Article 10(3), Article 11(3), Article 12(2), Article 13(2), Article 14(2), and Article 15(2), of Regulation (EU) 2020/852, irrespective of whether that economic activity meets any or all of the technical screening criteria laid down in those delegated acts;
- (6) ‘taxonomy-non-eligible economic activity’ means any economic activity that is not described in the delegated acts adopted pursuant to Article 10(3), Article 11(3), Article 12(2), Article 13(2), Article 14(2) and Article 15(2), of Regulation (EU) 2020/852;”

²⁷⁷ Article 8 (2) (a) – (b) TR.

²⁷⁸ Commission Delegated Regulation (EU) 2021/2178 of 6 July 2021 supplementing Regulation (EU) 2020/852 of the European Parliament and of the Council by specifying the content and presentation of information to be disclosed by undertakings subject to Articles 19a and 29a of Directive 2013/34/EU concerning environmentally sustainable economic activities, and specifying the methodology to comply with that disclosure obligation.

²⁷⁹ Annex I point 2 (a) and (d) CDR 2021/2178.

²⁸⁰ Annex I point 1.2.2.1 (a) and (b) CDR 2021/2178.

Once the business has categorised all its activities, it can calculate the three KPIs which have to be disclosed.

5.3.2 Turnover KPI

The turnover KPI provides information on the percentage of the business's turnover, or revenue, that is derived from Taxonomy-aligned activities. This KPI thus contains information on the proportion of money the business is making through Taxonomy-aligned activities.²⁸¹ The turnover KPI is calculated by dividing the net turnover derived from Taxonomy-aligned activities by the total net turnover.²⁸² The net turnover derived from Taxonomy-aligned activities is defined as: "the part of the net turnover derived from products or services, including intangibles, associated with Taxonomy-aligned economic activities."²⁸³ However, the second paragraph excludes from this numerator:

"the part of the net turnover derived from products and services associated with economic activities that have been adapted to climate change in line with Article 11 (1), point (a) of Regulation (EU) 2020/852 and in accordance with Annex II to Delegated Regulation (EU) 2021/2139, unless those activities:

- (a) qualify as enabling activities in accordance with Article 11(1), point (b) of Regulation (EU) 2020/852; or
- (b) are themselves Taxonomy-aligned."²⁸⁴

This exclusion is puzzling. Article 11 (1), point (a) TR contains a description of climate change adaptation activities, which are elaborated in Annex II of CDR 2021/2139 by virtue of article 11 (3) TR. Any activity that qualifies under article 11 (1), point (a), is an activity that is Taxonomy-aligned. These activities thus are first excluded from the net turnover derived from Taxonomy-aligned activities, only to be included again in the net turnover derived from Taxonomy aligned activities under (b). This part of the exclusion thus seems self-defeating and obsolete.

5.3.2 CapEx and OpEx KPI

The CapEx and OpEx provide information on the proportion that the business is spending on Taxonomy-aligned activities. The Capital Expenditure KPI focuses on spending on tangible and intangible assets of the business – it thus

281 Note that special rules apply for financial businesses, see: article 3-7 CDR 2021/2178.

282 Annex I point 1.1.1. CDR 2021/2178. The net turnover is based on the definition from the Accounting Directive: "the amounts derived from the sale of products and the provision of services after deducting sales rebates and value added tax and other taxes directly linked to turnover" and calculated in accordance with the relevant IAS standards.

283 Annex I point 1.1.1. CDR 2021/2178.

284 Annex I point 1.1.1. CDR 2021/2178.

gives a picture of the business's long-term assets such as buildings, machines, and intangible assets.²⁸⁵ This can be contrasted with the Operating Expenditure, which are the costs associated with running the business on a day-to-day basis, including research and development, building renovations, short-term leases, maintenance, etc.²⁸⁶ The CapEx and OpEx are calculated by dividing the Taxonomy-related capital or operating expenses by the total capital or operating expenses of the relevant financial year.²⁸⁷

The Taxonomy-related expenses contain three categories. First, expenses on assets of processes that are associated with Taxonomy-aligned activities.²⁸⁸ Second, expenses in a so-called CapEx plan to expand Taxonomy-aligned economic activities or to allow Taxonomy-eligible activities to become Taxonomy-aligned.²⁸⁹ Third, expenditures related to the purchase of output from Taxonomy-aligned economic activities and to individual measures enabling target activities to become low-carbon or lead to GHG reduction, and some other specific measures, some of which are Taxonomy-aligned.²⁹⁰

5.4 Commentary

5.4.1 Complete

In paragraph 2, I set out two markers for completeness: whether (a) the qualitative information covers all four aspects of the double materiality principle and (b) quantitative data is included in the disclosures. In the previous paragraphs, I discussed that the CSRD/ESRS in principle meet this criterion. Whereas this may lead to the disclosure of complete information and reduce information asymmetry, one risk is that the overload of information released under the CSRD is hard to interpret.²⁹¹ This risk is partially tempered by

285 Annex I point 1.1.2.1 CDR 2021/2178.

286 Annex I point 1.1.3.1 CDR 2021/2178.

287 Article 3-7 CDR 2021/2178. Special rules apply for financial businesses.

288 Annex I point 1.1.2.1 and 1.1.3.1 CDR 2021/2178, both under point (a).

289 Annex I point 1.1.2.1 and 1.1.3.1 CDR 2021/2178, both under point (b).

290 Annex I point 1.1.2.1 and 1.1.3.1 CDR 2021/2178, both under point (c).

291 This problem was already addressed years ago. On information overload in relation to decision-making in general: Casey C.J., "Variations in Accounting Information Load: The Effect on Loan Officers' Predictions of Bankruptcy", *The Accounting Review* 1980, vol. 55(1), p. 36; Eppler M.J. & Mengis J., "The Concept of Information Overload: A Review of Literature from Organization Science, Accounting, Marketing, MIS, and Related Disciplines", *The Information Society* 2004, vol. 20(5), p. 325; Laud R.L. & Schepers D.H., "Beyond Transparency: Information Overload and a Model for Intelligibility", *Business and Society Review* 2009, vol. 114(3), p. 365.

On information overload in relation to non-financial reporting: Baumüller J. & Schaffhauser-Linzatti M., "In search of materiality for nonfinancial information – reporting requirements of the Directive 2014/95/EU", *NachhaltigkeitsManagementForum | Sustainability Management Forum* 2018, vol. 26, p. 101, 102.

article 8 TR, which demands disclosure of what proportion of turnover, capital expenditure and operating expenditure is Taxonomy-aligned. These numbers give a quick overview of how sustainable the business is, supplementing the lengthy information in the sustainability report. Article 8 TR, therefore, complements the expansive ongoing disclosures in the sustainability report that are made on the basis of the CSRD/ESRS by providing immediate insight into the business's sustainability performance.

5.4.2 Coherent

In paragraph 2, I set out the criteria to evaluate coherency, namely by assessing whether core terminology and concepts are defined and are used coherently throughout the legislation. In general, the structure of the TR is relatively complex, as determining whether an economic activity is environmentally sustainable requires a business to evaluate criteria that are contained in the TR itself as well as in separate Delegated Acts. Moreover, two coherency issues stand out.

First, much of the text in articles 10-15 TR is obsolete. Whereas these articles appear to define what an environmentally sustainable economic activity is, the actual criteria for determining whether an activity is an environmentally sustainable economic activity are contained in the TSC that are contained in the Climate Delegated Act and the Environmental Delegated Act. This raises the question what the purpose of the descriptive parts in articles 10-15 TR is. For example, article 10 (1) TR on economic activity that qualify as contributing substantially to climate change mitigation includes a long list of activities such as improving energy efficiency and increasing clean or climate-neutral mobility, which however seem to have a mere illustrative purpose. After all, to qualify as economic activity that contributes substantially to climate change mitigation, the activity has to meet the criteria set out in the TSC, rendering the list of activities in article 10 TR irrelevant from a legal point of view. The activities in the TSC on climate change mitigation, however, do not refer back to any specific category under article 10 TR: there is no activity that specifically qualifies as improving energy efficiency or increasing clean or climate-neutral mobility.²⁹² The descriptions of activities in articles 10-15 TR thus appear to be only that: descriptions – not actual criteria. Given the already complicated structure of the Taxonomy Regulation, it would have been better to not include

²⁹² As a matter of fact, the only activities that are specifically mentioned in the Annexes of the CDR are those described in article 10 (1), point (i) and article 11 (1), point (b) TR. These two activities are both enabling activities: both article 10 (1), point (i) and article 11 (1), point (b) TR refer to article 16 which contains the requirements for enabling activities. From this, it can be deduced that an enabling activity in the sense of article 16 TR can only be Taxonomy-aligned if it applies in conjunction with one of the articles 10-15, and fulfils the relevant TSC. An activity that only complies with article 16 TR thus is not an 'enabling activity' in the sense of that article, and thus not Taxonomy-aligned.

these descriptions under articles 10-15 TR and instead to directly refer to the TSC in the Delegate Acts.

Second, the definitions that are introduced at the beginning of CDR 2021/2178 only apply within the context of that Delegated Regulation, which is on disclosures under article 8 TR. As this CDR introduces definitions that are useful for the entire TR – terms such as Taxonomy-aligned economic activity, enabling economic activity, and Taxonomy-eligible economic activity – it would have been better to either include these in the TR itself or to broaden their scope so that they apply to the entire TR framework.

Next to this, some smaller incoherencies have surfaced. Firstly, article 3 TR lists four criteria whereby criterion (d) to fulfil the TSC is already contained in criterion (a) to contribute to one or more environmental objectives set out in article 9 TR in accordance with articles 10-16 TR, which includes complying with the TSC. Criterion (d) thus is obsolete. Second, the definition of net turnover derived from Taxonomy-aligned activities in CDR 2021/2178 excludes activities that comply with article 11 (1) point (a) TR, only to include them again a few lines later. These types of textual incoherencies make the framework difficult to read and use, which increases the regulatory burden on businesses that have to comply with the article 8 TR.

5.4.3 *Accurate*

In paragraph 2, I set out that I evaluate accuracy by assessing whether the qualification of an activity as sustainable is either (a) based on the Taxonomy Regulation or (b) warranted by procedural safeguards that ensure the qualification is supported by scientific evidence.

In principle, article 8 TR fits seamlessly with the evaluation criteria that I formulated, as it requires disclosure on how Taxonomy-aligned a business is with respect to turnover, operating expenditure, and capital expenditure. It should however be noted that both the CapEx and OpEx include two categories of expenses that strictly speaking are not Taxonomy-aligned. First, expenses on the CapEx plan,²⁹³ and second expenses on individual measures enabling target activities to become low-carbon or lead to GHG reduction.²⁹⁴

Both of these expenditures in principle pertain to activities or measures that are not yet taxonomy-aligned. Including these under the CapEx and OpEx is however justifiable as these expenses should eventually result in Taxonomy-aligned activities. This justification however only endures if there are enough safeguards to guarantee that the expenses really do result in Taxonomy-aligned activities. For the CapEx plan, this seems to be the case: the upgrade of Taxo-

293 Annex I point 1.1.2.2 and 1.1.3.2 CDR 2021/2178, both first subparagraph under point (b).

294 Annex I point 1.1.2.2 and 1.1.3.2 CDR 2021/2178, both first subparagraph under point (c).

onomy-eligible activities should take place within the next five years – or ten years if this is objectively justified.²⁹⁵

Regarding the individual measures, the safeguards are more lenient: for the CapEx, the target activities should become “low-carbon or to lead to greenhouse gas reductions, notably, activities listed [in the TSC].”²⁹⁶ For the OpEx, the expenses should be on individual measures “to become low-carbon or to lead to greenhouse gas reductions as well as individual building renovation measures as identified [in the TSC].”²⁹⁷ This means that individual measures need not necessarily result in Taxonomy-aligned activities, as long as they are sufficient to become “low-carbon” or to lead to “greenhouse gas reductions” – two undefined terms. This is puzzling as it seems to open up the possibility of including expenses that do not lead to Taxonomy-aligned results. If that were the case, the numbers disclosed under the CapEx and OpEx KPI actually could represent something slightly different than what article 8 TR informs us that it would, namely the proportion of expenditure related to Taxonomy-aligned activities. It would therefore be better to include a deadline for individual measures to become Taxonomy-aligned in the sense of article 3 TR, as with the CapEx plan.

5.5 Conclusion

Article 8 TR applies to businesses that must publish a sustainability report on the basis of the CSRD. On the basis of article 8 TR, these businesses have to disclose how Taxonomy-aligned they are: how and to what extent their activities are Taxonomy-aligned and what percentage of their turnover and capital and operating expenses are derived from or spent on activities that meet the criteria for environmentally sustainable economic activity of article 3 TR? This information supplements the information that is disclosed in line with the ESRS. While the disclosures on the basis of the ESRS are neutral and descriptive, the disclosures under article 8 TR are normative – they inform the user how sustainable the business is. This is crucial in narrowing the information gap between businesses and investors.

Although the disclosures of article 8 TR seem relatively straightforward (what part of the business activities and expenses is Taxonomy-aligned), the process of identifying these KPIs is quite complex: it requires businesses to navigate both the TR itself, with its adjacent Technical Screening Criteria in the Climate Delegated Act and the Environmental Delegated Act, as well as CDR 2021/2178 on how to calculate the turnover, CapEx, and OpEx KPI. In that context, it is not very helpful that both the Taxonomy Regulation and

²⁹⁵ Annex I point 1.1.2.2 and 1.1.3.2 CDR 2021/2178, second subparagraph.

²⁹⁶ Annex I point 1.1.2.2 CDR 2021/2178, first subparagraph point (c).

²⁹⁷ Annex I point 1.1.3.2 CDR 2021/2178, first subparagraph point (c).

CDR 2021/2178 suffer from repetitious, unnecessary, and confusing sections. This includes the superfluous criterion (d) under article 3 TR, the lengthy descriptions of environmentally sustainable economic activities under articles 10-15 TR, and the vagueness surrounding the calculation of the individual measures to become low-carbon or to lead to greenhouse gas reductions under CDR 2021/2178.

6 CONCLUSION

In this chapter, I analysed how successful the EU SFF is in minimizing information asymmetries between issuers and investors by introducing new ongoing disclosure requirements for EU-listed companies in the annual reports that those businesses have to disclose on the basis of the Accounting Directive by focussing on the question: *How effective are the ongoing disclosure requirements from the CSRD/ESRS and article 8 TR in reducing information asymmetries regarding sustainability between issuers and investors?*

The sustainability disclosures under the CSRD/ESRS and article 8 TR complement each other. On the one hand, the CSRD/ESRS contains detailed requirements to disclose material actual or potential, positive and negative impacts on sustainability matters by the business as well as impacts on the business. These disclosures thus should provide a (very) elaborate overview of the business' relation to sustainability. On the other hand, article 8 TR requires businesses to disclose the proportion of turnover derived from and the proportion of spending on environmentally sustainable economic activities, providing a succinct overview of how the business's financial position relates to sustainability.

A drawback of this structure is that businesses must comply with two complex but distinct legal frameworks. Nonetheless, it should be relatively straightforward to generate the article 8 TR disclosures after drawing up a sustainability report in line with the CSRD/ESRS. After all, the ESRS (broadly) follow the structure of the TR, ensuring that all the information required to assess whether activities meet the thresholds outlined in the TSC should ideally have been compiled during the sustainability reporting process.

To assess how successful these ongoing disclosure requirements are in reducing information asymmetries between issuers and investors, I formulated three assessment criteria – whether the information disclosed is complete, coherent, and accurate. For *completeness*, I focussed on whether (a) the qualitative information covers all four aspects of the double materiality principle and (b) quantitative data is included in the disclosures. *Coherency* was assessed by determining whether core terminology and concepts were defined and used coherently throughout the legislation. I judged *accuracy* by assessing whether the qualification of an activity as sustainable is either (a) based on the Taxo-

onomy Regulation or (b) warranted by procedural safeguards that ensure the qualification is supported by scientific evidence.

In general, new ongoing disclosure requirements are an enormous leap toward reducing information asymmetries between issuers and investors. The information disclosed meets the criteria of completeness and accuracy. The open norm of materiality mandates disclosures for all information potentially material to users, which should, in principle, comprehensively address investors' informational needs. One improvement to increase the completeness of the sustainability report is to include "nature" as one of the stakeholders whose information needs must be addressed. However, as investors are included among those stakeholders, the open norm of materiality should in principle be sufficient for their needs.

The CSRD/ESRS is built on the principle of double materiality, requiring issuers to disclose both financial and impact-related material information. While the inherent openness of double materiality introduces a risk of materiality washing – wherein businesses might strategically omit certain impacts or risks by declaring them immaterial – the ESRS incorporates safeguards. Most importantly, businesses must explicitly disclose their process for identifying and assessing material impacts, risks, and opportunities across all applicable topical standards, even when the assessment concludes that specific impacts are immaterial. Furthermore, the ESRS mandate quantitative disclosures of impacts, often using mandatory methodologies. When businesses have discretion to use other methodologies or estimates, the ESRS require sufficiently contextual disclosures to enable meaningful interpretation by the investor.

It can therefore be concluded that although materiality remains an inherently flexible concept, the ESRS contain sufficient safeguards to prevent the obfuscation of material information and ensure investors can make well-informed investment decisions integrating sustainability considerations. Additionally, disclosures under article 8 TR provide investors with information on how Taxonomy-aligned the business is, thereby reinforcing the accuracy of reported sustainability information.

Throughout this Chapter, I have also identified some shortcomings that may undermine the ongoing disclosures and therefore negatively affect the transmission of sustainability information from issuer to investor. These shortcomings predominantly relate to the second criterion: coherency. The legislative framework consisting of the CSRD and ESRS on the one hand and article 8 TR with delegated acts for TSC and KPI on the other hand, is already very complex and difficult to navigate. Hence, the existence of various types of incoherencies that I identified form a significant challenge.

The first issue is the presence of textual inconsistencies that undermine an easy understanding of the law. Examples are the repetition of the scope in article 1 and article 19 CSRD, and the lengthy but legally insignificant descriptions of economic activities in articles 10-15 TR. Second, the structure

of sustainability reporting that can be deduced from article 19a (2) (a) – (h) CSRD, which contains reporting topics, does not match the structure of the ESRS – which is (broadly) aligned to the TR. Reading the CSRD thus does not prepare one at all for writing a sustainability report. Third, incoherencies that arise from illogical definitions or ambiguous definitions where specificity is necessary. For example, there is no convincing reason why the CSRD distinguishes ‘sustainability matters’ and ‘sustainability factors’ when their definitions are almost identical. Another example is the ambiguous definitions of individual measures in the calculation of the CapEx and OpEx, effectively broadening Taxonomy-aligned expenses beyond those strictly in line with the TR. Whereas these incoherencies may appear to be only textual, they may carry substantial risks. Firstly, an incoherent framework is difficult to use and can cause unnecessary expenses. Secondly, it can lead to inconsistent disclosures between businesses, undermining the comparability of information. Thirdly, it can increase the risk of deliberate obfuscation of negative information and render information meaningless to investors. Hence, I suggest that the legislature critically assess the inconsistencies that I have identified throughout this chapter and revise the legislation to achieve a more coherent and precise framework.

The second type of coherence I evaluated concerns whether both sides of the double-materiality principle are expressed in financial terms: not only should businesses disclose their sustainability-related risks and opportunities in financial terms, but they should also translate their impacts on sustainability into financial terms. From an L&E perspective, this is desirable as investment decisions require financial rationalization. By monetizing environmental impacts, investors gain a more standardized and comparative framework for assessing business performance. Although the idea of valuing the costs of sustainability impacts is reflected in the recitals of the CSRD – and the ESRS contain the obligation to disclose whether the business applies a (voluntary) internal carbon pricing scheme – there is no general requirement to value the sustainability-related impacts of the business in monetary terms. Consequently, the market is left to determine the economic value of sustainability impacts – a problematic approach given the inherent limitations for investors in accurately valuing non-tradeable goods such as environmental ecosystems and climate stability. I therefore recommend that the legislator introduce a robust mandatory method within the CSRD framework for determining the costs of environmental impacts.

Regardless of this critique, I can only conclude that the ongoing sustainability disclosures under the EU SFF are a significant advancement from an L&E perspective: they lead to the generation of detailed and relevant sustainability information that meets investors’ needs and thereby significantly contribute to closing the asymmetry on sustainability information between issuers and investors.