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Sustainable on the long bench

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Abstract

For over 18 months, the German government has failed to implement an important EU directive on sustainability - to the detriment of German companies.

Zusammenfassung

Über 18 Monate ist es der Bundesregierung nicht gelungen, eine wichtige EU-Richtline zur Nachhaltigkeit umsetzen – zum Schaden der deutschen Unternehmen.

5 January 2022 was a special day for a select few. In Berlin, Sven Lehmann was appointed the first "Queer Envoy" of the German government. Hours later, the Dallas Mavericks announced that they would no longer be issuing the player number 41, which basketball legend Dirk Nowitzki had worn during his career with the Mavs. And, largely overlooked by the public: In Brussels, the European Union enacts the Corporate Sustainability Reporting Directive (CSRD). Another political success for the Commission under the leadership of its President Ursula von der Leyen (CDU), which is driving forward the growth of bureaucracy.

A good 18 months have passed since then. Exactly the period of time in which the EU countries should have transposed the CSRD Directive into national law.

Strict rules

The directive lays down strict rules on how companies have to report on their efforts to reduce CO2 emissions. It also requires information on social issues and corporate governance.[1] In Germany, the German Commercial Code (Handelsgesetzbuch, HGB) serves as the legal basis into which the directive is incorporated. The latest deadline for this was 6 July 2024.[2]

In France, the parliament issued decree no. 2023-1142 on 6 December 2023 and decree no. 2023-1394 on 30 December 2023 to implement the CSRD.[3] Germany was still a long way off, as was neighbouring Austria. It was only on 22 March of this year that the draft for implementation was submitted to the Federal Ministry of Justice in Berlin. [4]

It became apparent shortly before the summer break: The German government would break the barrier on 6 July. To ensure that the slowdown could at least continue after the summer break in September, at least the cabinet should have had a final discussion on the CSRD at its meeting on 3 July. Even this did not materialise. The 2025 budget took priority.

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[1] https://www.flossbachvonstorch-researchinstitute.com/de/studien/im-esg-dschungel/

[2] https://www.bmj.gv.at/themen/Zivilrecht/Richtlinie-%C3%BCber-die-Nachhaltigkeitsberichterstattung-von-Unternehmen-(CSRD,-Corporate-Sustainability-Reporting-Directive).html#:~:text=The%20Directive%20(EU)%202022%2F,Information%2C%20that%20companies%20must%20report%20on%C3%BC

[3] https://www.roedl.de/themen/esg-news/2024-2/csrd-frankreich-nichtfinanzielle-berichterstattung-unternehmen-reformieren-oekologische-ambitionen

[4] https://www.bmj.de/SharedDocs/Gesetzgebungsverfahren/DE/2024_CSRD_UmsG.html

No legal basis

Over the summer, and possibly even longer, the officially estimated 13,200 companies in Germany affected by the directive are faced with the question: What now?

The CSRD has been applicable since 1 January 2024. This means that the annual reports to be prepared from next January onwards must take the directive into account.

This is being done in stages. Initially, all companies that already fall under the *Non-Financial Reporting Directive* (NFRD), which will be replaced by the CSRD, will be affected. These are public interest entities with more than 500 employees. In the EU, that is 11,700 companies. It is envisaged that all companies with more than 250 employees, a balance sheet total of 25 million euros and annual revenues of at least 50 million euros will gradually have to fulfil the CSRD reporting obligations, regardless of whether they are listed on the stock exchange.[5] The lower limits for total assets and annual turnover have been increased slightly compared to the original requirements.

Hardly any room for manoeuvre

It would actually be easy for the coalition government to wave the CSRD through. This is because the room for manoeuvre provided by Brussels is minimal. Company stakeholders should receive reports under the same legal framework throughout the EU in order to ensure comparability, at least in theory.

But Germany would not be Germany if it were easy. On the one hand, resourceful experts have found an important implementation error in the translation of the directive into German and its interpretation. Secondly, a dispute is raging about who is allowed to take a slice of the cake. It's all about the lucrative audit mandates.

The cost of implementing the CSRD is not just a small sum. The one-off costs are estimated at 748 million euros and the ongoing annual costs at 1.4 billion euros.[6]

Double materiality

But first things first. A central theme of the CSRD is what is known as "dual materiality". According to the concept, non-financial aspects must be compared with financial aspects in order to determine what is important for reporting. Non-financial aspects are the effects of a company's business activities on people and the environment in the short, medium and long term. Financially material are

[5] https://www.deutscher-nachhaltigkeitskodex.de/de/berichtspflichten/corporate-sustainability-reporting-directive-csrd/wichtige-informationen/

[6] https://www.bmj.de/SharedDocs/Gesetzgebungsverfahren/DE/2024_CSRD_UmsG.html)

environmental aspects that have a monetary impact on the company's operations, profits and existence.

This is precisely where the problem lies. For example, it is criticised that Germany has not found an "unambiguous formulation" for the implementation of the required "dual materiality" according to the draft bill. [7] According to this, in the original English version, a material passage is to be interpreted as "or"[8] , but the German version clearly mentions "as well as". The latter would probably result in even more extensive information than originally intended.

The extent to which the CSRD could conflict with the German Supply Chain Due Diligence Act (Lieferkettensorgfaltspflichtengesetz) in terms of reporting obligations remains to be seen. Technical specifications for digital processing, which has been mandatory since 2020, are also not yet fully available.

Who checks?

German companies still have to wait for clarification on the points mentioned, as well as for an answer to the question of who will check the information in the annual reports.

The draft bill published in March has so far provided for auditors.[9] Unsurprisingly, the Institute of Public Auditors in Germany (IDW) welcomes and supports this.

However, some trade associations, SMEs and medium-sized auditing companies, which lack the personnel to expand their audits, are pushing for an opening.[10] Technical certifiers such as TÜV should also be authorised to audit sustainability reporting. The TÜV naturally takes the same view.[11] Whether so-called *Independent Assurance Services Providers* should be authorised as additional auditors has been the subject of controversial debate for years and has so far been unsuccessful. [12]

In any case, the scope of the audit can be considerable. Depending on the size of their turnover, companies must include up to 1,200 data points in their new sustainability reporting.

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[7] see KoR IFRS June 2024, page 235 and draft bill of the BMJ, page 8

[8] https://eur-lex.europa.eu/legal-content/en/TXT/?uri=CELEX:32023R2772, page 1

[9] Draft bill, pages 50 and 177

[10] https://www.tuev-verband.de/pressemitteilungen?tx_news_pi1%5Bnews%5D=703

[11] https://www.tuev-verband.de/pressemitteilungen?tx_news_pi1%5Bnews%5D=813

[12] https://www.wpk.de/fileadmin/documents/Oeffentlichkeit/Stellungnahmen/WPK-Stellungnahme_21-06-2021.pdf

Massive regulatory gap

As the preparation of an annual report for the year 2024 does not start on 1 January 2025, but is an ongoing process, German companies are faced with a massive regulatory gap. Although the requirements of the EU directive are certain, they have not been clarified in every detail in the German implementation. And anyone who is reliant on an external, additional audit should have already organised one. However, as long as it is not clear whether contracts may also be awarded outside the auditing sector, SMEs in particular will be at a loss.

What's more, even the data collection will be incomplete, as the Deutsche Bundesbank recently admitted in its new climate report.[13]

The valid verification of data is a Herculean task. If investors should approach even audited, traditional balance sheets with caution in view of numerous accounting scandals, this applies all the more to the new field of environmental data. Either way, the enormous costs - at least initially - are unlikely to be in proportion to the information content.

Incidentally, ESG funds have been recording outflows since the fourth quarter of 2023.[14] The interest of investors, for whom the companies primarily prepare annual reports, is therefore waning before there is even a halfway valid basis for a "climate-friendly" investment decision.

And there is no counter-relief for the CSRD obligations. This is because, as an EU regulation, the directive is not subject to the German government's "one in, one out" rule , which stipulates that for every new regulation, another is abolished.

So one thing is certain: once again, more staff will be needed to dutifully fill in lists and tick boxes.

The Federal Ministry of Justice has 897 employees. The Bundestag, with its 734 members of parliament, has plenty of staff. Nevertheless, it was not enough to pass the directive, which is extremely important for the economy, at least at the last minute. So there is plenty of material for a successor to the brilliant Franz Kafka.

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[13] https://www.flossbachvonstorch-researchinstitute.com/de/kommentare/die-bundesbank-auf-klimareise/

[14] https://www.morningstar.de/de/news/245492/artikel-8-fonds-erlitten-im-q4-die-h%C3%B6chsten-quartals-abfl%C3%BCsse-%C3%BCberhaupt.aspx

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