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Content:

→ Law

New bill to Employment Act: Free access of third-country nationals to labor market

On 1 July 2024 a new bill came into effect that amended the Employment Act and a government decree listing the countries, whose citizens do not require an employment permit, employment card, an intra-company employee transfer card or a blue card to perform work or obtain employment in the Czech Republic.

Thomas Britz
Rödl & Partner Prague

The new bill allows the nationals from nine third-party countries to work or obtain employment even in the absence of an employment permit, employment card, an intra-company employee transfer card or a blue card, specifically the citizens of the Commonwealth of Australia, Japan, Canada, Republic of Korea, New Zealand, Republic of Singapore, the United Kingdom of Great Britain and Northern Ireland, United States of America and the State of Israel.

The free access of the citizens of the listed countries to the Czech labour market does not include a residence permit, which must be obtained separately. The residence permit may be obtained, inter alia, by way of a non-dual mode employment card. The Ministry of Interior together with the Ministry of Labor and Social Affairs (MLSA) have already announced how they are going to treat foreign nationals who were holders of a non-dual mode employment card on 1 July. The current policy has changed several times since the initial announcement, which is why we prefer to inform our clients about the current status of the Government policy as at the date when we assess their case.

The reporting obligations owed to the Labour Bureau under the Employment Act have also been substantially changed by the amending bill. It would be logical to assume that foreign nationals with a free access to the Czech labour market or other foreign nations, who do not require an employment permit, will be released from the reporting obligation. And currently, this is also the case, as the reporting of the foreign national employment info is still voluntary. However, a reporting obligation is expected to be introduced effective from 1 January 2025.

Instead of sending completed reporting forms in a hardcopy, the MLSA has launched an online portal through which employers will be able to send their completed forms, which will then be kept in a central database.

The reporting system for posted employees has also been changed. Until now, posted employees had to be reported to the relevant regional branch office of the Labor Bureau. The obligation to accept the reports will now shift to the State Labor Inspection Office. Foreign employers will be able to report the posting of employees to the Czech Republic via SLIO's online portal, which will also accept uploads of all requisite information, such as employment contracts and their translation.

Last but not least, the process of recording information in the register of vacant job positions for dual-mode employment cards has also changed. It is no longer necessary to pass the labour market test, although the local Labor Bureau may still re-introduce the requirement if the unemployment rate in the region rises. In order to improve the informational value of the vacancies' register, new vacancies will be erased automatically from the register after 6 months from notification. The register record will also include new entries, such as the CZ-ISCO code.

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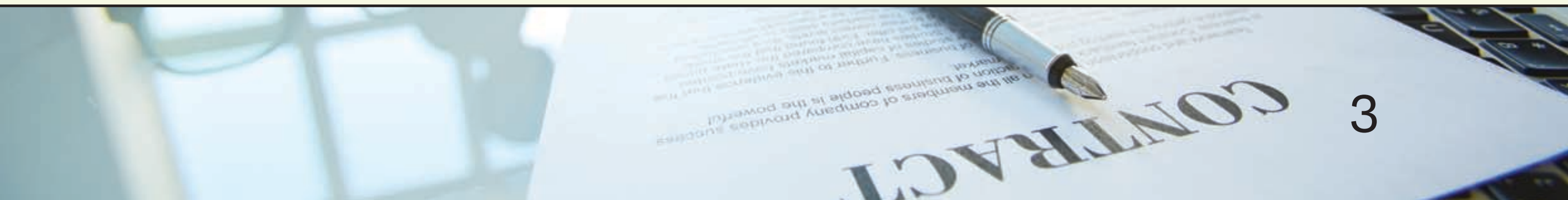

→ Law

Changes in foreign employee reporting

The Employment Act has been amended effective from 1 July 2024. Under this law, employers are bound to notify their regional branch office of the Labour Bureau about the start and the end of employment of foreign nationals within 10 calendar days. Pursuant to the amending bill, the employers are obliged to deliver the notice only in the manner stipulated in the law and in the implementing regulation, specifically in regulation No. 117/2024 Sb., on the use of electronic communication in performing information duty of employers when employing foreign nationals.

Employers are required to use either of the following methods:

- A form in the XML file format sent from the employer's data box,
- A report sent via an online form, or
- A report filed by direct call to the phone line using the GovTalk standard.

The regulation stipulates additional details that must be included in the report. A failure to satisfy the information duty constitutes an administrative infraction which may be punished by a fine of up to CZK 100 thousand.

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→ Law

Pre-contractual liability and a loss of profit

According to the Czech Civil Code, if contract negotiations between parties reach a point where the conclusion of the contract seems highly likely, the party which terminates the negotiations without a just cause despite reasonable expectations of the other party that the contract will be concluded is deemed to have acted unfairly. Does this entitle the "disappointed" party to claim profit lost on account of the parties' failure to conclude the contract?

Václav Vlk
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When one of the parties reasonably assumes that the negotiations have advanced to such a degree that they will culminate in the conclusion of the contract and the other party suddenly and without good cause discontinues the negotiations, the law lays down the obligation on the party that terminated the negotiations to compensate its counterparty for the ensuing harm.

In its ruling of November 2023 (in case No. 23 Cdo 3191/2022), the Supreme Court addressed the issue as to whether the harm which warrants such compensation includes also the profit lost of on such failed contract. In the case at hand, a contract for work failed to be made in spite of the contractor's reasonable expectations and the contractor claimed compensation from the prospective client for the profit lost from the project had the parties entered into the contract to work.

The Supreme Court found that the so-called precontractual liability entails the legal responsibility for raising the expectations that the contract will be made rather than the responsibility for the failure to enter in such contract. In other words, the mere failure to enter into a contract is not illegal and therefore does not constitute a cause of harm. A party may be deemed to have acted unfairly only if it acts unfairly in conducting the pre-contractual negotiations, since anyone may conduct the negotiations about a contract freely, without becoming liable for the decision not to proceed with the contract. The duty to compensate the harm arises only if the wrongdoer acts unfairly in the parties' negotiations. It is the unreasonable raising of expectations that the contract will be concluded rather than the failure to enter into the contract that is considered unfair and that may merit compensation from the wrongdoer. The loss of profit from the failed contract (i.e. contract that was not consummated and performed) therefore may not be attributed to a party's termination of the negotiations to enter in the contract, even if the negotiations are terminated without good cause. This means that the contractor as the plaintiff did not prevail in this lawsuit.

> A termination of pre-contractual negotiations without good cause does not merit compensation for profit lost

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→ Law

There's no silly season in IT law

On 17 July 2024, the Czech Government gave a green light to the new Cybernetic Security Act and sent it, with a couple of amendments, to the Chamber of Deputies for consideration. Conservatively, the new act may be expected to be adopted and promulgated in the first quarter of 2025. If you still don't know whether you will be an obligated person under the new law, you may check the wording of the draft government decree on regulated services, which is available here.

The publication of the Artificial Intelligence Act in the Official Journal of the European Union is a major landmark in this area of law. The new Act will enter into force on 2 August 2024 and will become effective over several stages. AI systems that are deemed to pose a threat to people, i.e. so-called unacceptable risk AI systems, will be prohibited from 2 February 2025, while providers and deployers of AI systems will be bound to adopt measures to ensure a sufficient level of AI literacy of their employees.

The new rules to apply starting from 2 August 2025 also include rules for general-purpose AI models, the obligation to establish regulatory authorities and certain provisions on applicable sanctions. The remaining articles of the AI Act will become effective from 2 August 2026 barring certain provisions on high-risk systems and certain obligations applicable to the deployers of large-scale AI systems.

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→ Law

Providers of goods and services may be classified as insurance intermediaries

According to a landmark ECJ judgment in the case number C-633/20, a legal person, whose activity consists in offering its customers membership on a voluntary basis in return for payment which it receives from them, of a group insurance policy to which it has subscribed previously with an insurance company, may now be classified as an insurance intermediary. What does this judgment imply for the providers of such goods or services?

Alice Kubová Bártková
Rödl & Partner Prague

The judgment became the reason for drafting an amendment bill to the Insurance and Reinsurance Distribution Act (IRDA), which should have become effective at the start of the year. According to the most recent information published so far, the amending bill has just been presented to the Chamber of Deputies for consideration.

As a consequence, the rights and obligations of insurance intermediaries will now apply also to any legal person that has a previous insurance policy and offers membership in such policy to his customers. This is the case of many freight forwaders, carriers or ship owners, who, in addition to transporting the goods, offer their customers to take up a cargo insurance or the case of many leasing firms which, subject to certain terms, offer a compulsory vehicle insurance, or the case of retailers, who offer extended insurance cover for electronic goods and so forth (this is frequently referred as group insurance or fleet insurance).

In view of the aforesaid, the new bill requires the policyholders who carry out the said activities to observe the rules laid down in the EU Directive and the applicable law. They will have to obtain the requisite permits, observe internal rules, be adequately qualified and satisfy the obligations related to information and proper conduct. These policyholders will be recorded in a register kept by the Czech National Bank, which will also act as the supervisory authority in this area.

In other words, undertakings that will mediate insurance in this manner, their employees and officers will therefore have to satisfy the professional qualifications required under IRDA. In addition to having a certain degree of education, they will have to acquire the professional expertise and skills needed to distribute insurance, documented by a certificate that they have passed an expert exam, qualification course or professional practice. The certification exam is organised by the Czech National Bank in cooperation with the Ministry of Finance. The undertaking will have to obtain a permit to carry out the said activities and will have to register with CNB.

Concerning undertakings that were previously engaged in a mediation of insurance, according to the Explanatory Report to the new bill, they will now have the opportunity to obtain the education and arrange the satisfaction of other prerequisites within two years from the effective date of the new law. In addition to liability for a dutiful arrangement of insurance and for the damage caused by the failure to do so, the law also will impose potential administrative sanctions for a failure to observe some of the material obligations, in the amount of up to CZK 10 million.

> Providers of goods and services that wish to arrange insurance for their customers shall be liable to observe the obligations laid down in the Insurance and Reinsurance Distribution Act

All in all, this area of law is rather complex. Please contact us if you wish to make any further inquires.

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→ Law

Changes to the rules for the services of payment orders

Effective from 1 July of this year, an amending bill to the Code of Civil Court Procedure changed the rules for the service of electronic and conventional payment orders.

The legal fiction that a payment order has been duly served on the recipient will now apply upon the lapse of ten days since the delivery of the data message into the data box even if the defendant did not log in into the data box. When the payment order is served, a 15-day time limit will start to run for filing an objection. If the recipient fails to file the objection, the payment order will become final and conclusive.

The amending bill also modified the financial limits for electronic payment orders. The motion for the issue of an electronic payment order shall no longer be limited when it comes to the amount sought. This is good news for creditors, since this change should substantially accelerate the debt collection process. But for everyone else, we would strongly recommend checking the data box regularly and set up an e-mail notification of any incoming data box messages.

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→ Taxes

Upcoming changes to the Czech VAT Act for year 2025

The Czech Government has recently brought forward to the Chamber of Deputies a new amending bill to the Value-Added Act, which is planned to become effective on 1 January 2025, with some of the changes to become effective as late as in 2026 and 2027. The Government hopes that the substantial changes to the law will simplify or resolve some of the contradictions in the interpretation of law. Let us introduce some of the contemplated changes in the following paragraphs.

Johana Imbr, Barbora Dolejšová
Rödl & Partner Prague

The first important change is the extension of a special tax regime for small undertakings operating in the Czech Republic. This special tax regime will be available to businesses registered in EU Member States whose annual turnover does not exceed CZK 2 million. Such businesses will not be bound to register for VAT in Czechia, so long as they do not exceed the annual turnover limit.

The second important change is the modification of the VAT registration process. New entities that exceed the CZK 2 million limit will have to register as VAT payers as at the first calendar day of the subsequent year. But, if their turnover exceeds the limit of CZK 2,536,500, they will have to register on the day following the date on which the limit was exceeded.

The bill also intends to amend the time limits stipulated in the VAT Act. The time limit for claiming the VAT deduction will be reduced from 3 years to 2 years, while the time limit for correcting the tax base will be extended from 3 years to 7 years starting from the last day of the calendar year in which the original taxable supply took place. In addition, the running of the time limit will not be suspended for the duration of the associated court proceedings. However, the changes to the time limits will only apply to taxable supplies after 1 January 2025.

One of the changes that could be welcome by VAT payers is the cancelation of the limit for a VAT deduction for racing cars. Effective from 2027, the Government contemplates cancelling the limit for all cars.

The bill should also relax the rules and bring more options for refunding VAT paid on bad debts. The new wording focuses mostly on smaller claims and claims from non-payers. When it comes to unpaid debts, the new bill introduces the customer's obligation to return the VAT deduction after the lapse of 6 months from the due date of the unpaid debt.

The minor changes introduced by the bill include the duty to appoint an agent with a data box access for foreign entities that become Czech VAT payers.

If you are interested in this topic, we will cover the numerous changes brought about by the upcoming bill in detail in our future newsletters, and we will also prepare online seminars for our clients.

If you wish to learn more about the proposed changes to the VAT Act and their potential impact of your business, please feel free to contact or join one of our upcoming webinars. Our dedicated VAT team will be ready to answer all your inquiries.

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→ Taxes

Recent changes to the statutory regulation of agreements to perform work

Starting from 1 July 2024 and subsequently from 1 January 2025, a new law will change the statutory regulation of agreements to perform work (APW).

Kateřina Jordanovová, Michal Gola
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As from 1 July 2024, employers will gain new registration obligations with respect to their APW employees. More specifically, employers will have to register all their APW employees with the Czech Social Security Administration (ČSSZ), while reporting the start and end of employment of their APW employees every month. All information must be reported electronically by the 20th day of the subsequent month (i.e. on 20 August 2024 for the first time) using ČSSZ forms.

The statutory charges and levies collected under APW will also change. So far, no social security and health insurance payments are due under on APW's if the monthly wage does not exceed CZK 10,000. The author of the amending bill intended to make the regulation stricter by setting out two bands, which, if exceeded, would create a duty to pay the levies from APW. However, in the end, the idea was abandoned, which means that until the end of the year 2024, no statutory levies will be charged on APW's with the agreed monthly wage of less than CZK 10,000.

Nevertheless, starting from 1 January 2025, the amending bill No. 163/2024 Sb introduces three new APW bands for health and social security payments instead:

1) AWP in the so-called reported agreement regime. This regime may be exercised for AWP employees only by the employer who "reserves" the employee first. To do so, the employer will make a reservation of the specific employee with ČSSZ. Under this regime, statutory levies are not charged on AWP wage as far as it does not exceed 25 % off the average wage per month (currently about CZK 10,500). The reported agreement regime will first apply for the month of January 2025, i.e. for

the period from 1 January 2025 to 20 February 2025. The agreement reported in this manner will be recorded in a special public register, which will be accessible by all employers. For employers that do not "reserve" their employee in time, the levies will be determined in accordance with subsection 2 or subsection 3.

2) AWP in the small-scope employment regime, in which the monthly wage does not exceed the amount of CZK 4,000 (the amount may change in future). Statutory levies are not charged if the foregoing condition is satisfied. The amounts will add up for several employments of a single employee with a single employer and if the limit is exceeded, statutory levies will be charged accordingly. But the small-scale employment regime still applies for each additional employer who exercises the regime, as far as the monthly wage does not exceed CZK 4,000.

3) AWP in the so-called regular employment regime. All other AWP's will be liable to the same statutory levies as wages earned under a regular employment contract.

The institutions involved in the application of the foregoing changes are expected to give their opinion on the recommended practice in the upcoming weeks. We will keep you updated on further developments in this matter.

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→ Taxes

Updated guidance on country-by-country reporting implementation

OECD updated its guidance on the implementation of the country-by-country (CBC) reporting. CBC reporting duty applies to large multinational corporations (MNE's) whose consolidated annual turnover exceeds EUR 750 million. The reports include the information about the fiscal figures and activities of member companies of such MNE's in their relevant jurisdictions.

Petr Tomeš
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In May 2024, the Organisation of Economic Cooperation and Development published a yet another update of its ever-popular Guidance on the Implementation of Country-by-Country Reporting.

CBC reporting is a part of the OECD's 2014 BEPS initiative, an attempt at regulating so-called base erosion and profit shifting on the part of multinational enterprises whose annual consolidated revenue exceeds EUR 750 million. In the CBC reports, MNE's are bound to report the financial figures and activities pursued by their member companies in the relevant countries. The aim of CBC reporting is to prevent MNE's from shifting their profits to countries with more favourable taxation regime, thus violating the transfer pricing rules.

The OECD's CBC reporting implementation guidance has been updated on several occasions since 2014. The most recent update sums up the changes enacted so far, focusing mostly on improving the definition of certain terms, such as reported financial indicators, in view of the diverse local rules enacted by individual OECD member states.

The guidance also addresses some practical issues such as by specifying the exact types of entities whose fiscal data need to be reported (investment funds, partnerships) and by setting out rules for companies that are members of multiple MNE groups (joint ventures) and for reporting the fiscal data of permanent establishments.

Last but not least, the update improves the definition of total consolidated group revenue for relevant qualified groups and the application of FX currency rates to convert figures from non-Eurozone countries.

The reporting data are shared among the tax administrations of OECD member states (while the report itself is prepared by the main parent company of the group and filed with the tax administration in its home country). To this end, the new guidance improves the interpretation of the rules for the exchange of such data.

If the CBC reporting duty applies also to your company, please contact our experts who will assist you in reviewing the obligations that apply to your local subsidiaries.

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→ Taxes

Is a managing director liable for the tax arrears of his or her company?

The Supreme Administrative Court addressed the question whether a managing director is liable for the company's tax arrears as a guarantor and when a guarantor's payment order may be imposed on the managing director. The SAC's findings cannot quite leave the managing director at ease as far as he has violated the duties of his office and in so doing harmed the company. In addition, the liability may not even become time-barred if the managing director violated good morals or abused his rights by his or her conduct.

Jakub Šotník
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In the case at hand, the tax authorities assessed VAT and late payment charges on a company based on its finding that the company did not pursue any business activities and was founded for the sole purpose of collecting input VAT deductions. However, the company failed to pay the additionally assessed VAT and late payment charged and was wound up and liquidated instead.

In response, the tax authorities sent the managing director a guarantor's payment order, instructing the managing director to pay the tax arrears on the company's behalf. Based on rulings in the associated criminal proceedings, the tax authorities found that the managing director had violated his duty to act with due managerial care. This created the managing director's guarantor's obligation under the Tax Code read in conjunction with Section 159 of the Civil Code, which stipulates a special guarantee obligation. In support of its reasoning, SAC noted that the defendant was the sole managing director of the company through which he unlawfully collect excess VAT deductions.

In his defence, the managing director argued that his liability owed to the company under Civil Code has become time barred and therefore the tax authorities erred in issuing a guarantor's payment order under the Tax Code. The managing director also argued that the tax authorities failed to establish that he actually caused the damage and that he had not compensated the damage already.

The Supreme Administrative Court noted that under the Tax Code, the guarantor must pay the tax arrears so long as the law lays down the guarantee obligation on such person. The special law to which the SAC refers is Section 159 of the Civil Code, which regulates the conditions under which a person is liable and bound to guarantee for his or her liability.

According to SAC, the basic condition for the issue of a guarantor payment order under the Tax Code is continued existence of the liability for the damage under Section 159 of the Civil Code. The Supreme Administrative Court therefore acknowledged that managing director's argument that if his liability to compensate damage under Civil Code expired, his obligation to pay the company's tax arrears in accordance with the tax authority's guarantee's payment order has also ceased to exist.

At the same time, this does not automatically mean that the managing director is released from his obligation to guarantee for the tax arrears. The defence that the obligation has become time barred does not apply if the defence is exercised contrary to good morals or amounts to an abuse of law, as recognised in earlier case law.

The Supreme Administrative Court also noted that the burden of proof as to whether the managing director acted with due managerial care rested on the managing director. The managing director was likewise required to establish that he compensated the damage to the company, thus discharging his statutory guarantor's obligation, which the managing director failed to do so in the present case.

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→ Economics

Are we facing a "recodification" of the laws regulating the area of accounting and taxes? (Part 1)

The new Accounting Act is once again a little closer to coming into force. There is still a question whether the new Accounting Act will become effective in 2026[1] or later, but we are getting there! The more information we have available about the new Accounting Act and the related amending bill to the related legal regulations, the more it becomes clear that, in terms of its scope and implications, this situation may be compared with the recodification of commercial and civil law that took place in 2014.

Ladislav Čížek
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On 31 May 2024, the Ministry of Finance of the Czech Republic published the theses of implementing regulations for the new Accounting Act and the refined draft of the new Accounting Act. These documents have some interesting consequences for all those who work with financial statements – whether as their creators or users. For example: the time value of money (a change in valuation methods), the recognition of current leases under assets, "mandatory" component depreciation, the residual value of assets, changes in the method how provisions are recognized and, last but not least, changes in the terminology used.

[1] Practically speaking, the intended effective date for the new Accounting Act set for 1 January 2025 is highly impossible.

This and much more is what the draft of the new Accounting Act entails! On the same day, a draft of the amending bill to the related legal regulations, the so-called "Accompanying Act" was published. This Accompanying Act not only amends the Income Taxes Act, but also the Business Corporations Act, the Civil Code, the Code of Judicial Procedures and more than 115 other acts and laws. As you can see, this cannot be covered in one afternoon.

"Accompanying Act" has been already undergoing the standard inter-ministerial comment procedure. The published theses of the implementing regulations for the new Accounting Act and the refined draft of the new Accounting Act should provide a better understanding what direction this legal regulation for the accounting area is going. This is not a draft of the wording of a legal regulation. Instead, it merely explains what each accounting method entails and what it is based on.

In our previous newsletters, we have already informed you about the most important changes introduced by the draft of the new Accounting Act. Today, we wish to present an overview of selected, interesting, upcoming and discussed changes that have arisen from the newly published materials.

Accounting

Compensation in the financial statements

The thesis of the implementing regulations anticipates that the area of permitted compensations in the financial statements will be larger. The newly permitted compensations are marked in red. For the sake of providing complete information, we may say that most of the changes mentioned below are in line with the IFRS concept and framework, or any other generally accepted frameworks where only "gains and losses" are shown.

- Expenses and revenues from the sale of fixed assets
- Interest revenues and expenses
- Costs of damage and any entitlement to their refund
- Rebilled expenses
- Debts[2] (incl. estimated debts) and advances
- FX gains and losses
- Shortages and surpluses (already in force as per the interpretation of the National Accounting Council)
- Corporate income tax and advances paid
- Deferred tax asset and debt

Present value

Under the new Accounting Act, medium and large reporting entities will be required to take into account the time value of money. In other words, they will be required to disclose and present long-term receivables and debts (previously, we would say payables) at present value. The issue of setting a discount interest rate (or incremental interest rate) is inherently connected. The thesis of the Implementing Regulation for Entrepreneurs says that the incremental interest rate will be the interest rate at which an available bank would be willing to grant a loan for the same purpose for which the debt arose.

At the same time, however, a (indicative) transitional (temporary) provision is proposed that sets the discount rate at a minimum level of "PRIBOR + 8 percentage points" for a specified period of time, if reported in Czech korunas.

Component depreciation

The draft discusses a mandatory implementation of the so-called component depreciation that has been mentioned in the Regulation only as an alternative method of depreciation. In the usual practice, this method is not practically used at all. The theses of the regulations mention the option that a reporting entity must consider breaking down its significant assets into its components or parts for separate depreciation and assigning a specific useful life.

Conclusion

You will find more information on other changes proposed for both the area of accounting and taxes in our next newsletter.

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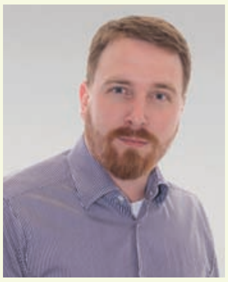

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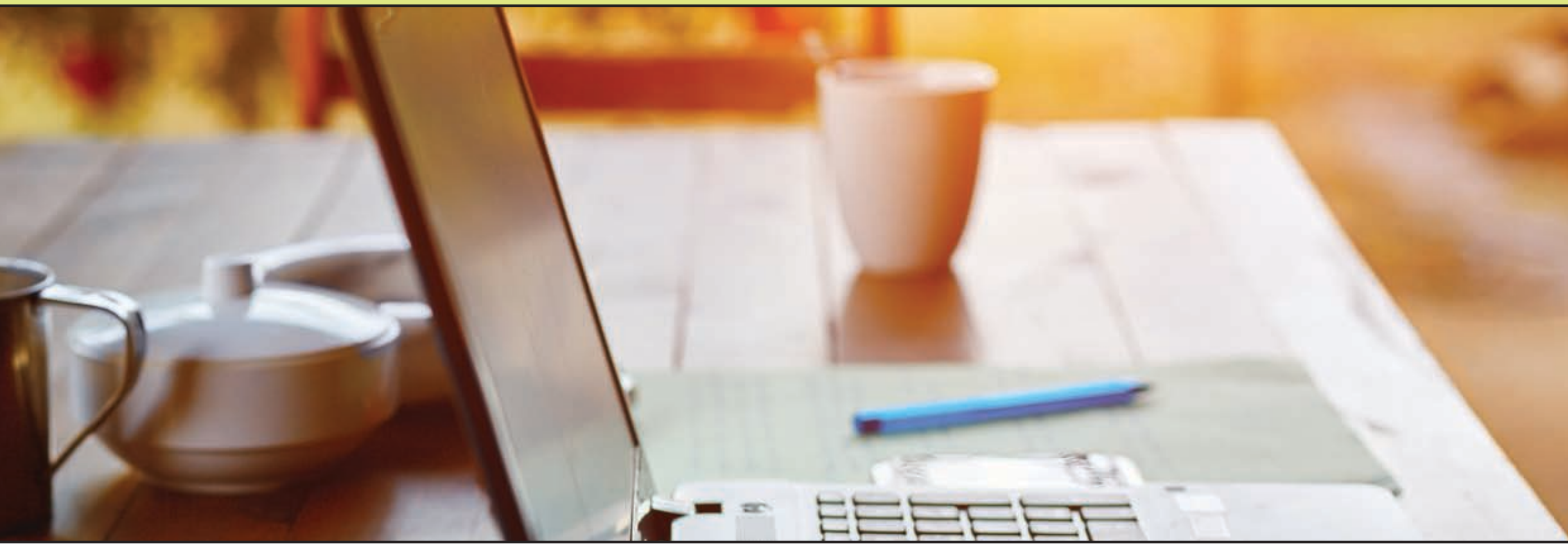
[2] Using the current terminology, we may say "payables"



→ ESG Insights

ESRS 1 – Value chain and other requirements

In today's continuation of the series on the European Sustainability Reporting Standards, we conclude the discussion on the first cross-cutting standard, ESRS 1.

Radim Botek
Rödl & Partner Prague

Due diligence

European Sustainability Reporting Standards are and will be significantly intertwined with other regulations. One example is due diligence, which is primarily regulated in UN and OECD guidelines and more recently in the EU Corporate Sustainability Due Diligence Directive (CSDDD), of which the already existing German supply chain law, the so-called "Lieferkettensorgfaltspflichtengesetz" (LkSG), has become an important precursor. And it is due diligence that is one of the key prerequisites for a number of disclosures, primarily under ESRS 2 – for example, the inclusion of due diligence in governance, stakeholder engagement or the taking of corrective action.

Value chain

In addition to double materiality (see the previous edition of our newsletter), a key cross-cutting theme of the ESRS is the value chain (which should not be narrowed down to the supply chain). Enterprises should always consider in their sustainability report all relevant and material information on impacts, risks and opportunities arising not only from their own activities but also from their business relationships (direct and indirect), across the entire value chain. The value chain is essentially two parts – upstream, which is primarily the suppliers of raw materials, components, and services; and downstream, which includes customers, end-users, and even recyclers.

The value chain is one of the many ways in which non-financial reporting differs from the financial reporting we are all familiar with, where the financial statements, whether individual or consolidated, always show only the activities of the enterprise or group itself.

The objective of the ESRS is to ensure that enterprises provide information on sustainability not only for their own operations but also in a broader context. Indeed, it is highly likely that many sustainability risks and impacts, not only environmental, will be outside EU-based enterprises.

For example, textile importers and retailers in the Czech Republic can be expected to respect all employee rights (including their reasonable remuneration) and customer rights and to ensure compliance with strict environmental principles. In contrast, the risk of significant negative impacts on employees and the environment is significantly higher for a textile supplier/manufacturer, for example from Asia. The consideration of the value chain will be crucial in meeting the requirements of ESRS E1 - in particular for the reporting of greenhouse gas emissions under Framework 3.

Obtaining information for the ESG report from individual trading partners – especially from outside the EU and from SMEs – will be very complicated in the early years. This is why the ESRS also offers the possibility of using sectoral averages. The crucial transitional provision 10.2 on Chapter 5 Value chain also introduces a three-year period for which the following is set out: "In the first three years of reporting on the sustainability of an enterprise under the ESRS, if all the necessary information is not available on upstream and downstream parts of its value chain, the enterprise shall explain what efforts it has made to obtain the necessary information on upstream and downstream parts of its value chain, the reasons why it has not been possible to obtain all the necessary information, and its plans to obtain the necessary information in the future." From the fourth year onwards, reporting for the entire value chain will be mandatory.

The importance of this topic is also reflected in one of the two available methodological guides that EFRAG has published so far - EFRAG IG 2 Value Chain. This should clarify any questions enterprises may have about the value chain and make it as easy as possible to take it into account when preparing the Sustainability Report.

Other parts of ESRS 1 cover the following areas necessary for a proper Sustainability Report:

Time horizons

The reporting period for the ESG report is the same as the accounting period. Enterprises will link retrospective information to current period information and expected developments in their reports as appropriate. Setting a reference year for selected topics will be key.

A significant part of the disclosures will be described by enterprises in relation to three time horizons – short-term, medium-term (2 to 5 years) and long-term (>5 years). An enterprise may deviate from this definition and describe the change in justified cases.

Preparation and presentation of sustainability information

European Sustainability Reporting Standards require disclosure of comparative information, not only for quantitative indicators but also for descriptive information. Another important transitional provision – 10.3 Transitional provision relating to Section 7.1 Presentation of comparative information states that an enterprise need not disclose comparative information in the first year of preparing an ESRS sustainability statement.

If the information in the sustainability report is based on estimates, not only of selected indicators but also of future events, the enterprise will need to comment on the underlying assumptions for the estimates, the sources of uncertainty and ensure that the estimates are consistent with the assumptions in the financial statements.

The standard also describes possible changes in the preparation of the report, the issue of correcting errors, (non)disclosure of confidential and sensitive intellectual property information, and possible consolidation of data for a group of enterprises.

Structure of the sustainability statement, linkages with other parts of corporate reporting

The Sustainability Report is required to include information according to Article 8 of the EP-EU Taxonomy Regulation. The report should then be divided into 4 sections – general information, environmental affairs, social affairs, governance and management. European Sustainability Reporting Standards allow cross-references to other parts of the report or financial statements, but only if the prescribed requirements are met.

ESRS 1 has a number of useful additions that we have discussed in previous articles. These include information quality requirements, phased-in requirements, a model structure for a sustainability report, etc.

In the next article, we will cover ESRS 2, which is a general Information cross-cutting standard that is equally important for ESG reporting.

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→ ESG Insights

ESRS 2 – General Disclosures

The second ESRS cross-cutting standard is ESRS 2. Unlike ESRS 1, this standard already defines mandatory disclosures for all enterprises, regardless of their industry and activities, in the form of so-called disclosure requirements.

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The standard was the first to use certain abbreviations that other standards continue to use:

ABBREVIATION	ENGLISH DESCRIPTION
DR	Disclosure Requirement
IRO	Impacts, Risk, Opportunities
BP	Basic Principles
GOV	Governance
SBM	Strategy and Business Model
MDR	Minimum Disclosure Requirements
MDR-P	MDR – Policy
MDR-A	MDR – Actions
MDR-T	MDR – Targets
MDR-M	MDR – Metrics

As required by ESRS 2, an enterprise must disclose the following in its sustainability report:

1. BASIC PRINCIPLES FOR THE REPORT

– BP-1 – General basis for the preparation of the sustainability statement
  The basis on which the enterprise has prepared the report - individual or consolidated, including a description and the extent of consideration of the value chain and any omission of classified information.

– BP-2 – Disclosure of information in relation to specific circumstances
  These may include:
  – Time horizons – the enterprise's own definition of the business and its rationale
  – Estimates along the value chain – metrics, level of uncertainty and the enterprise's plan for refinement
  – Sources of uncertainty in estimates and results – in the case of metrics with a high degree of uncertainty, sources of measurement uncertainty and underlying principles and judgements
  – Description of changes in reporting, including reasons and revised comparative data
  – The nature of material errors and their correction for each period
  – A list of any information incorporated by reference
  – When using the phased-in approach in accordance with Appendix C of ESRS 1 - identification and description of significant issues

2. CORPORATE GOVERNANCE

– GOV-1 – Role of administrative, management and supervisory bodies
  Specifically, the enterprise is required to disclose information on the members of the bodies, including composition, identification of those responsible for sustainability, details of diversity, roles and responsibilities, including sustainability expertise. Diversity is represented by the proportion of employees, women and non-executive members.

– GOV-2 – Information provided to the enterprise's administrative, management and supervisory bodies and sustainability issues addressed by these bodies
  That is, how, when and by whom the members of the bodies are informed what significant sustainability IROs have been addressed in the given period.

– GOV-3 – Incorporating sustainability-related performance into incentive schemes
  Incentive schemes are rewards for board members conditional on the achievement of certain sustainability-related targets or indicators. Where such are in place, the enterprise will disclose a description of the incentive, how it is set, and the proportion of variable remuneration so set.

– GOV-4 – Due Diligence Statement
  This requirement does not set out specific requirements for corporate behaviour but does require disclosure of how and where the due diligence practices established by the enterprise are reflected in the Sustainability Report.

– GOV-5 – Risk management and internal controls for sustainability reporting
  In this section, the enterprise will describe the key elements of the risk management and internal controls in the sustainability reporting process.

3. STRATEGIES

– SBM-1 – Strategy, Business Model and Value Chain
  The enterprise discloses information on the key elements of its overall strategy in relation to sustainability issues, specifically:

- Description
- Significant product and service groups, markets and customer groups, including material changes in the current period
- Number of employees by region
- Any materials and products prohibited in certain markets
- Breakdown of total revenue by industry, reconciled to the IFRS 8 reported segment data, where applicable
- Statements of operations in selected industries – fossil fuels, chemicals, tobacco production
- Objectives and elements of the enterprise's strategy in relation to products, markets or stakeholders
- Description of the business model along the value chain
    - Inputs and their sourcing and development
    - Outputs and customer benefits
    - Position of the enterprise and description of the main business stakeholders (suppliers, customers, etc.)

– SBM-2 – Stakeholder interests and views

The enterprise discloses how stakeholder interests are factored into the strategy and business model, i.e. their engagement by area and key representatives and understanding within due diligence processes.

– SBM-3 – Significant impacts, risks and opportunities and how they relate to the strategy and business model (BM)

In this section, the business discloses:

- A description of the significant IROs arising from the dual materiality assessment, including their allocation to the relevant parts of the BM and value chain
- The current and expected effects of the impacts on the BM and the enterprise's anticipated actions
- Current and projected financial impacts on assets, liabilities, performance and cash flows
- Information on the resilience of the enterprise's SBM in relation to the identified IROs

4. MANAGING IMPACTS, RISKS AND OPPORTUNITIES

4.1. Disclosure of the materiality assessment process

– IRO-1 – Description of procedures for identifying and assessing significant impacts, risks and opportunities

It is only in this section that the enterprise describes the process for identifying significant IROs that form the basis for the sustainability report. This includes the methodology, assumptions, prioritisation and evaluation criteria, consideration of the value chain, involvement of affected stakeholders, integration of the whole process into the management of the whole enterprise, etc.

– IRO-2 – Disclosure requirements in ESRS covered by the corporate sustainability statement

According to this requirement, the enterprise must, among other things, publish a list of ESRS requirements (e.g. in the form of an index) that have been followed in the compilation of the ESG report, including links to relevant pages. If the enterprise assesses climate change as an insignificant topic under ESRS E1, it must explain its conclusions in detail, including its own forward-looking analysis.

4.2. Minimum disclosure requirement on policies and actions

– MDR-P – Policies adopted to manage significant sustainability issues

– MDR-A – Actions and resources related to significant sustainability issues

This section of sets out the minimum disclosure requirements on its policies and actions to prevent, mitigate and remedy actual and potential significant impacts, address significant risks and/or take advantage of significant opportunities.

5. METRICS AND TARGETS

- MDR-M – Metrics related to relevant sustainability issues
- MDR-T – Monitoring the effectiveness of policies and actions through targets

The last section sets out the minimum requirements for disclosing information on its metrics and targets relating to each material sustainability issue. They are applied in conjunction with the disclosure and application requirements set out in the relevant thematic ESRS.

Conclusion

Was it a difficult read? I agree. However, this theoretical introduction to ESRS, which we have brought to you in the last 3 issues of the newsletter, was necessary so that we could dive into the individual thematic standards in future issues. And the very first one will probably be the most anticipated by everyone – ESRS E1 – Climate Change.

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→ Rödl & Partner Intern

Congratulations to new Partners

Rödl & Partner, Czech Republic, appointed new Partners – lawyer Petra Budíková, lawyer Jakub Šotník, certified expert Martin Koldinský, tax advisor Petr Tomeš and auditor Radim Botek.

International advisory firm Rödl & Partner, which operates in fifty countries all over the world, appointed new Partners in the Czech Republic for the first time in eight years, raising to fifteen the total number of Partners in the Czech branch, with its 320 experts in legal, tax and audit advisory, accounting and business consulting. The new Partners consult in some of the most significant practice areas of one of the leading advisory firms on the Czech market.

"The appointment of our colleagues to the position of Partners is a recognition of their professional excellency and their remarkable personal qualities. They are all invaluable for our firm's success, and their hard work, commitment and vision contribute to the continuous growth and development of Rödl & Partner in the Czech Republic. It is my honour and a great pleasure to congratulate all our new Partners on their appointment," says Petr Novotný, Managing Partner of Rödl & Partner, Czech Republic.

JUDr. Petra Budíková, LL.M.

a graduate of Palacky University in Olomouc and of a study programme at the University of Passau, joined Rödl & Partner in 2005 and was appointed an Associate Partner in 2012. Her principal practice areas include M&A, due diligence, leases, employment law and corporate advisory for both Czech and international clients. She is an author of numerous articles and a popular lecturer.

Mgr. Jakub Šotník

a graduate of the Faculty of Law at Masaryk University in Brno, joined Rödl & Partner in 2014 and was appointed an Associate Partner in 2018. He represents clients in disputes with tax authorities and in tax-related lawsuits before administrative courts. He also advises clients on criminal tax law and transactions. He publishes papers and articles in expert journals, and he is an author of numerous publications in the Czech Republic and abroad. He regularly lectures on expert topics and is a member of the Public Law Section of the Czech Bar Association.

Ing. Martin Koldinský

a graduate of a Faculty of International Relations of the Prague University of Economics and Business, joined Rödl & Partner in 2016 and was appointed an Associate Partner in 2020. A certified transfer pricing expert, he specialises mostly in transfer pricing and valuation of business and real estate, but also represents clients during tax audits and inspections and in disputes with tax authorities. He is a member of the R&P's international transfer pricing practice group; he is a published author of many articles in expert journals and lectures both in the Czech Republic and abroad.

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a graduate of the Prague University of Economics and Business joined the Prague branch office of R&P Czech Republic in 2012. He founded the transfer pricing department of our firm and was appointed an Associate Partner in 2015. He advises clients on transfer pricing and represents clients at tax audits and inspections and in cross-border tax disputes, especially in the area of international taxation. He is a member of R&P's international transfer pricing practice group; he publishes articles and papers in expert journals and regularly lectures in the Czech Republic and abroad.

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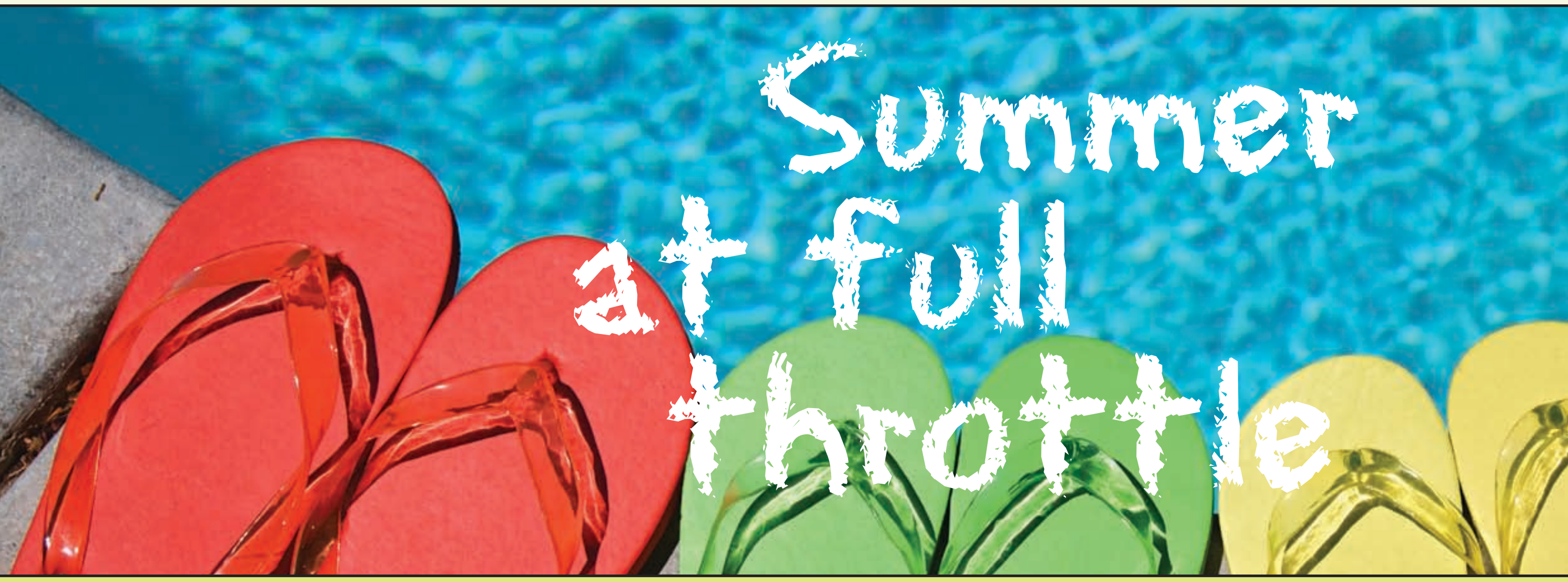

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