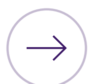
CSRD: No time to lose!

Exploratory research into the application of new regulation on sustainability reporting in annual reports (CSRD) at listed companies and audit firms



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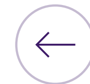
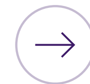

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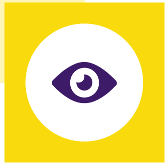


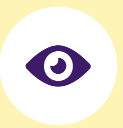
Summary

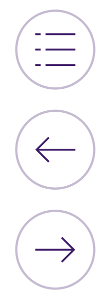
Figure 1. Timeline: implementation CSRD

Good information on sustainability in reporting is a key factor in the sustainability transition

The transition to a sustainable society is one of the most important challenges of our time. Much regulation to encourage the sustainability transition and put this on the right course is on the way, especially from Europe. The Corporate Sustainability Reporting Directive (CSRD) is an important part of this.

The CSRD requires companies to report more extensive and more specific non-financial information (NFI) based on the European Sustainability Reporting Standards (ESRS) in their reporting. The CSRD moreover requires a statutory auditor or assurance provider to provide limited assurance regarding the non-financial information prepared on the basis of the ESRS.





Give priority throughout the value chain in obtaining good sustainability information

The number of companies subject to the new reporting requirements will increase substantially from 2024 onwards as a result of the CSRD. The same challenges will be faced by companies, audit firms and other parties in the value chain. This means that they will have to prioritise getting their sustainability reporting in order and must therefore seek to obtain sufficient capacity and expertise to be able to do this. It is clear from figure 1 that there is no time to lose. The CSRD will take effect in just nine months' time and will replace the Non-Financial Reporting Directive (NFRD), the CSRD's predecessor, which has been applicable since 2017. The scope of the CSRD will also be extended after 2024 to include other large non-PIEs (in 2025) and small and medium-sized listed companies (in 2026).

In anticipation of the CSRD: exploratory research into reporting and assurance provided for non-financial information

The introduction of the CSRD and the concerns of investors and other users regarding the connection between non-financial information and financial information led the AFM to carry out exploratory research in 2022 of non-financial information in management reports and the associated assurance provided.

Findings of the research and good practices to be used, because the CSRD is coming soon

With our research findings we aim to encourage listed companies and audit firms to improve their NFI reporting and assurance. This report also includes examples of good practice that we have seen. This will better prepare companies for the introduction of the CSRD and enable them to fulfil the information needs of investors and other users. We wish to stress that the path to a more sustainable society will not be an easy one and that the situation is urgent. Companies, investors, auditors, social organisations, consumers and supervisors are all part of a complex system. All parties in the value chain need to work on this and take responsibility for complying with the law and moving towards a sustainable society.

In this AFM research: 27 listed companies and the 4 largest audit firms

We selected a number of sectors in which climate impact, such as CO_2 emissions, plays a major role. These are banks, oil and gas, manufacturing, food and technology. The annual reports (for the 2021 financial year) of 27 listed companies in these sectors were included in the research. This represents roughly a third of the companies that have been subject to the NFRD since 2017 and whose reporting is subject to supervision by the AFM.

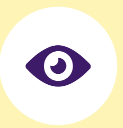
With effect from 2024, 'limited assurance' from a statutory auditor will be required with respect to non-financial information. The assurance statements on the non-financial information of the selected listed companies were provided only by the Big 4 audit firms. The research accordingly focused on how the four largest PIE audit firms (Deloitte, EY, KPMG and PwC) have dealt with this.

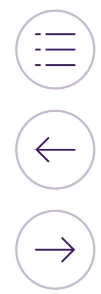
Focus of the research on application of the ESG theme 'climate'

We restricted our research to the application of one of the six environmental (E) themes in the ESRS, that of climate. 'Climate' is only one of the many ESG topics, but it has a large and important impact on the sustainability transition. Climate is therefore the subject of intense public attention, and most of the sustainability regulation relates to climate risks.

Findings of the research of the ESG theme 'climate': Companies still have much homework to do

Our research shows that half of the 27 listed companies provided no or only limited disclosure of their negative impacts on the environment and society. We also note that most of the companies in the research were not sufficiently transparent on the (financial) impacts of climate change and the energy transition on their business operation. In addition, half of the 27 companies were not clear as to how they intended to achieve their climate goals. Lastly, we note that, in a number of cases, insufficient attention was devoted in the annual report to key sustainability aspects for the company concerned.





Sustainability reporting by large companies has a long way to go in a very short time – actions:

1. Give more prominence to key sustainability topics in the annual report.
2. Improve the reporting of the negative impacts of the business activities.
3. Be more transparent about the (financial) impact of climate change and the energy transition on the company.
4. Give more clarity on how climate goals will be achieved and the dilemmas experienced in this respect.
5. Involve the auditor based on his role in the assessment of a balanced presentation of the sustainability reporting.

Note

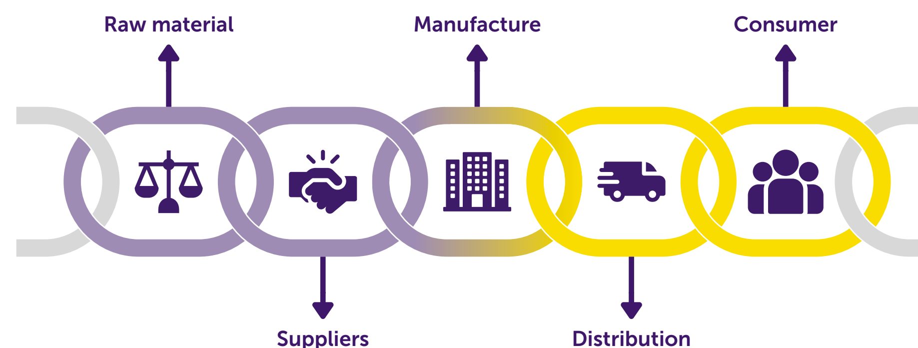
Companies need to be transparent regarding their impact on the environment, their employees, society at large and the financial impact of ESG factors on the company. Investors and other users, such as governments and NGOs, increasingly demand this information. Companies need to devote adequate attention to both the favourable/positive aspects and the unfavourable/negative aspects of their business activities. Furthermore, greenwashing must be avoided. Additionally, connectivity between financial and non-financial reporting is important for users of the annual report. Finally, there needs to be a logical and cohesive connection between the various parts of the management report relating to ESG, such as strategy, targets, the risk paragraph and performance, and the company's policy on dividends and remuneration.

One good example of an important step that still needs to be taken is the reporting of double materiality. This means that companies need to report on both the (financial) impact of the environment, such as climate change, on the company (outside-in) and their positive and negative impacts on the environment and society (inside-out). In our research the companies indicated that double materiality is one of the challenges posed by the CSRD. Translating the environmental aspects to financial impacts is particularly complicated. Our research also shows that companies' negative impacts on the environment and society are not or only barely disclosed.

Available and reliable sustainability data leaves much to be desired – actions:

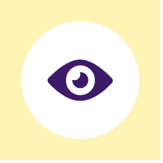
1. Speed up investment in IT systems and processes relating to sustainability data.
2. Expand reporting on scope 3 emissions.
3. Engage the value chain: your customers and suppliers are also responsible.

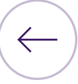
Figure 2. The value chain

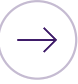


Note

It is important that companies need to check which data they need from both internal and external parties in their value chain to report in accordance with the CSRD. In addition, they need to (further) invest in IT systems and processes relating to sustainability data in a timely manner, so that systems and processes are in place to deliver available and reliable data. We still see a number of serious challenges regarding the collection and registration of these data. Far more data and more specific data need to be collected than the data that are currently being reported. Non-financial information is frequently not as reliable as financial information, and NFI data can often not be derived from existing financial records. As a result, the reporting on scope 3 emissions is still not as extensive as it needs to be. Companies therefore need to accelerate their investment in IT systems and processes relating to sustainability data and remind their value chain partners of their role in collecting and registering these data in the same way.







Concerns regarding the understandability of the statutory auditor's assurance statement – actions:

1. Give greater clarity regarding the nature and scope of the assurance procedures.
2. Be transparent regarding challenges and dilemmas in the assurance statement.

Note

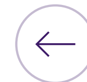
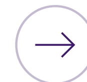
After the CSRD takes effect in 2024, the non-financial information that companies present in their annual reports has to be provided with an assurance statement. In their current form, the understandability of the assurance statements provided for the NFI of the listed companies selected is still lacking on a number of points. This could mean that users attach greater value to these statements than is actually justified. For instance, scope limitations in the assurance statement are not clearly comprehensible, and combinations of 'reasonable assurance' and 'limited assurance' in an assurance statement are confusing. The CSRD forbids 'cherry picking' and provides for a single 'limited assurance' statement according to uniform standards.

Threat of lack of capacity and expertise – actions:

1. Companies need to assess the capacity and expertise they need as a result of the introduction of the CSRD.
2. Review the organisational structure of the audit firm and assess the capacity and expertise needed to quickly cope with the expected increase in assurance engagements.

Note

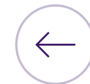
Substantial progress on both capacity and expertise is needed at both companies and audit firms. The organisational structure of audit firms must also adapt quickly to cope with the expected increase in assurance engagements.

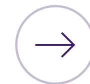



Key terms

The following is a list of key terms that give context when reading this report.

Key terms	Note
Scope 1, 2 and 3	Scope 1: direct emissions from sources owned or managed by the issuer. Scope 2: indirect greenhouse gas emissions from purchased energy, such as electricity, heating or air conditioning, generated outside the issuer and used by the issuer. Scope 3: all indirect emissions occurring in an issuer's value chain.
PIE audit firms	Audit firms with a licence from the AFM to perform statutory audits of clients that are public interest entities and statutory audits of clients that are not public interest entities.
Non-PIE audit firms	Audit firms with a licence from the AFM to perform statutory audits of clients that are not public interest entities.
Assurance engagement	An assurance engagement is a professional service in which an auditor wishes to obtain sufficient and appropriate assurance information in order to express a conclusion that strengthens the degree of reliability for the intended users, other than the responsible party, in the result of the measurement or evaluation of the audited entity in comparison to criteria.
Qualified audit opinion	An unqualified audit opinion with the exception of a part of the reporting.
Limited assurance statement	In a statement with limited assurance, a statutory auditor states that they have not identified errors in the information they have assessed ('negative assurance').
Reasonable assurance statement	In a statement with reasonable assurance, a statutory auditor states with a reasonable degree of assurance that the information they have audited is correct and complete ('positive assurance').
Carbon credits	A negotiable certificate or licence enabling organisations and individuals to offset their CO_2 emissions by reducing CO_2 emissions elsewhere.
Corporate Sustainability Reporting Directive (CSRD)	A new European directive obliging companies to report on sustainability with effect from the 2024 financial year.
European Sustainability Reporting Standards (ESRS)	European reporting rules that companies have to apply for their sustainability reporting in accordance with the CSRD.





Key terms	Note
Greenwashing	The wrongful labelling of products as sustainable, or the presentation of company performance as more sustainable than is actually the case.
Quality safeguards	Quality safeguards are the methodologies, procedures and measures that form part of the quality control system of an audit firm. These should lead to a situation in which the statutory auditor who issues the audit opinion or assessment can do this in a professional, independent, ethical and recognisable manner.
Non-financial information (NFI)	For the purpose of this research, NFI means information relating to the environment, social matters and governance (ESG).
Non-Financial Reporting Directive (NFRD)	The predecessor of the CSRD.
Engagement Quality Control Review (EQCR)	An EQCR is a quality safeguard intended to prevent serious deficiencies in the quality of statutory audits before the issue of an audit opinion.
Sustainable Finance Disclosure Regulation (SFDR)	A European regulation on sustainability-related disclosures in the financial sector.
Quality control system	Among other things, a quality control system concerns procedures, descriptions and standards that are designed to safeguard compliance by an audit firm with regulations set by or pursuant to statute.
Statutory audit	A statutory audit is an audit of the financial reporting of an enterprise for public use that is specifically designated as a statutory audit in the Audit Firms (Supervision) Act (Wet toezicht audit firms, or 'Wta'). This concerns the audit of financial statements of medium-sized and large companies, municipalities, provinces and various financial enterprises, for instance.

01 **Introduction**

Figure 3. Timeline: implementation CSRD

2017
Regulation NFRD
Applicable to: Large Public Interest Entities
> 500 employees (Large PIEs)

Attention, last
9 months go into effect!

2024
Regulation CSRD
Applicable to:
Large PIEs

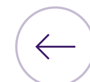
2025
Regulation CSRD
Applicable to:
all large companies

2026
Regulation CSRD
Applicable to:
Medium-sized and small listed entities, other than micro-companies

2028
Regulation CSRD
Applicable to:
Non-EU companies with revenue > 150 million euro in the EU

The transition to a sustainable society is one of the most important challenges of this time.
We expect market participants to be transparent regarding their sustainability impact and risks and to enable investors to take well-founded decisions on that basis. Good information on sustainability is the key here, and this is thus a priority for the AFM. It is a priority that belongs to the AFM's strategy for 2023-2026, in which sustainability, digitalisation and internationalisation receive special attention.[1] Much regulation to encourage the sustainability transition in the financial sector and put this on the right course is on the way, especially from Europe. We encourage parties to apply this new regulation on sustainability correctly and in a timely manner.

1 Strategy 2023-2026 (afm.nl)



Reporting of and assurance on non-financial information will be mandatory for an increasing number of companies

The EU's new Corporate Sustainability Reporting Directive (CSRD) for reporting by companies on sustainability is an important step towards better sustainability reporting. For large public interest entities (PIEs), the CSRD will become mandatory with effect from the 2024 financial year.[2] This will be followed by the remaining large companies from the 2025 financial year, small and medium-sized listed companies from the 2026 financial year[3] (other than micro-companies) and non-EU companies with revenue of more than €150 million in the EU from the 2028 financial year. Under the CSRD, these companies will have to report more extensive and more specific non-financial information based on the European Sustainability Reporting Standards (ESRS).[4] Reporting on sustainability is still very much a moving target, and the ESRS will be further developed in the years to come. Sector-specific standards still have to be developed, with initial proposals for this to be published in 2023, and there will also be standards for SMEs.

At global level, the International Sustainability Standards Board (ISSB) of the IFRS Foundation published draft international standards for sustainability reporting in 2022. These standards should improve the relevance and comparability of sustainability reporting internationally.[5] Publication of the first two final standards is expected in mid-2023.

2 These are organisations as defined in Section 398(7) of Book 2 of the Dutch Civil Code (DCC).
3 Small and medium-sized listed companies can choose to delay application of the CSRD until the 2028 financial year (a two-year opt-out period).
4 The European Financial Reporting Advisory Group has formulated the European Sustainability Reporting Standards (ESRS) that companies have to apply to their sustainability reporting under the CSRD. The ESRS relate to various aspects of ESG, including climate, and were published in draft form in November 2022. The ESRS have to be approved by the European Commission by 30 June 2023.
5 AFM argues for greater clarity and practicability of international standards for sustainability reporting

1.1 Our research

AFM has carried out an exploratory research of non-financial information in management reports and the associated assurance provided.

The introduction of the CSRD and concerns of investors and other users regarding the connection between non-financial information and financial information led the AFM to carry out exploratory research in 2022 of non-financial information in management reports and the associated assurance provided.

The research focused on the aspect of 'climate' and was primarily exploratory in nature. The research-questions centred on:

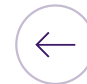
1. the degree of connection between the non-financial and financial reporting.
2. the extent to which audit firms and statutory auditors fulfil their role of providing assurance with respect to non-financial information and how audit firms support statutory auditors in the provision of assurance with respect to non-financial information.

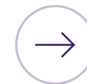
The research involved 27 listed companies and the 4 largest PIE audit firms

We identified a number of sectors in which climate aspects and risks, such as CO_2 emissions, play a significant role: banks, oil and gas, manufacturing, food and technology. In each sector, the annual reports of the most companies in that sector were selected. In total, the research comprised the annual reports of 27 listed companies for the 2021 financial year. We included four PIE audit firms (Deloitte, EY, KPMG and PwC) in our research.

The CSRD will not only affect the listed companies and the four PIE audit firms in the research

The CSRD will apply to all large, medium-sized and small listed companies and non-EU companies with revenue of more than €150 million in the EU. We also expect the introduction of the CSRD to mean that the other PIE audit firms and the non-PIE audit firms will provide more companies with assurance with respect to NFI. The observations in this report are therefore relevant for other companies and audit firms as well.





AFM research: Serious efforts required at companies to comply with the CSRD/ESRS in a timely manner

In this report, the AFM highlights a number of challenges and concerns it sees on the way to application of the new sustainability reporting standards. It also puts forward recommendations on a number of issues, such as disclosure of climate goals, the (financial) impact of climate change (mitigation and adaptation), the extent to which climate goals are being and will be realised and the use of scenarios. Based on these new reporting standards, these disclosures will become mandatory pursuant to ESRS E1 climate. For many companies, this will entail a serious further effort to be able to comply with the new reporting standards in time.

1.2 Background to the research

Increasing attention to ESG targets with focus on climate risks

Public attention to issues associated with the environment (E), social issues (S) and governance (G), collectively referred to as ESG, has sharply increased in recent years. The focus in the public debate is currently on climate risks, as the negative consequences of climate change are becoming ever more visible and require urgent measures. In the Paris climate agreement for 2020-2050, it was agreed that the average global temperature should not increase by more than 2 degrees Celsius compared to the pre-industrial era and that countries should strive to restrict the increase in temperature to 1.5 degrees Celsius. Europe aims to be climate-neutral by 2050. The European Commission accordingly introduced its Green Deal package in 2019, under which greenhouse gas emissions will have to be sharply reduced on the way to 2050. The increased attention to ESG, partly as a result of the European Green Deal, has far-reaching consequences for various parties. The impact will be significant, also for companies and audit firms. Not only financial, but also for internal IT systems and processes and the way in which companies will have to report on ESG aspects and statutory auditors will have to issue assurance statements.

Transparency is required on green targets, their realisation and the financial consequences

For instance, investors, governments and other users want companies to be transparent in their reporting on their climate-related goals. They also want transparency on how companies intend to realise these goals and when and to what extent companies have progressed in their realisation of these goals. Investors also want information on the (long-term) financial consequences of a company's climate strategy.

In the context of (annual) reporting by companies, this means that there needs to be consistency and connectivity between financial and non-financial reporting. Many reports have expressed concerns regarding a lack of connectivity.[6] Stakeholders such as investors can make better-informed[7] decisions if non-financial information (NFI) is properly disclosed in the annual reporting and the relationship with financial effects in both the short and the long term is explained.

New legislation should lead to greater transparency regarding how sustainable a business model is

The CSRD will replace the current NFRD directive (Non-financial Reporting Directive, implemented in the Netherlands in the 'BNFI', the Decree on the disclosure of non-financial information) from 2017 that applies to large public interest entities with more than 500 employees. The Sustainable Finance Disclosure Regulation (SFDR), in force since 2021, also contributes to greater transparency on sustainability. This regulation contains new rules for sustainability-related disclosures in the financial services sector. The aim of the new sustainability legislation and regulation is to shift financial flows towards activities and companies that are more focused on the transition to a sustainable society.

6 These concerns have been voiced in reports such as Flying blind: The glaring absence of climate risks in financial reporting - Carbon Tracker Initiative and Still Flying Blind: The Absence of Climate Risk in Financial Reporting - Carbon Tracker Initiative from the Carbon Tracker Initiative.

7 What we mean here is that information has to be understandable, relevant, verifiable and comparable, with faithful representation.

The CSRD and SFDR are useful in combating greenwashing

Issuers have an incentive to exaggerate the sustainability of their activities ('greenwashing'). This makes it easier for them to raise funding, it usually costs them less in interest and they present an image of sustainability to investors and consumers. Exaggerating the sustainability of performance, either intentionally or otherwise, creates a gap between perceived and actual performance. With its new disclosure requirements, the CSRD contributes to the prevention of the risk of greenwashing and promotes sustainable investing. Among other things, the SFDR aims to provide investors with greater insight into sustainability risks and to improve the comparability of financial products with respect to sustainability. It also aims to combat greenwashing.

Provision of assurance with respect to non-financial information to be mandatory in the auditor's assurance statement

The sustainability reporting required in the management report under the CSRD must be accompanied by an assurance statement with respect to the non-financial information that is prepared on the basis of the ESRS. This concerns limited assurance. This assurance may be provided by the statutory auditor who performs the statutory audit of the financial statements or by another auditor at an audit firm with a licence to perform statutory audits.[8] By 1 October 2026, the European Commission will set assurance standards in relation to the provision of limited assurance. Assurance standards for the provision of reasonable assurance have to be set by the European Commission by 1 October 2028.[9]

Reading guide

Chapters 2, 3, 4 and 5 describe the findings of our research at companies and audit firms. Chapter 2 deals with transparent, balanced and cohesive sustainability reporting. Chapter 3 describes the challenges for companies and audit firms in relation to the availability and reliability of sustainability data. Chapter 4 concerns the understandability of the assurance statement. Chapter 5 addresses the necessary capacity and expertise, the organisational structure of audit firms and their quality control systems. Chapter 6 describes the research methodology.

8 And possibly by an independent assurance provider (other than an audit firm), depending on whether the Netherlands makes use of the Member State option.
9 This will follow an assessment of whether reasonable assurance is feasible for auditors and companies.

02 Sustainability reporting has a long way to go in a very short time

Companies have to be transparent regarding their impact on the environment and society and the financial impact of ESG factors on the company. This is increasingly expected by users, such as investors, governments and NGOs.[10] Companies need to devote sufficient attention to both the favourable/positive aspects and the unfavourable/negative aspects of their business activities. Greenwashing has to be prevented. This is about telling the truth. Additionally, connectivity between financial and non-financial reporting is important for users of the annual report. Finally, there needs to be a logical and cohesive connection between the various parts of the management report relating to ESG, such as strategy, targets, the risk paragraph and performance, and the company's policy on dividends and remuneration.

Based on our research, in this Chapter we present 5 action items that will contribute to the balanced and cohesive sustainability reporting that companies are expected to provide under the CSRD:

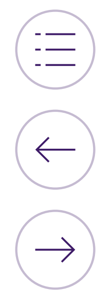
2.1 The major sustainability issues for a company need to be given more prominence in its reporting

It is useful for users if companies explain the relative importance of sustainability issues. Many companies have a materiality matrix, which shows the relative importance of the main sustainability issues for a company in visual form. These issues arise, for instance, from dialogue with various stakeholders. Climate change frequently scores high in this regard, but how this is then reflected in strategic actions and financial planning is not given sufficient prominence. In addition, many companies do not explain how their financial return targets relate to the potential costs associated with limiting their environmental damage or other social costs, for instance. It can be useful for users if companies explain this in their materiality analysis and matrix, by stating the relative importance of financial items, such as financial return.

Good practice:
How does the importance of financial items relate to major sustainability themes? Include a materiality matrix that shows both financial and non-financial items. This will explain the relative importance of both items to a user. This is illustrated by the materiality matrix in the annual report of BAM. Link: https://annualreportbam.com/annual-report/?page=22..

There needs to be a clear connection between the weight of sustainability issues in the materiality matrix and the extent of attention to these issues in the annual report. There is room for improvement in this regard in some cases, so that balanced and cohesive sustainability reporting is provided. For example, we see that performance indicators for important significant issues are missing in some cases. We also note that the assurance requested from the statutory auditor does not correspond to the relative importance of the sustainability issue in question in a number of cases. For instance, reasonable assurance was provided for one company on relatively less important sustainability issues, while limited assurance was provided for the issues that were actually relevant to the company concerned. This could be because the more important sustainability issues are more difficult to measure and check.

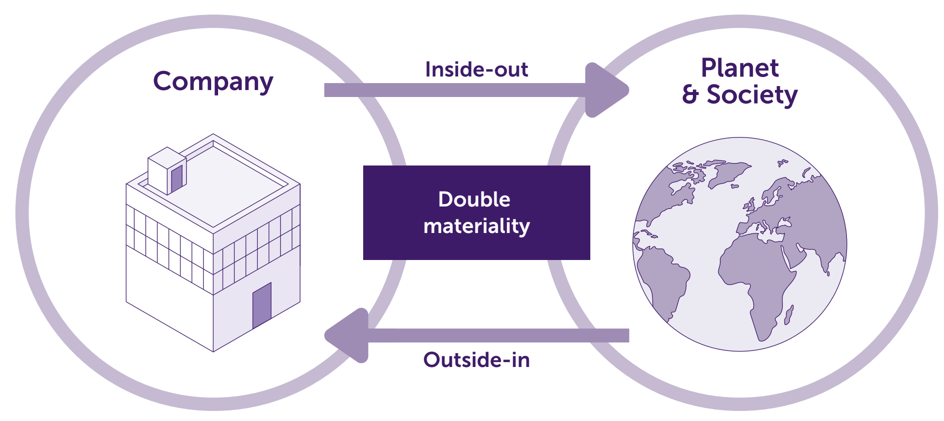
10 NGOs are non-governmental organisations. These are not-for-profit organisations involved in social, humanitarian or political objectives.



2.2 Companies need to improve their reporting of the negative impacts of their business operation on the environment and society

In our interviews with the companies, they indicated that double materiality is one of the challenges of the CSRD. Double materiality means that companies have to report on both the (financial) impact of the environment, such as the effect of climate change on the company (outside-in) and their positive and negative impacts on the environment and society (inside-out). In our research, which focused on climate, companies stated that they experience the translation of this into financial impact in terms of financial risks and the valuation of assets to be complex.

Figure 4. Double materiality



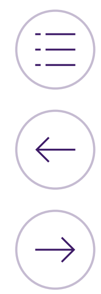
Our research reveals that half of the 27 listed companies do not or only barely disclose the negative impacts of their activities on the environment and society. This corresponds to observations in previous researches.[11] Apart from greenhouse gas emissions, which are disclosed by most companies in their reporting, the companies provide little or no other information on other potentially negative impacts. The users therefore are not given a balanced view of the consequences of the business operation, which may lead them to take poor decisions. A balanced presentation of both the positive and negative aspects reported is needed to give a balanced view and combat greenwashing. This is also explicitly stated in the ESRS.

2.3 Companies need to be more transparent regarding the (financial) impact of climate change and the energy transition on their business

The (energy) transition to a more sustainable society and the mitigation and adaptation of climate change will have financial consequences for companies. They may need to invest in new energy technologies and protect themselves against the potential physical impact of climate change. Climate change is also leading to a change in demand for certain products and services. Demand for non-sustainable products is falling, while demand for sustainable products is increasing.

Most of the companies are not transparent regarding the risks and (financial) consequences of climate change. This also includes the investments needed for the energy transition and climate adaptation measures. We also see insufficient connection between the information in the management report and the financial statements. Only a limited number of companies state that the consequences of the energy transition and climate change have an impact on their financial position and result and apply a write-off to assets. The vast majority of the companies state that the financial consequences of climate risks are still too uncertain and that there is currently no impact on their financial position and result. Some companies add that this is due to the use of a different time horizon, for example because the assessment of impairments is based on a budget period of three to five years and not on a much

11 Toepassing nieuwe verslaggevingsregels op koers (afm.nl) (Application of new reporting regulations on course)

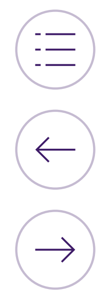


longer period, such as until 2050. Others refer to the uncertainty regarding future climate events and uncertainties in relation to future legislation and regulation.

The ESRS state that companies have to disclose how they have applied scenario analysis in the identification of climate risks. Many companies disclose that scenarios are used to identify climate risks. However, very few of them present actual information on these scenarios. Where they do, there is no link between the scenarios and the impact on the financial position and result. For example, if this concerns the assessment of potential impairment of assets.

We urge companies to explain how the scenarios for climate risks are linked to their strategy and financial planning and the implications of this for their current financial reporting. This will improve the connection between financial and non-financial reporting.

Good practice:
How can companies be more transparent on the (financial) impact of climate change and the energy transition? Include disclosures in the annual report that show the (potential) effect of various climate scenarios and measures and consequences. *For a good example see the annual report of Unilever.*
Link: https://www.unilever.com/files/92ui5egz/production/e582e46a7f7170fd10be32cf65113b738f19f0c2.pdf (Page 61).



2.4 Companies need to be more clear in their reporting on how they think they will achieve their climate goals and the dilemmas they face in this respect

Figure 5. Scope 1, 2 and 3.

H_2O CO_2 CH_4

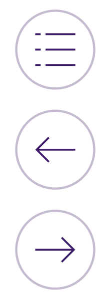
Scope 3
Upstream emissions
Business travel
Purchased goods and services

Scope 2
Indirect sources
Emissions from purchased electricity for own use

Scope 1
Direct sources
Onsite energy consumption and materials processing
Company-owned vehicles

Scope 3
Downstream emissions
Investments
Transportion and distribution
Use of sold products
Processing of sold products

Scopes 1, 2 and 3 are terms used to categorise and express sources of greenhouse gas (GHG) emissions. GHG emissions are emissions of gases that contribute to the greenhouse effect that leads to global warming, such as carbon dioxide (CO_2), methane (CH_4) and water vapour (H_2O). Reducing these emissions is an important part of achieving the climate goals. Scope 1 covers emissions released directly in a company's operational activities due to the use of fossil fuels such as gas, oil or coal. Scope 2 refers to emissions not directly caused by a company but which are attributable to that company's activities. For example, purchased electricity. The emissions are not released in the use of the electricity; they arise from the generation of the electricity by burning fossil fuels at the power station. Scope 3 covers indirect emissions other than those in scope 2 that arise in the company's value chain: the upstream and downstream emissions. For example, emissions released during the obtaining and transport of raw materials.



Companies only include scope 3 emissions in their CO_2 reduction targets to a limited extent, even though these emissions make by far the greatest contribution to total greenhouse gas emissions. Companies frequently express their climate targets in CO_2-neutral (or net-zero) terms. It is notable that these reduction targets concern mainly scopes 1 and 2 and only concern scope 3 to a limited extent. The annual reports of companies that do fully disclose their scope 3 emissions show that these emissions account for up to 95% of the total greenhouse gas emissions of the company and its value chain partners.[12]

Half of the companies researched do not clearly state how they think they will achieve their climate goals and the dilemmas they face in this respect. The ESRS prescribe that companies need to address this in detail. We therefore wish to stress that companies need to be specific as to how they will (or intend to) meet their climate goals. They also need to be transparent regarding the uncertainties associated with the feasibility of these climate goals. For example, in relation to uncertainties relating to the capture and storage of CO_2. Questions have also recently been raised regarding the reliability of voluntary carbon credits, involving the risk of greenwashing.[13]

An increasing number of businesses are joining the Science Based Targets initiative (SBTi)[14] and having their climate targets validated on a science-based method. This represents a positive development on the part of companies; however, they need to disclose where they are in the validation process. This concerns, for instance, the question of which activities are included in the calculations, the reduction targets and the temperature increase, and the time period used. The ESRS state that a scientific approach such as SBTi can be used to substantiate a company's reduction targets.

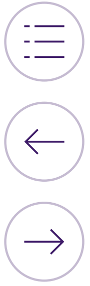
12 This corresponds to the report from Carbon Market Watch (page 24).
13 Publicatie trendzicht-2023.pdf (page 21)
14 Science Based Targets

2.5 The statutory auditor has an important role in assessing whether the sustainability reporting is presented in a balanced way

We see that the audit firms are paying attention to climate risks and the disclosure thereof in annual reports. This is evident from the assurance statements selected with respect to the non-financial information we have researched, from the Big 4 firms. The audit firms offer support in the form of available guidelines, templates and working programmes for the identification and estimation of climate risks.

If a statutory auditor gives assurance with respect to sustainability reporting, they must evaluate the overall presentation. In any case, they must establish that the information provided is not misleading and that the report is balanced. The items addressed must also be disclosed clearly and adequately. Engagements for the provision of assurance with respect to non-financial information have to be performed on the basis of the international standard 3000A, or the Dutch standard for social reports 3810N.[15] We note that assurance statements on non-financial information are issued on the basis of both Standard 3000A and Standard 3810N. In our research, 7 of the 17 assurance statements on non-financial information were issued on the basis of Standard 3000A, and 10 were based on Standard 3810N. Standard 3810N explicitly calls for attention to a balanced presentation. Sustainability reporting where assurance is provided based on Standard 3810N features a more balanced presentation.

15 The auditor performs these engagements on the basis of NV COS – Further regulations regarding audit and other standards (*Nadere Voorschriften Controle en Overige Standaarden*).



Good practice:
How can auditors establish that companies give a balanced presentation in their annual reports? The audit firm supports its statutory auditors with a methodology in which material themes from the materiality matrix are linked to the relevant disclosures in the annual report and the related Key Performance Indicators (KPIs).[16] It is then established on the basis of certain criteria, such as whether the KPI is linked to management remuneration, which disclosures and KPIs are significant and whether these are given sufficient prominence in the annual report so that a balanced picture is presented.

Good practice:
How can companies better involve the statutory auditor based on their role in the assessment of a balanced presentation of sustainability reporting? The auditor applies automatic tooling to check whether the tone, in terms of positive and negative statements in the annual report is balanced, so that the company presents a balanced picture.

16 These are measurable values that are used to measure company performance.

03 Available and reliable sustainability data leave much to be desired

The ESRS call for many disclosures and performance indicators on various sustainability issues. Companies' internal controls and IT systems and processes relating to sustainability data need to be designed accordingly. This section offers a number of recommendations that companies can work with.

3.1 Companies need to accelerate their investment in IT systems and processes relating to sustainability data

Timely further investment in IT systems and processes relating to sustainability data is crucial. We currently still see a number of serious challenges for companies regarding the collection and registration of sustainability data, such as:

- **Companies need to collect much more and more specific sustainability data than the data on which they currently report**
  First of all, companies need to establish the data they require and the parties from which they need to obtain these data, both internally and externally in their value chain, in order to be able to report in accordance with the ESRS. They then need to design their IT systems and processes accordingly to ensure that the data are available and reliable. In most cases, these data are not available from existing financial or other records. Moreover, much sustainability data are not yet as reliable as financial data. It is thus important that companies properly disclose the degree of reliability and the extent to which estimates are involved.

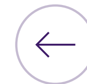
- **There is a lack of uniformity in the collection and registration of sustainability data**
  Companies need to collect and register data in the same way throughout their organisation and value chain, so that sustainability information is comparable and easy to report.

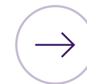
- **IT systems, processes and governance relating to sustainability data are currently not yet sufficiently mature**
  A properly designed system of processes and internal controls enables companies to collect and report relevant and reliable sustainability data efficiently and effectively. We urge companies to start on this in a timely manner, so that any challenges and improvements can be identified and addressed prior to the introduction of the CSRD. The elements that need to be involved include:
  - Integrate sustainability into the strategy. Sustainability data help for allocation of capital by investors.
  - Implement specific internal controls for sustainability data.
  - Involve the financial department and the audit committee.

3.2 The statutory auditor has their own challenges with external sources

The statutory auditor relies on the internal controls of the company's IT systems and processes and depends on the information provided by the company. In cases where the internal controls of the company's IT systems and processes do not operate adequately, the statutory auditor carries out substantive procedures.

Problems experienced by the company in the collection and reporting of relevant and reliable data are reflected in the procedures performed by the statutory auditor. In these procedures, the auditor uses external sources to check specific items in the sustainability reporting. The auditor has to assess or test that these sources are reliable, correct and complete. The question is how detailed these procedures need to be in order to obtain sufficient and appropriate assurance information.





One example concerns whether the testing of the external parties and the carbon offset certificates they voluntarily issue are reliable. There is no official supervision in this area.

3.3 Sustainability data on scope 3 is lacking

Companies do not report adequately on scope 3 emissions due to the lack of sustainability data on scope 3. Our research reveals that 11 of the 27 companies presented no or only limited scope 3 disclosures. This is in line with our observation in Chapter 2.4 that CO_2 reduction targets relate mainly to scopes 1 and 2 and only to a limited extent to scope 3.

Scope 3 emissions are the most important factor in climate change. In view of the introduction of the CSRD, we therefore believe that all companies need to make a greater effort to disclose their scope 3 emissions. Information on scope 3 emissions is relevant for users, as it gives insight into a company's impact on climate change and shows what companies can do to combat this. Companies also need to state which customers and suppliers in their value chain are involved in the calculations and the extent to which their scope 3 information is correct, complete and reliable. Under the ESRS, reporting of scopes 1, 2 and 3 data is mandatory.

In interviews, companies state that reporting on scope 3 emissions is complex. We recognise that obtaining scope 3 emissions data is not a simple matter, as scope 3 emissions are based on a combination of various methods, assumptions and sustainability data involving both exact and extrapolated data. In addition, scope 3 includes indirect emissions arising from activities that are not under the company's direct control, such as emissions from suppliers and customers. This means that companies depend on data from various parties in the value chain in order to obtain a complete picture of their scope 3 emissions. Companies and their value chain partners will have to work together on obtaining these data from the value chain.

Companies currently have no or limited access to reliable data on emissions in the entire value chain. This is because suppliers or customers, due to challenges in relation to technical knowledge, resources or finance, do not provide sustainability reporting or do not (or not yet) collect and register sustainability data. Even if these data are available, it may be difficult to collect and register them centrally and integrate them in the company's sustainability information. This is due to the variety of available methods and assumptions and the lack of uniformity throughout the value chain.

Precisely because of these dilemmas, we urge companies to be transparent regarding their challenges in relation to the collection of sustainability data on scope 3 emissions and involve their entire value chains in the delivery of these data.[17] Companies can increase value chain involvement by, for instance, identifying their suppliers and customers with the largest scope 3 emissions and working with these parties on the collection and standardisation of scope 3 emissions data. This will help to increase data quality from the value chain.

Good practice:
How can a company get its value chain partners more involved?
Perform audits of suppliers and take initiatives to encourage parties in the value chain to supply data, such as a loyalty programme under which they receive a consideration in return for making their data available.

Good practice:
How can a company improve its reporting of scope 3 emissions? In the disclosure of scope 3 emissions, state which customers and suppliers in the value chain are involved in the calculations and the extent to which their scope 3 information is correct, complete and reliable. In this respect, the annual report of ASML is a good example. Link: https://www.asml.com/en/investors/annual-report/2021 (Page 231).

17 See guidance on communication with stakeholders: https://sciencebasedtargets.org/resources/files/Net-Zero-Standard.pdf

04 Concerns regarding the understandability of the assurance statement

After the CSRD takes effect in 2024, the non-financial information that companies present in their annual reports has to be provided with an assurance statement. Some companies already request their auditor to provide assurance on all or part of the non-financial information that they report on a voluntary basis.

The statutory auditor's assurance statement has to be understandable to users so that no unjustifiably high expectations are raised. The level of assurance for each element of the non-financial information also has to be made clear, and the procedures performed by the statutory auditor must be described in detail. This depends among other things on the availability and reliability of the non-financial information.

The statutory auditor's opinion regarding the reliability of the non-financial information is expressed in an assurance statement.[18]
The assurance statement may be provided through a combined statement[19] or separate statement.

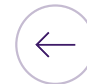
In the annual reports we researched, we see that the statutory auditor issued limited assurance for the non-financial information in most cases. There were a number of cases in which the statutory auditor provided reasonable assurance as well.[20] It needs to be clear to users what limited or reasonable assurance means and what procedures have been performed by the statutory auditor in order to arrive at the level of assurance in question. In this section, we share a number of concerns regarding the understandability of assurance statements, as well as some good practices.

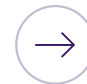
18 There are two types of assurance statement with reference to non-financial information: a limited assurance statement and a reasonable assurance statement.
19 This is a statement that relates to both the financial and the non-financial reporting.
20 In the short term, we expect mainly limited assurance statements to be provided, as in the first instance this is the level of assurance required under the CSRD.

4.1 Users could attach greater value to an assurance statement than is justified

Our main concern is that users of annual reports may attach greater value to an assurance statement with respect to non-financial information than is justified. There are several reasons why this is the case:

Scope limitations applied in the assurance statement lead to lack of clarity. In our research, we encountered only unqualified assurance statements. We also note that scope limitations were applied by the statutory auditor in the assurance statements we researched, either in consultation with the company or otherwise. In these cases, the auditor issued an unqualified statement, even though they may have arrived at a different conclusion if the scope had not been changed. In such cases, an assurance statement with a qualification may have been more appropriate. The effect and impact of the scope limitations applied were not clearly described in most of the assurance statements we researched. Users could therefore gain the impression that all the reported sustainability figures and text claims were part of the assurance statement, while this was not necessarily the case.





Combinations of 'reasonable' and 'limited' assurance are confusing. In some cases, we note that the assurance statement included a combination of reasonable and limited assurance. Combining these different levels of assurance in an assurance statement does not improve readability and understandability for users. Users can in this case gain the incorrect impression that similar procedures in terms of scope and depth were performed by the statutory auditor with respect to all the non-financial information reported.

Differences in the nature and depth of the assurance procedures performed for a limited assurance statement raise questions. Our research of the limited assurance statements shows that the nature and depth of the procedures performed by the auditor varied from one engagement to another. These variations in the procedures performed could cause confusion for users as to what a limited assurance statement actually means. If the auditor were to explicitly state the procedures they performed for both limited and reasonable assurance statements, it would be clearer how they had arrived at the assurance statement they had issued. The introduction of standards for assurance statements for sustainability reporting will help to reduce the risk of various interpretations and expectations regarding what a limited or reasonable assurance statement actually means.

The reported figures may not be correct. In a number of cases, assurance is provided for specific reported figures that are influenced by several variables, assumptions and uncertainties and are reported after one year's delay, for example. So there is the question of whether the figure reported is correct. This concerns specific reported figures for scope 3 emissions, for instance. The auditor could have taken note of this in their assurance statement.

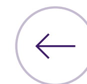
4.2 The CSRD helps to remove some concerns

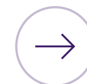
The concerns regarding the understandability of assurance statements issued for non-financial information will to some extent be removed by the introduction of the CSRD. Choosing to leave certain non-financial information out of consideration, for example because this information is not available or reliable, will no longer be permitted. The CSRD thus aims to exclude the possibility of 'cherry-picking'. This may lead to more qualified assurance statements being issued in the future, such as an assurance statement with a qualification.

4.3 Be transparent regarding challenges and dilemmas in the assurance statement

In the assurance statements we researched, we saw little attention paid to difficult issues encountered by the statutory auditor and how these were addressed. We wish to see more transparent reporting on this. This will make the assurance statement more informative and increase the transparency of the assurance engagement, thus giving users greater insight. For example, some of the assurance engagements researched featured data on which assurance had to be given that was not available or reliable, although this had been assumed when the engagement was accepted. Some auditors subsequently chose to keep these data out of the scope of their statements, even though this circumstance could also have been included in the opinion expressed in the assurance statement.

Good practice:
How can an auditor explain challenges and dilemmas in their assurance statement? List the challenges and dilemmas in a Key Review Matter, a Key Audit Matter or the list of procedures performed. This is illustrated by the following assurance statement. Link:https://www.signify.com/static/2021/signify-annual-report-2021.pdf (Page 163).





Good practice:
How can an auditor prevent the risk of greenwashing? In the assurance statements reviewed that were issued on the basis of Standard 3000A, we see that the statutory auditor carried out procedures to establish whether the presentation was balanced, in addition to the minimum procedures required. For instance, besides the KPIs that were in scope of the engagement, the statutory auditor also performed procedures on the entire set of KPIs to address the potential risk of greenwashing.

Good practice:
How can an auditor express their attention to climate risk? Auditors can show how they have devoted attention to climate risk by including a climate paragraph in their assurance statement.[21]

21 The article '*Klimaatrisico's als kernpunt van de controle (accountant.nl)*' ('climate risk as a key audit matter') shows that there is wide variation in how auditors report on climate risk in their statements.

05 Threat of lack of capacity and expertise

The CSRD will present challenges for companies and audit firms with respect to time, resources, capacity and expertise. Companies need to take steps to bring their internal IT systems and processes in relation to NFI data to a higher level of maturity (see Chapter 3). Audit firms need to grow their organisational structures and existing quality control systems to cope with the expected increase in the number of NFI assurance engagements.

5.1 Much progress is still needed in terms of capacity and expertise in the run-up to the CSRD

Companies face a serious challenge in terms of capacity and expertise to meet the requirements of the CSRD on time. This is a major challenge. There is relatively little time left for implementation, and they will be competing with the audit firms, for example, for the same good personnel. The issue is not only the number of employees, it is also about recruiting people with specific and scarce expertise in the field of sustainability. It is also important that knowledge and expertise with respect to NFI are developed further in all layers of the organisation, up to and including board level.

We see the capacity issue as a major challenge at the audit firms as well. The labour market is tight at the moment. Demand for specific sustainability expertise is increasing, while outflow at the audit firms is increasing and inflow is declining. Increasing attention to themes such as fraud and corruption at companies and audit firms is also a factor in the rising demand for expert personnel.

All the Big 4 accounting firms have separate ESG departments, with specialists in areas such as carbon accounting, climate risk, circularity, water, biodiversity and human rights. These departments focus on both the provision of advisory services on sustainability and the issuing of assurance with respect to non-financial information. At all four of these organisations, these departments currently consist of around 100 employees. These organisations are currently considering how many employees and which specific ESG expertise they will need in the future. Most firms are looking to expand their ESG departments to include 200-250 employees over the next three years.

They have launched various initiatives to this end:

- Training of current personnel with internal and external courses to obtain sufficient expertise to perform assurance engagements with respect to ESG.
- Recruitment of new personnel, in which the audit firms note that sustainability is a socially attractive issue for (young) professional people. The Netherlands is moreover acknowledged as being at the forefront in terms of sustainability and is thus an attractive destination for foreign employees within an audit firm's global network.
- Outsourcing of relatively simple procedures and customer divestment to free up current capacity; and
- Integration of ESG departments and the audit practice in future; many of the basic competences needed to audit financial statements can also be used in NFI assurance engagements.

5.2 The organisational structure of audit firms must grow rapidly to cope with the expected increase in assurance engagements

The number of engagements for audit firms to provide assurance for non-financial information reported by companies is currently still limited. This is due to the fact that provision of an assurance statement for non-financial information is still voluntary. The introduction of the CSRD will lead to a number of changes:

- Assurance on non-financial information will be mandatory.
- The assurance will concern the entirety of much more and more specific non-financial information; the non-financial information will indeed become mandatory under the ESRS; and
- Many more companies will have to comply with the new reporting requirements and the related mandatory assurance.

The introduction of the CSRD will lead to an explosive increase in the number of assurance engagements for audit firms. This huge increase in the number of new NFI assurance engagements will occur mainly due to the increase in the number of companies[22] that will be obliged to report on sustainability with effect from the 2025 financial year. We therefore see a risk that due to a shortage of expert personnel, the audit firms will not be able to accept all these mandatory NFI assurance engagements or be able to perform them with due care. They need to prepare for this development. Not only by accepting the challenges posed with respect to capacity and expertise, but also by rapidly growing their organisational structures and existing quality control systems to cope with the expected sharp increase in the number of (more complex) NFI assurance engagements.

Organisational structures need to be changed to cope with the expected growth in NFI engagements. We see that the Big 4 accounting firms are taking steps to take further account of NFI in their organisations. In the last year or two, they have been scaling up their ESG departments and the related organisation and organisational structure in various ways. In addition, the Big 4 are setting up organisational and consultation structures and are developing a methodology for the performance of NFI engagements.

We see that a number of NFI issues are aligned informally, with a lack of well-defined procedures. This applies, for example, to:

- Coordination of supply and demand for ESG specialists.
- Further integration of sustainability in the financial audit practice.
- Consultation policy on NFI.
- Specific policy for acceptance of NFI assurance engagements; and
- Further formalisation of structures and processes, such as regularly seeing what works in practice and translating this into guidance, templates and other training material.

We expect to see accelerated growth in existing quality control systems in this respect.

Good practices

How can audit firms strengthen their quality control systems?

- Having an Engagement Quality Control Review (EQCR) carried out by someone with specific sustainability expertise; and
- Internal coaching of teams on current NFI assurance engagements.

How can audit firms strengthen their capacity and expertise?

- Making a minimum number of hours spent on training and practice a requirement for authorisation to sign off on assurance statements on sustainability reporting.
- Standard policy of involving the ESG team as well as the team performing the statutory audit in all assurance engagements relating to NFI; and
- Offering combined training for statutory audits and assurance engagements relating to sustainability.

22 The CSRD will apply to large public interest organisations with more than 500 employees with effect from the 2024 financial year. These are organisations as defined in Section 398(7) of Book 2 of the Dutch Civil Code (DCC). The remaining large companies will become subject to the CSRD with effect from the 2025 financial year, and medium-sized and small listed companies will follow with effect from the 2026 financial year.

06 Description of the research methodology

6.1 Selection of annual reports and audit firms

The AFM has identified certain sectors in which climate aspects and risks such as CO_2 emissions have a significant role. These include banks, oil and gas, manufacturing, food and technology. In each sector, the annual reports of most companies in that sector were selected. In total, the research comprised the annual reports of 27 listed companies for the 2021 financial year.[23] An assurance statement in relation to non-financial information was provided in 17 of these 27 annual reports.

We included four PIE audit firms (Deloitte, EY, KPMG and PwC) in our research. The assurance statements on the non-financial information from the listed companies selected were provided by these audit firms only.

Of the 27 annual reports, 8 were selected for interviews with the companies concerned and their statutory auditors. Assurance on non-financial information was provided in 7 of these 8 annual reports. The interview selection also took account of a balanced representation across the four PIE audit firms.

6.2 The research focused on climate risk

In our research, we focused on the E in ESG, in particular climate risk, and included the following elements:

- An analysis of the annual reports from companies in which climate aspects and risks, such as CO_2 emissions, have a significant role (desktop reviews).
- Holding interviews with a number of CEOs, CFOs, audit committee members, Sustainability officers and other members of the management at companies.
- An analysis of the documentation of the PIE audit firms researched (desktop reviews); and
- Holding interviews with Board of Directors and other representatives of the PIE audit firms researched and the statutory auditors of these audit firms who had issued an assurance statement with respect to all or part of the non-financial reporting.

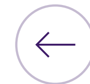
23 This represents roughly a third of the companies that are subject to the NFRD and whose reporting is subject to supervision by the AFM.

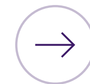
6.3 Findings of the research

The research was primarily exploratory in nature. Relevant findings from the analysis of the annual reports selected have been shared with the listed companies.
In the exploratory element of the research, we obtained insight into:

- The level of connectivity between the non-financial and the financial reporting.
- The extent to which the various elements of the management report relating to ESG (strategy, objectives, risk paragraph and performance), as well as the policy on dividends and remuneration, are logically linked and mutually cohesive.
- The extent to which audit firms and auditors fulfil their roles in the provision of assurance with respect to non-financial information; and
- How the audit firms support the statutory auditor in the provision of assurance in relation to non-financial information.

The exploratory research led to observations that companies can use to further improve their reporting of non-financial information. Audit firms can use the observations to further refine the structure of their quality control systems.





6.4 The AFM based its findings on analysis of annual reports, documents and interviews

We conducted this research on the basis of the selected annual reports and documentation received from the audit firms. We also held interviews with representatives of the companies and audit firms.

6.5 Reporting on the findings of the research

After conclusion of the research, we shared the provisional findings of the research with the audit firms concerned, both orally and in writing.

Public report
The research findings have been separated from any information that is traceable to individual companies, audit firms or persons. We have accordingly amended our report where relevant.

6.6 The AFM acknowledges the limitations of its research

There are inherent limitations due to the manner in which the research was conducted, including the conclusions that can be drawn from the findings.

No opinion as to whether an assurance statement issued was adequate
We do not supervise the activities of the statutory auditor relating to the provision of assurance with respect to non-financial information. We did not assess the extent to which the assurance provided with respect to non-financial information was based on sufficient and appropriate evaluation and audit evidence.

No comprehensive research conducted
We did not conduct a comprehensive research of all aspects of the annual report or the assurance statement. The findings stated in this report should be seen in this context. The absence of comments or remarks should therefore not be understood to mean that no other omissions may exist.

No statistical sample taken
We have not performed statistical sampling. We do not draw any conclusions with regard to all the annual reports included in the research in each sector. Furthermore, we do not draw any conclusions regarding all the assurance statements provided by the PIE audit firms included in the research.

Any questions or comments about this publication?

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