KPMG

No escape

Study of the CSRD-readiness of Dutch companies

July 2021

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Introduction

On the 21st of April 2021, the EU commission announced the adoption of the Corporate Sustainability Reporting Directive (CSRD) in line with the commitment made under the European Green Deal. The CSRD will amend the existing Non-Financial Reporting Directive (NFRD) and will substantially increase reporting requirements on the companies falling within its scope in its efforts to expand the sustainability information for users.

The proposed directive will also entail a dramatic increase in the number of companies subject to the EU sustainability reporting requirements. The NFRD that is currently in place for reporting on sustainability information, covers approximately 11,700 companies and groups across the EU. The CSRD is expected to increase the number of firms subject to EU sustainability reporting requirements to approximately 49,000.

This will come with significant changes and potential challenges for companies in scope. We believe that companies should start preparations effectively now – as only one and a half year is left to the date of implementation.

We analyzed the readiness of the 25 largest listed companies in the Netherlands (AEX index) as well as the 25 largest unlisted Dutch companies against the requirements of the CSRD. This paper provides an overview of the level of preparedness for critical elements of the CSRD of those companies, which will help these and other companies to assess where they stand and might need to focus on. We conclude with key recommendations for companies to consider.

The CSRD: what it means

A summary of the planned changes is presented in the diagram below.

	Current EU Directive 2014/95/EU	Corporate Sustainability Reporting Directive
WHEN WILL IT BE APPLICABLE?	FY 2018	**FY 2023** — **FY 2023:** first set of Sustainability Reporting Standards (draft standards available mid-2022) — **FY 2024:** second set of Sustainability Reporting Standards — Adoption EU-Directive in member states legislation: **Dec 1, 2022**
TO WHICH COMPANIES WILL IT BE APPLICABLE?	**Large public interest entities with > 500 employees** *Public interest entities are:* — Listed companies — Banks and Insurance companies	— All large companies: **> 250 employees** and/or **> €40M Turnover** and/or **> €20M Total Assets** meeting at least **2** out **3** criteria — Listed companies *Note: small and medium listed companies get an extra 3 years to comply.*
HOW MANY COMPANIES ARE SUBJECT TO THE NEW DIRECTIVE? EU	**11,600**	**49,000** Covering > 75% of total EU companies' turnover
WHAT IS THE SCOPE OF REPORTING REQUIREMENTS?	Companies are to report on: — Environmental protection — Social responsibility and treatment of employees — Respect for human rights — Anti-corruption and bribery — Diversity on company boards (in terms of age, gender, educational and professional background)	**Adding additional requirements on:** — **Double materiality concept**: Sustainability risk (incl climate change) affecting the company + Companies' impact on society and environment — Process to select material topics for stakeholders — More **forward looking** information, including targets and progress thereon — Disclose information relating to **intangibles** (social, human and intellectual capital) — Reporting in line with **Sustainable Finance Disclosure Regulation (SFDR)** and the **EU Taxonomy Regulation**
IS INDEPENDENT 3RD PARTY ASSURANCE MANDATORY?	**Non-mandatory (for most countries)** In some countries part of legal audit requirements (for example in NL under NVCOS 720 requirements).	**Mandatory – limited level of assurance** Including: — Integration in Auditor's Report, — Involvement of key audit partner, — Scope to include EU Taxonomy and process to identify key relevant information.
WHERE SHOULD COMPANIES REPORT?	**Included in the Annual Report** (for NL companies)	**Inclusion in the Management Report**
IN WHAT FORMAT SHOULD COMPANIES REPORT?	**Online or PDF version**	**To be submitted in electronic format** (in XHTML format in accordance with ESEF regulation)

All companies will have to take further preparations

None of the companies in our study reported on all the requirements that we identified as central to the CSRD. In particular, none of the companies explicitly included a 'double materiality' perspective as required by the CSRD within their reporting (see page 3 for further details). Some companies do include both the risks they face from environmental and social developments and the adverse impacts these could have on environmental and social issues, but none have prioritized the topics based on an integrated approach.

New areas that need further attention

The CSRD has emphasized a number of aspects that we have noted in our research as areas that require further attention regarding reporting for all companies.

Due diligence throughout the value chain

Due diligence regards the analysis companies have conducted to assess which negative environmental and social impacts (may) exist in their value chain – as well as the actions taken to prevent, mitigate or remediate these. The CSRD will require companies to disclose a description of the due diligence process implemented.

Most companies do not yet have such process in place across their value chains and should start implementing it as soon as possible.

Resilience to risks and identification of opportunities

The CSRD will require companies to disclose information on their resilience to sustainability risks, from an 'outside-in' perspective: what may be the impact of the environmental and social developments on the enterprise value? Equally, companies are required to report on the positive side of this: the opportunities from sustainability.

Traditionally, companies have taken an 'inside-out' perspective on sustainability: how can we mitigate the impacts we have on environmental and social issues? Whereas a number of companies report on sustainability-related risks in their risk paragraphs, these are typically non-specific and only focused on the short term.

Both listed and unlisted companies will have to conduct a long-term risk analysis for such issues and describe how their business will stay resilient under these changing circumstances, alongside the opportunities they have identified.

Due diligence

The report should include a description of:

- the due diligence process implemented with regard to sustainability matters;
- the principal actual or potential adverse impacts connected with the undertaking's value chain, including its own operations, its products and services, its business relationships and its supply chain;
- any actions taken, and the result of such actions, to prevent, mitigate or remediate actual or potential adverse impacts.

Risks and opportunities

The report should include a description of:

- the undertaking's business model and strategy, including the resilience of the undertaking's business model and strategy to risks related to sustainability matters;
- the opportunities for the undertaking related to sustainability matters.

Intangibles

The Integrated Reporting Framework has identified six capitals, which include intellectual, human and social & relationship capital – in addition to natural, financial and manufactured capital. These three have now been incorporated in the CSRD to understand the company's sustainability. As this field is still in development, companies need to get prepared to start measuring such intangibles, in particular when they are identified as material issues.

Time horizons

The CSRD will require companies to report forward-looking information, both qualitative and quantitative. Such information should cover short-term, medium-term and long-term time horizons. This not only requires companies to define these time horizons, it will also mean that a description of plans against targets as well as risks and opportunities need to cover these time horizons. Generally, to date companies are not used to provide a lot of forward-looking information and where they do, this is typically covering the short term – although for sustainability a number of companies have set mid- to long-term targets.

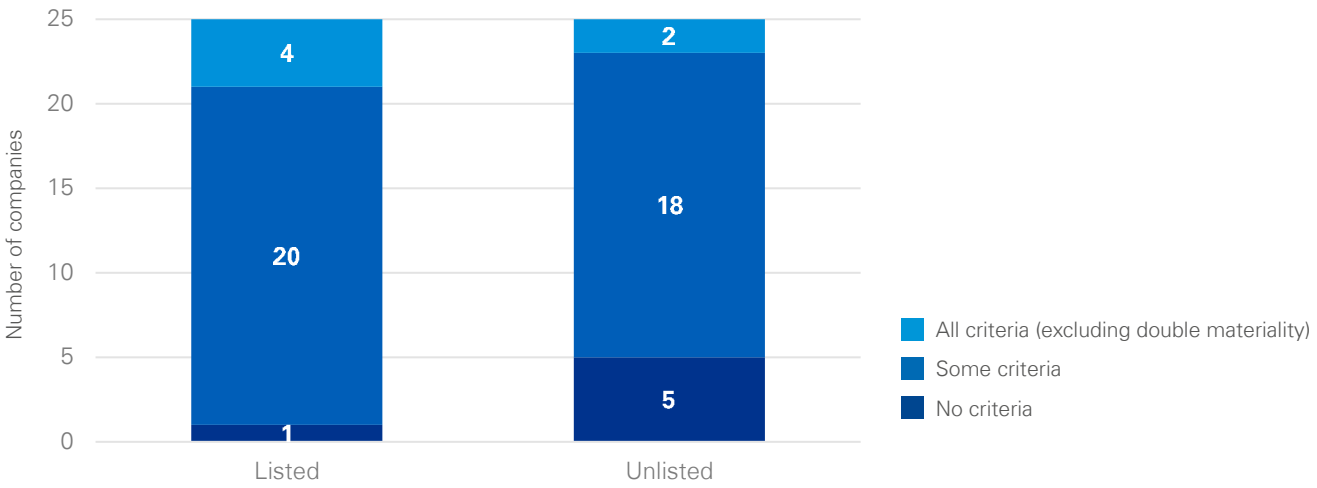
We believe that companies need to start understanding in particular what the long-term implications of sustainability developments could be for their company and develop an appropriate reporting strategy for these.

Still a vast majority will have to take further preparations

Excluding the double materiality focus, we found six of the companies had covered all other reporting requirements. This implies that 44 companies, so more than 80% of our sample, need to take further steps, in addition to implementing the double materiality process that all companies need to work on.

About one in ten companies has not started at all and would therefore have a significant task ahead in order to meet the requirements in time. It is our experience that, for example, implementing the data systems and developing a reasonably well-developed report, requires a minimum of two reporting cycles (i.e. years), so for these companies the clock is ticking.

Graph 1 Requirements covered



Private companies can expect a sea change

Due to a number of pressures, including from investors, listed companies have already been reporting on sustainability for a long time. Shell, for example, already started their reporting in the mid-90s and, by the first decade of this century, most large listed companies have started reporting on sustainability – first in the sustainability report, later increasingly in the annual report.

It is not surprising, therefore, that listed companies show better preparedness than non-listed companies. Still, as per our assessment, one in five need to take significant steps, meaning they need to work on most of the CSRD requirements that we included in our study.

Unlisted companies are lagging behind

For most of the unlisted companies the CSRD will be a sea change. From the results of our survey, the vast majority qualifies as not 'close to ready', and more than 60% even as 'far from ready'. The areas that require significant attention for these companies include (double) materiality reporting, target setting and disclosure of progress towards the set targets and getting ready for external assurance. Integrated reporting is an attention area as well, with 20% of the unlisted companies not including sustainability information in the management reports at all.

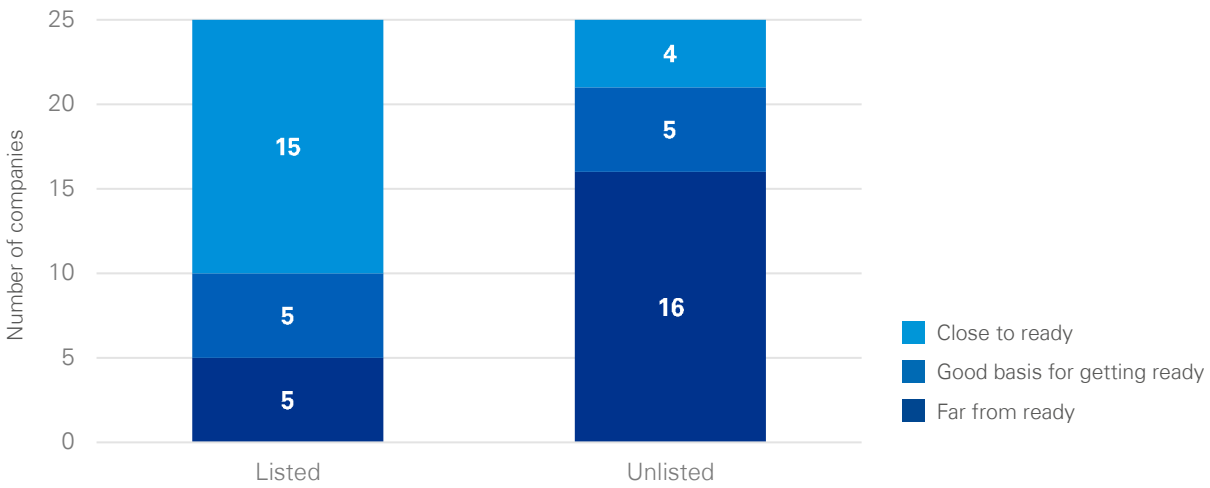
We expect that many unlisted companies will need to get their heads around what sustainability means for their company, both in terms of risks and opportunities. They can learn a lot from the listed companies and their reporting – but we would not expect them to deliver reports that are on par with those of listed companies by 2023. We know that it takes time to set the agenda and translate that in a proper report that integrates financial and sustainability performance. This should be built on a solid foundation of internal analyses of trends, sustainability impacts, as well as risks and opportunities, targets and plans to achieve those, and a robust reporting process that delivers high quality and auditable data.

We would also expect that non-listed companies may meet the minimum requirements as of 2023, but will need another couple of years to disclose a strong sustainability story that addresses the underlying needs of their stakeholders properly and links sustainability to their business.

If done well, the reporting cycles are used to further improve internal management, strategy and related control.

We found large differences in the preparedness of listed and unlisted companies. This pattern was visible for all of the key requirements that we described in the previous section. In order to quantify this difference we assigned a rating system to our answers per CSRD requirement, per company. We defined 'close to ready' as the situation where the company already reports on the majority of key topics and 'far from ready' where the company currently meets less than a third of the requirements. This is set out below, showing that 60% of the listed companies qualifies as being 'close to ready' for the requirements as set out under the CSRD, with 20% being 'far from ready'. The results for unlisted companies are almost the reverse, with just 16% being 'close to ready' and 64% 'far from ready'.

Graph 2 Reporting rating



Mandatory assurance will raise the bar for information quality

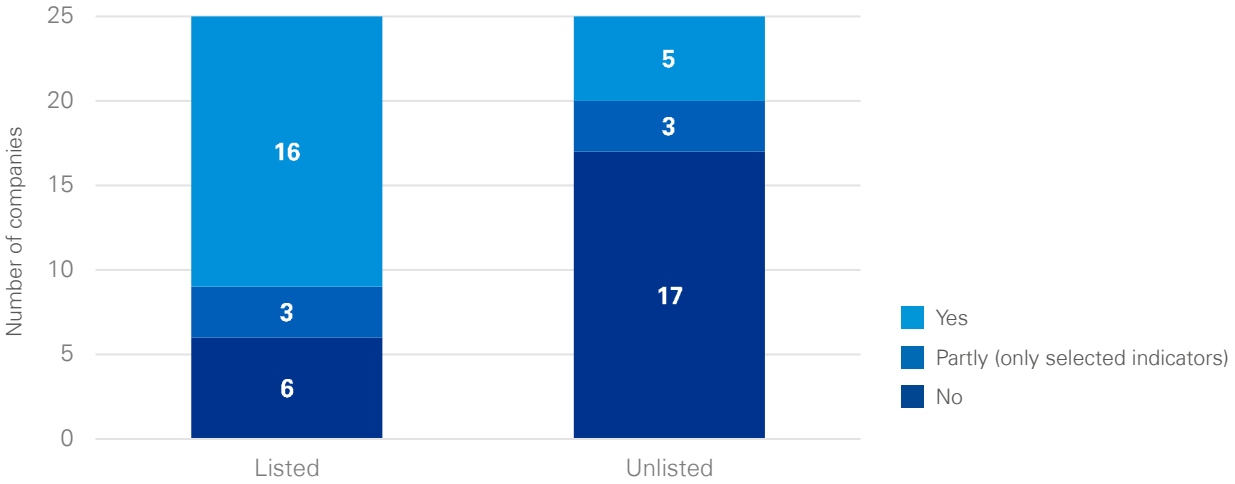
Assurance is common to sustainability reporting for a large number of companies. Having started in the mid-90s, the number of large companies around the world requesting assurance on their reporting has grown to 51% in 2020 [The time has come, the KPMG survey of sustainability reporting 2020]. Of the 250 largest companies in the world, a majority of 71% have assurance nowadays. Some companies, like Philips and DSM, have provided for a number of years already the same level of (reasonable) assurance over their sustainability information as their financial data.

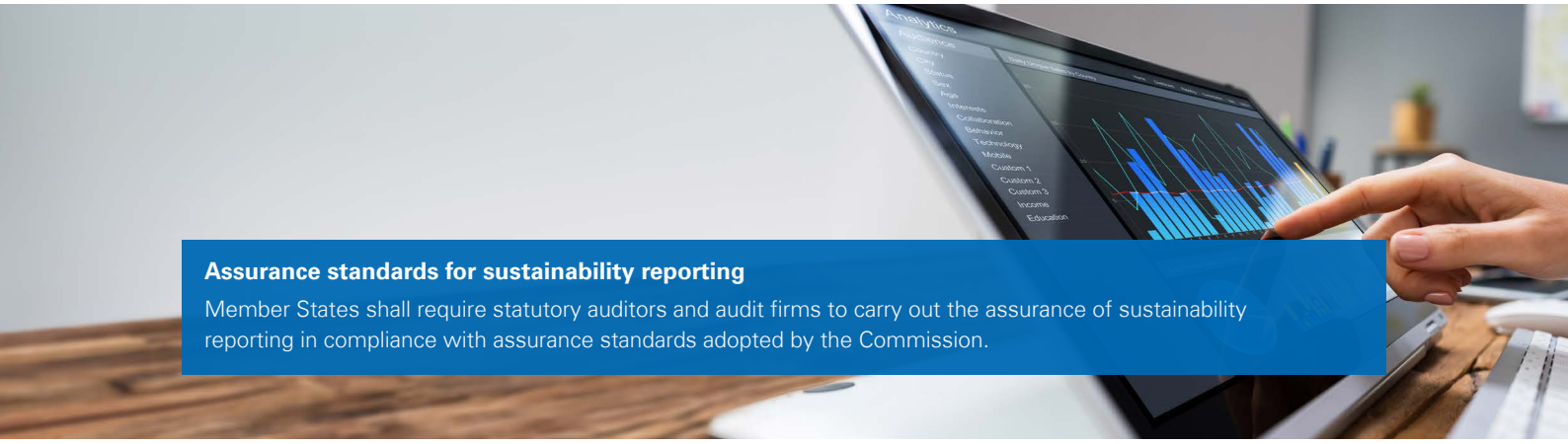
The CSRD is mandating assurance for all large companies as of 2023 – the first time that assurance on non-financial information is being mandated in the world at such a scale. Initially, for the CSRD limited assurance over the sustainability information will be required as a whole, with the option to move towards reasonable assurance requirements, after an evaluation by the EU Commission of the state of practice three years after implementation.

We found that over 50% of the companies we studied did not seek assurance to a sufficient level on their sustainability information. Again, non-listed companies are behind on listed companies with their implementation of this upcoming requirement.

External assurance comes with scrutiny to the data collection processes, the controls and the resulting data quality. We know from our decades of working with companies on assurance that such external scrutiny comes with areas for improvement to achieve sufficiently high-quality data. This also creates opportunities, however, to improve internal processes and controls as the basis for integration into internal governance and decision-making.

Graph 3 Assurance provided





Assurance standards for sustainability reporting

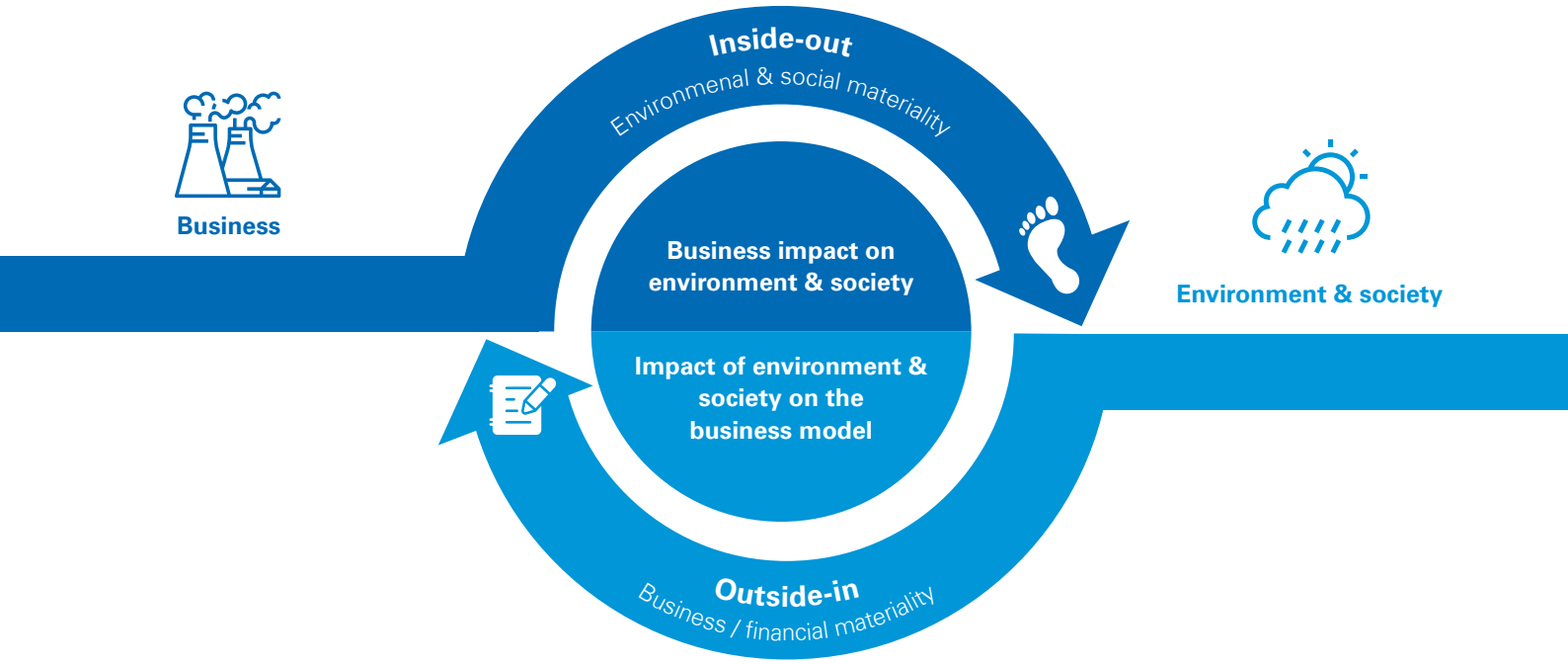
Member States shall require statutory auditors and audit firms to carry out the assurance of sustainability reporting in compliance with assurance standards adopted by the Commission.

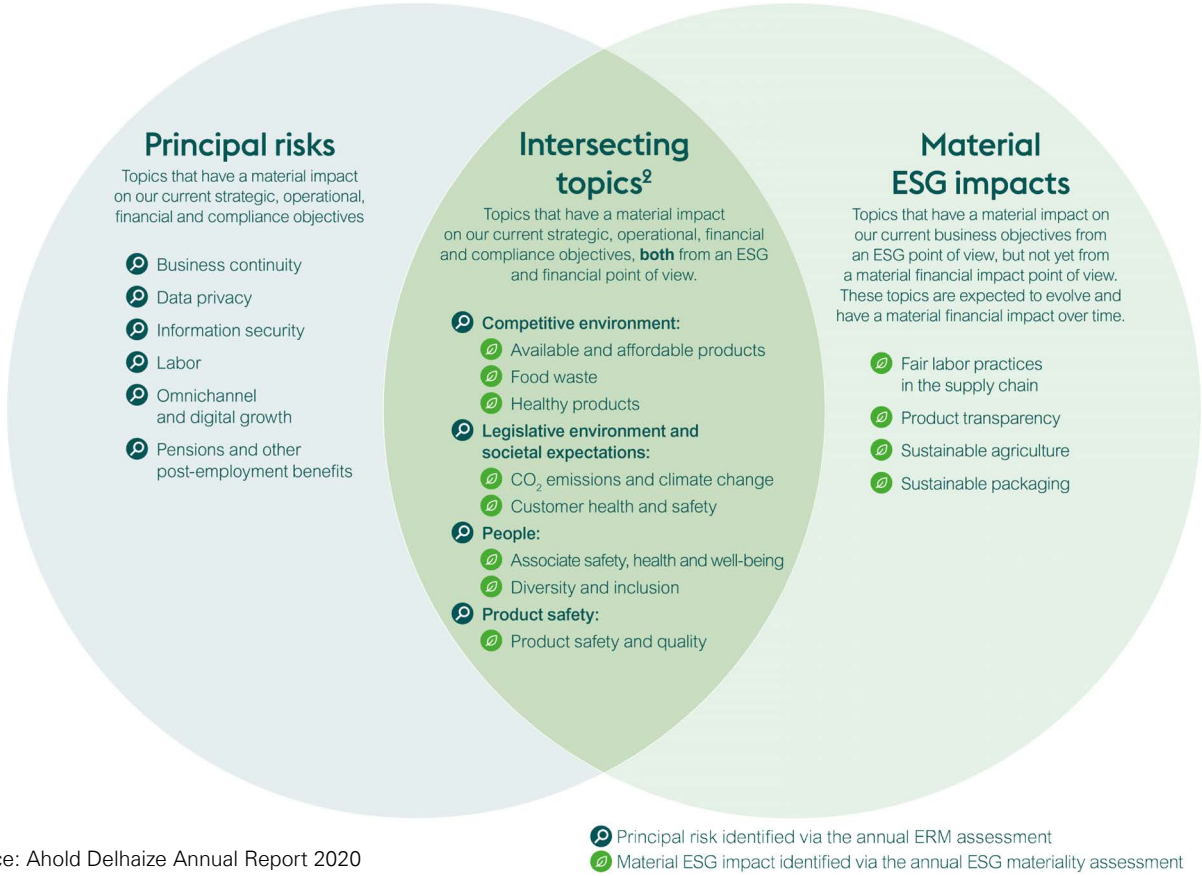
Companies have to connect key impacts and risks in defining topics for reporting

Investors and other stakeholders need to know that the report provides a comprehensive and complete view of the sustainability topics that matter to them. Traditionally, these topics have been assessed by means of a so-called materiality process, in which the company defines the key topics based on the level of impact the company has on the individual topic against the interest that stakeholders have in each topic (inside-out). The CSRD adds the other lens to this, namely the (potential) business impacts that sustainability topics have on the company value (outside-in) – dubbed *double materiality* by the EU.

Historically, materiality for sustainability was disconnected from the risk analysis and risk paragraph. The focus on both sides of the coin makes sustainability being comprehensively addressed in the annual report. By connecting the material impacts to the material risks for the company, the link to business value and long-term implications also becomes much stronger. The CSRD requires companies to look at both sides of the coin.

This is critical for users to understand how impacts of the company may also turn into a risk and therefore how company's management of the issue may impact company value.





Source: Ahold Delhaize Annual Report 2020

A few companies connect the 'material impact topics' and the 'principal risks' in their report. For instance, Ahold Delhaize does so, as shown above.

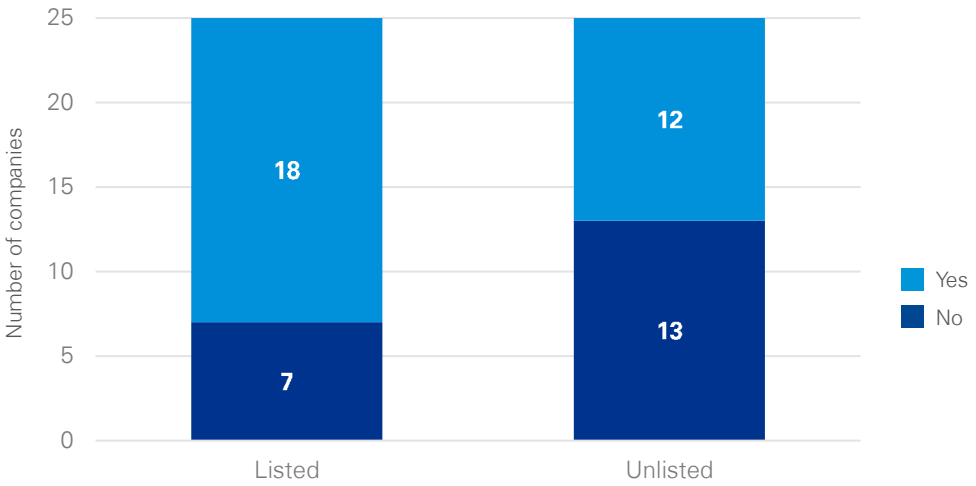
The double materiality approach is relatively new and it is therefore not completely surprising that none of the companies in our sample assessed the materiality of sustainability topics in accordance with the double materiality approach.

However, the traditional 'impact materiality' process has been applied since the early years of this century. It is therefore remarkable that more than 10% of listed companies do not disclose their process and results.

For non-listed companies it is encouraging that close to half do report on their material topics from an impact perspective, but obviously there is work to be done to get up to speed, especially for the other half that do not report yet and can deemed to not having a process in place.

We believe that every approach to sustainability should start with a materiality assessment based on the principles of 'double materiality' as laid out above and be long-term focused. This will inform strategy and reporting alike. To ensure trust in quality of the report and seriousness of companies, it is important to disclose both process and results.

Graph 4 (Traditional) materiality assessment



Many companies drive towards a sustainable business without consistent targets

The CSRD is expected to sharpen the requirements on target setting and the disclosure of progress towards these. Targets should be set and explained per material topic, in line with their materiality assessment.

If we want to achieve a sustainable economy, we need to manage progress on the basis of targets – just like companies do for financial performance. Historically, targets have been voluntary and in many cases showed inconsistencies in terms of horizons, coverage of the material topics and the type of targets (intensity vs absolute targets, for example). They also tend to focus on incremental improvements without taking account of the world's societal or environmental needs as expressed by the UN Sustainable Development Goals and as outlined by the science-based targets initiative for greenhouse gas emission reduction target setting in line with the Paris Agreement.

The CSRD implements part of the European Sustainable Finance Action Plan in this regard, by asking for clear targets and reporting on progress against these. Only then can companies be held to account and can progress against the strong ambitions of the EU be measured.

It is essential that targets cover all material topics, are long term with interim milestones and matter in terms of the material issues that they address.

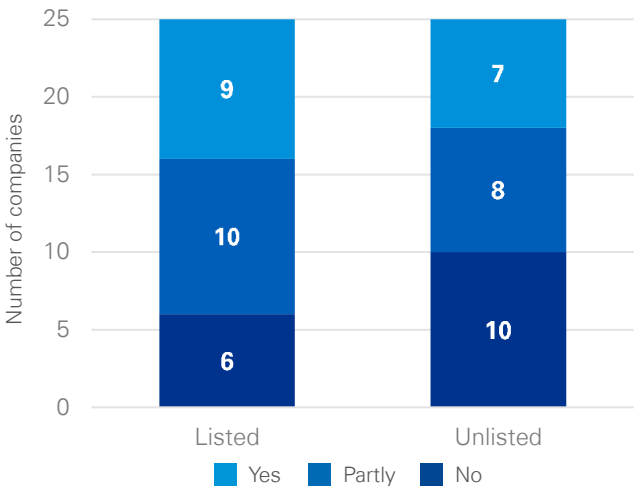
We found a fairly even split between three categories of disclosure, namely targets set on each material topic, targets set for some material topics and no targets set on any sustainability topics. More than two thirds of companies' target disclosures would be insufficient under the CSRD regulation. Notably, we found that not every company discloses progress against targets, a gap that can be especially observed among unlisted companies.

This needs significant attention, also because regardless of the regulations, companies are now increasingly held to account for their sustainability progress against planetary boundaries and in relation to social thresholds. In our view it is critical that this is being approached from a strategic perspective: what is it we want to achieve and how does this relate to our business performance and continuity? Reporting then logically follows again from this strategy set.

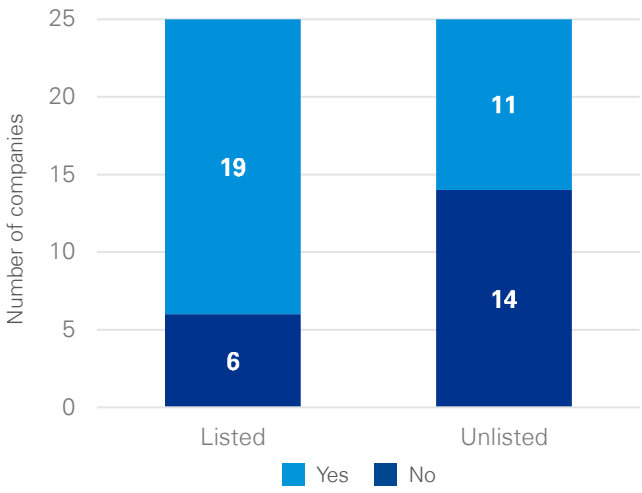
Targets

- The report shall contain in particular a description of the targets related to sustainability matters set by the undertaking and of the progress the undertaking has made towards achieving those targets;
- the plans of the undertaking to ensure that the group's business model and strategy compatible with the transition to a sustainable economy and with the limiting of global warming to 1.5 °C in line with the Paris Agreement.

Graph 5 Targets sets



Graph 6 Progress to targets disclosed



So, how from here? Steps to take

We found that only a small number of the sampled companies' 2020 annual reports included the level of detail required by the CSRD. This finding is stronger within the unlisted companies we studied than with the listed companies. Additionally, we noted that six companies didn't cover any of the requirements that we believe to be necessary in order to adhere with the proposed CSRD.

Start now with identifying and closing the gaps

This paper highlights a number of key gaps for the largest listed and the largest non-listed companies. Our findings show that every company has to fill one or more of these gaps. At the moment of release of this paper (July 2021) one-and-a-half year is left to implementation. That may seem like a long time, but in view of the time it takes to define, for instance, a strategy or to set up reporting systems and processes or to define key indicators, not a lot of time is left. We recommend all companies in scope of the CSRD therefore to start now. For those companies that already publish a sustainability or integrated report, a gap assessment against proposed CSRD requirements can help identify priority areas of focus to get CSRD ready.

Connect risk management to sustainability

As we mentioned above, the double materiality principle is key to the CSRD and relatively new to most companies. From our study it appeared that none of the companies studied had a bidirectional materiality assessment that sufficiently described their impact on sustainability issues, as well as the risks posed to the company itself by these issues.

In general, we recommend companies to start by conducting such an assessment and to include risk management in that process. The long-term perspective required for a proper materiality process will require an evolved perspective for many and will also entail updated processes. Furthermore, understanding both the impact on society as well as the business value of the results from the materiality assessment, is critical to establish a comprehensive strategy and ambitions.

Define critical indicators to track progress and set clear targets

While most companies set targets on at least some of their material topics, only a minority do so for all material topics. Reporting on progress towards targets is lagging, in particular for unlisted companies.
In order to track progress on material topics, meaningful KPIs and targets should be defined. Being in control of that information is important and the data collection process should include clearly defined roles and responsibilities and controls. This will not only serve the reporting purposes, but also enable companies to contribute to a sustainable economy in a managed way while simultaneously securing the company's own sustainability.

Get ready for assurance

One of the areas where the distinction between listed and unlisted companies is the largest, involves the external assurance on the report. More than 60% of listed companies have their sustainability information fully assured, compared to just 20% of unlisted companies. With the assurance requirement of the CSRD, and the additional rigour this requires of the reporting process, we believe this represents a key gap. We recommend companies in scope without assurance therefore to start the conversation with their auditor to get ready for assurance on your sustainability information and to develop a route to being ready by 2023.

Integrated reporting

Finally, in particular for unlisted companies – of which only eight publish an integrated report – this is an area of attention.

The CSRD no doubt creates a shift in corporate reporting and a drive towards a sustainable economy in the EU; for those in scope there is no escape. So the time to start is now.

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