Setting the baseline towards transparency

Insights into the first EU Taxonomy disclosures of non-financial undertakings in the Netherlands

May 2022

KPMG.nl

The dawn of the EU Taxonomy

Do you also wonder how many companies identify revenues and investments with the potential to contribute substantially to climate change mitigation and adaptation? What lessons can we draw from the first disclosures to prepare for alignment reporting in the next annual report? How do companies explain their findings and, ultimately, how do they connect the EU Taxonomy to their broader ESG strategy? If these questions also sparkle your curiosity, we invite you to keep reading.

This report brings you insights from large public-interest entities' Taxonomy reporting that could further refine and strengthen your Taxonomy reporting for the coming year.

Most companies in our sample[1] identified EU Taxonomy eligibility covering a range of economic activities. In this first year of disclosures, we see the level of information provided by companies vary significantly from a minimal paragraph in the back to extensive sections across the annual report. Overall, the image arises that companies went to some lengths to produce compliant and representative disclosures in 2022. We highlight some of the challenges reported, the use of voluntary disclosures and emerging good practice where a connection is made between EU Taxonomy and corporate strategy.

Most companies identified eligible activities

In this first year of the EU Taxonomy, disclosure requirements for companies falling under the Non-Financial Reporting Directive (NFRD)[2] were limited to eligibility reporting on the three Key Performance Indicators (KPIs) Turnover, Capital Expenditure (CapEx) and Operating Expenditure (OpEx). This meant disclosing the proportion of Taxonomy-eligible and non-eligible KPIs.

A total of 25 out of 34 companies in the sample identified eligible activities relating to climate change mitigation or adaptation. Seven have not identified eligible activities and two have not reported on their eligibility in the annual report.

Of the 25 companies, 15 used the terminology of economic activities described in the Climate Delegated Act (e.g. renovation of existing buildings) to explain the eligibility of their activities. Nine did not use the terminology and one has used it without specifying the KPIs to which its eligible activities relate.

Although not required to refer to economic activities as described in the Delegated Acts, it does provide more transparency if disclosed. Over 2022 this level of detail will have to be provided, as well as other disclosures as indicated in the Disclosures Delegated Act.

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1 Our sample comprises 34 non-financial undertakings with a corporate seat in the Netherlands included in the AEX, AMX and AScX indexes, which are under the Non-Financial Reporting Directive (NFRD) scope and have published their annual report by 10 March 2022. See Appendix 1 for the list of companies in the sample.

2 Directive 2014/95/EU of the European Parliament and of the Council lays down the rules on disclosing non-financial and diversity information by certain large companies. It amends the Accounting Directive 2013/34/EU.

A higher number of companies reported eligibility for CapEx and OpEx compared to Turnover

The pie charts on the right summarize the number of companies that reported eligible economic activities by KPI, and the bar charts show the reported proportion of eligibility. The materiality exemption for OpEx was claimed by two of the 12 companies reporting non-eligibility[3].

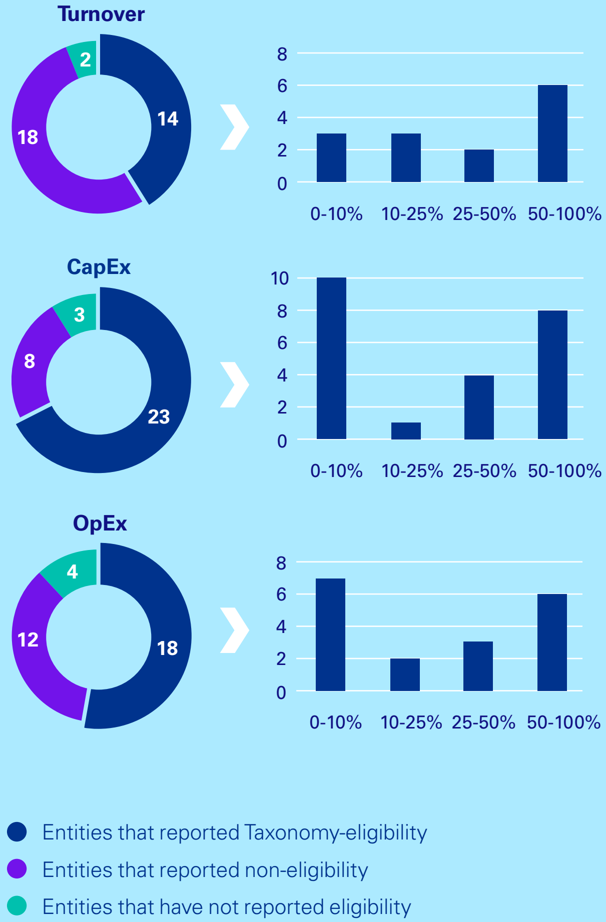
Starting with Turnover, 14 out of 34 companies reported eligible revenue-generating activities. As many companies in the Netherlands have core activities in Food, Retail, Wholesale, Technology and Services, and their core activities are not described in the EU Taxonomy yet, it is not surprising that the number of companies reporting eligible Turnover is relatively low. Regarding CapEx and OpEx, ten companies disclosed eligible CapEx and six eligible OpEx but did not disclose any eligible Turnover. We noted two routes for eligibility:

1. Via the revenue-generating activities, where the value is the portion of CapEx and OpEx associated with such activities (e.g. maintenance costs associated with the machine that manufactures plastic).
2. Via investments that do not generate revenue yet (e.g. Research & Development activities) or investments that will never generate revenue but are used in business operations (e.g. installing energy efficiency equipment for buildings).

The second route seems applicable to companies across different industries that report eligible CapEx and OpEx below 10% but do not report any eligible Turnover. Their eligible CapEx and OpEx often relate to "Construction and real estate activities" and "Transport".

[3] Disclosures Delegated Act, Annex 1, 1.1.3.2 provides an exemption for the calculation of the numerator of the OpEx KPI where the operational expenditure is not material for the business model of non-financial undertakings. However, when applying the exemption, non-financial undertakings shall disclose the total value of the OpEx denominator and explain the absence of materiality of operational expenditure in their business model.

Reported eligibility by KPI



For example, BESI, a supplier of semiconductor assembly equipment, reported Taxonomy-eligibility only for CapEx, and its eligible activities related to these two categories[4]. This shows that companies have the potential to substantially contribute to climate change mitigation and adaptation with investments in other than revenue-generating activities.

The Climate Delegated Act clusters eligible economic activities within 13 categories[5]. For the 15 companies in the sample that reported eligible activities using the terminology of this Delegated Act, the categories of activities are indicated in the chart on the right.

Not all of the 15 companies reported eligibility for all three KPIs and some reported multiple eligible activities. None of them reported eligible activities within categories 1, 2, and 10 to 13 of the Climate Delegated Act though.

Reasons for additional voluntary disclosure require explanation

Additional voluntary disclosures that help users gain a better understanding of the companies' eligibility (and alignment in the next annual disclosure) are encouraged. Some companies have provided voluntary disclosures. For example, Vopak, a tank storage company, discloses KPIs both including and excluding the investments in joint ventures and associates[6].

Companies should explain the reasons for making additional voluntary disclosures. As always with voluntary disclosures, these should not contradict, misrepresent or be more prominent than mandatory disclosures[7].

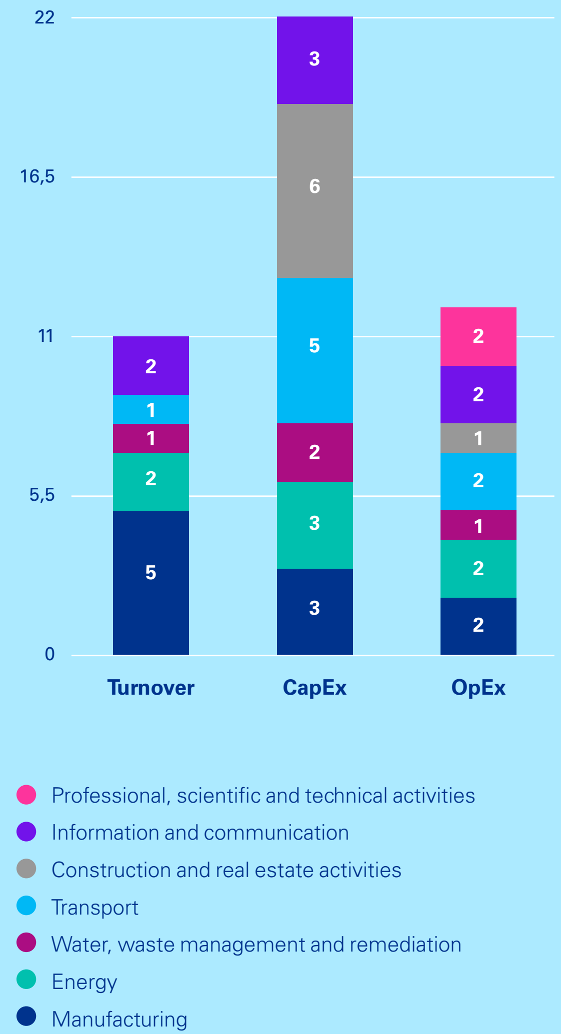
[4] BE Semiconductor Industries N.V. Annual Report 2021.

[5] Annex I to the Delegated Act relates to the climate change mitigation objective and clusters economic activities in nine categories, whereas Annex II relates to the climate change adaptation objective and clusters economic activities in thirteen categories. The name of categories one to nine overlap in both Annexes (e.g., 1. Forestry). Nevertheless, certain activities within these categories are included only in one of the Annexes, and certain activities included in both Annexes differ in their names and description.

[6] Koninklijke Vopak N.V. Annual Report 2021.

[7] FAQ released by the European Commission on 2 February 2022, item 7.

Categories of economic activities by KPI



Data gaps are a challenge for reporting

Three companies disclosed that they experienced difficulties with reliable data needed to perform the eligibility assessment, for example, due to a large volume of different activities or data simply not being available (yet). KPIs were therefore only partially and/or not reported.

While the eligibility assessment was often done at a corporate level, we anticipate that the alignment assessment will require more involvement from operations. We recommend starting with the alignment assessment sooner rather than later to allow more time to identify and close data gaps.

Level of qualitative information differs greatly

Due to a high-level requirement for qualitative disclosures in the first year[8], the level of information differs greatly between companies.

Only six companies in the sample explicitly indicated for all their Taxonomy-eligible activities whether they are related to the climate change mitigation or adaptation objective or both. Next year's disclosure on alignment will have extensive mandatory tables by KPI, which will drive further transparency. We anticipate that with increased transparency the reader should be able to better compare the disclosures of different companies.

Length of disclosure not indicative of relevance of information

The length of the EU Taxonomy disclosure varies significantly, from 241 words to over 3,000 words. It, however, does not provide a proxy for the quality of disclosure, as some companies describe in detail what the EU Taxonomy is but provide limited insights into their assessment and outcome. With more complex alignment reporting this year, we recommend companies put the effort into helping the reader understand the company specific application of the EU Taxonomy.

Accounting policy for calculating KPIs not always explained

A total of 19 companies in the sample referred to the financial statements in their EU Taxonomy disclosures to indicate how they determined the denominator of Turnover and CapEx KPIs. And 22 companies disclosed how they determined the OpEx compared to the definition of the financial statements by specifying the nature of the items included in the OpEx denominator.

Alfen's disclosure is a good example of the latter: "*OPEX-activities under EU Taxonomy comprise a restrictive list of the following operating expenses: direct non-capitalised R&D expenses, building renovation measures, short-term leases, maintenance and repair, and any other direct expenditures relating to the day-to-day servicing of assets of property, plant and equipment that are necessary to ensure the continued and effective functioning of such assets. Our total costs related to these activities amounted to € 5.6 million - i.e. 10.4% of our total operating expenses.*" [9]

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8 Disclosures delegated Act, Article 10: "From 1 January 2022 until 31 December 2022, non-financial undertakings shall only disclose the proportion of Taxonomy-eligible and Taxonomy non-eligible economic activities in their total turnover, capital and operational expenditure and the qualitative information referred to in Section 1.2. of Annex I relevant for this disclosure."

9 Alfen N.V. Annual Report 2021.

Whereas the EU Taxonomy definition of Turnover does not deviate from the revenues included in the financial statements, there is an EU Taxonomy specific definition for CapEx and OpEx. Therefore, it is important to disclose how the denominator of these two KPIs was determined. By making that clear, companies can help readers understand the starting point for determining eligibility (the denominator).

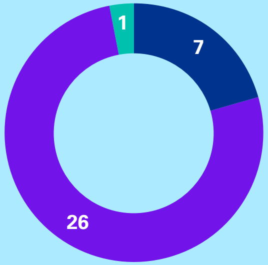
Few companies link EU Taxonomy and their broader ESG strategy

Companies could leverage (elements of) the EU Taxonomy to strengthen their broader ESG strategy. Firstly, the EU Taxonomy offers a comprehensive set of KPIs and performance thresholds based on scientific research that could be used to review, refine or extend existing targets and KPIs. Secondly, approaching different sustainability topics more systematically could be integrated into current ESG strategies. For example, connecting energy-saving projects with circular projects could create synergies and prevent unexpected negative rebound effects[10].

Interestingly only seven companies out of our sample connected the EU taxonomy to their broader ESG strategy, either by including (elements of) the EU Taxonomy in their targets and KPI framework, or by describing how the regulation links with the existing sustainability efforts. Most companies seemed to focus on compliance in their Taxonomy reporting, which is understandable given the extent of the requirements, the status of the regulation and the limited time available to do the assessment.

For the companies that make the connection to their broader ESG strategy and objectives, we observed three approaches. The first is the integration of EU Taxonomy elements into sustainability targets and KPIs. Here, the Taxonomy content is utilized to help steer towards more sustainable practices and accelerate or help achieve overall sustainability objectives, such as becoming net-zero by 2050 or sooner.

Link to ESG strategy



- Link to ESG strategy
- No link to ESG strategy
- No EU Taxonomy disclosure in the annual report

[10] For example, focusing solely on circularity and bringing back materials in the loop could have unforeseen and undesirable side effects. Reusing window frames from a demolished building across the country might seem like the right thing to do. Still, including transportation impact, potential energy leakage due to the outdated state of the frame might result in a higher net CO_2 impact than the frames' recycling. These effects are considered in the Taxonomy via the DNSH criteria and could be a valuable input to review the current strategy.

For example, SBM Offshore, an offshore energy company, included a target for 2022 of investing 50% of its R&D budget into EU Taxonomy eligible technologies[11].

A second approach was describing the link between the current (ESG) strategy and the EU Taxonomy. In these examples, companies show support for the objective of the EU Taxonomy and try to highlight touchpoints between the regulation and their existing sustainability strategy, goals, or projects but do not (yet) leverage on its potential to change the sustainability strategy. A good example is Heineken, an international brewer: "*Although we concluded that HEINEKEN is not in scope to report 'CAPEX' or 'OPEX' for non-eligible activities, we consider it relevant to explain the link of our net zero emission strategy with the Taxonomy regulation. Long term power purchase agreements (PPAs) and Energy certificates (EACs) are an important part of our sourcing strategy to contract renewable energy and make progress towards our net zero emissions commitment in production by 2030.*" [12]

The third approach that we observed is a description of a possible future link between the current (ESG) strategy and the EU Taxonomy. In this category, we see companies that recognize the strategic potential of the EU Taxonomy as something to explore going forward. For example, Kendrion, a technology supplier, mention that they *"anticipate the development of strategies aimed at the increase of the proportion of environmentally sustainable economic activities (...) to one or more of the environmental objectives of the EU Taxonomy."*[13]

We would expect and recommend more companies start aligning their ESG strategy and their Taxonomy disclosures over time. For one, the expectation is that more stakeholders will begin looking at how the Taxonomy disclosures relate to the broader equity story and could act based on their findings. For example, by directing their investment portfolios to include more companies with clear ambitions and strategies connecting strategy and Taxonomy-alignment targets. Secondly, the regulation is gradually moving towards a complete state, and companies will have more time to prepare for their next year's disclosures. Our expectation is to see the share of companies making the connection between their strategy and their Taxonomy disclosures increasing over the coming years.

[11] SBM Offshore N.V. Annual Report 2021.
[12] Heineken N.V. Annual Report 2021.
[13] Kendrion N.V. Annual Report 2021.

The EU Taxonomy is work-in-progress and so are companies' disclosures

The first EU Taxonomy disclosures reflect only a portion of what the EU Taxonomy is meant to be. About 40% of the companies in our sample reported eligible Turnover, but it doesn't mean that their revenue-generating activities are environmentally sustainable. This will be indicated in next year's disclosure on alignment. Further, companies might identify (additional) eligible Turnover, CapEx and OpEX when the other four environmental objectives come into play.

Due to limited guidance and no existing best practice, disclosures in 2022 varied from minimal in a short paragraph away in the back of the annual report to extensive sections, explaining the activities and linking the disclosures to the company's sustainability and corporate strategy. We expect that disclosures will become more comparable over time as more guidance is presented, more examples are made available, reporting timelines allow for better preparation and governance structures and processes are more established. However, for many companies this will require significantly more effort compared to what has been done so far.

The EU Taxonomy

In July 2020, the EU Taxonomy-Regulation came into force[14]. The Taxonomy-Regulation is intended as a 'green-language' to objectively determine which economic activities can be labeled as environmentally sustainable. This should both prevent greenwashing as well as direct both public and private capital towards sustainable investments, to help achieve the Paris goals[15].

Companies falling under the NFRD are required to annually assess their activities against the EU Taxonomy and report on the results of this classification on a company-specific basis, in the annual report. In particular, non-financial undertakings, shall disclose:

— The proportion of their Turnover derived from products and services associated with economic activities that qualify as environmentally sustainable;
— The proportion of their capital expenditure (CapEx) and the proportion of their operating expenditure (OpEx) related to assets or processes associated with economic activities that qualify as environmentally sustainable.

The Taxonomy-Regulation identifies the following six environmental objectives:

a) Climate change mitigation;
b) Climate change adaptation;
c) Sustainable use and protection of water and marine resources;
d) Transition to a circular economy;
e) Pollution prevention and control; and
f) Protection and restoration of biodiversity and ecosystems.

Delegated Regulations complement the Taxonomy-Regulation. They provide technical screening criteria for a list of economic activities with the potential to become 'environmentally sustainable' and also specify the content and presentation of information to be disclosed by undertakings subject to the Taxonomy-Regulation.

Currently, only the Delegated Act on climate change mitigation and climate change adaptation was adopted, confirming into law the associated Technical Screening Criteria for these two objectives[16]. In addition, a Delegated Regulation to specify the content and presentation of information to be disclosed by undertakings is also effective[17]. The Delegated Regulation for the remaining four objectives is expected to be published later this year.

Regarding the classification of an activity as 'environmentally sustainable' in terms of the EU Taxonomy, a distinction between Taxonomy-eligibility and Taxonomy-alignment is required. In the first step it is necessary to examine whether an activity is described in Delegated Regulations, since only those activities can be Taxonomy-eligible. Eligible activities are then assessed against technical screening criteria and can be labeled environmentally sustainable ('Taxonomy-aligned') when the activity:

— Substantially contributes to one or more of the environmental objectives;
— Does no significant harm to the other five objectives; and
— Complies with minimum safeguards.

Furthermore, the EU Taxonomy will continue to change over time. More activities will be added. Also the final report on the Social Taxonomy has recently been published, adding three social objectives, that together make up 'the Social Taxonomy'. Moreover, criteria for No Significant Impact and No Significant Harm might be added, providing more shades of green to allow for transition finance and further complicating the assessment for companies.

[14] Regulation (EU) 2020/852 of the European Parliament and of the Council.
[15] Legally binding international treaty on climate change adopted by 196 Parties at COP 21 in Paris.
Its goal is to limit global warming to well below 2, preferably to 1.5 degrees Celsius, compared to pre-industrial levels.
[16] Climate Delegated Act – Commission Delegated Regulation (EU) 2021/2139 of the European Parliament and of the Council.
[17] Disclosures Delegated Act – Commission Delegated Regulation (EU) 2021/2178 of the European Parliament and of the Council.

Appendix 1: Companies in sample

AEX	AMX	AScX
Akzo Nobel N.V.	Alfen N.V.	Accell Group N.V.
ASM International N.V.	Arcadis N.V.	Amsterdam Commodities N.V.
ASML Holding N.V.	Basic-Fit N.V.	B&S Group S.A.
BE Semiconductor Industries N.V.	Corbion N.V.	Brunel International N.V.
Heineken N.V.	Fugro N.V.	ForFarmers N.V.
IMCD N.V.	Koninklijke Vopak N.V.	Kendrion N.V.
Just Eat Takeaway.com N.V.	PostNL N.V.	Nedap N.V.
Koninklijke Ahold Delhaize N.V	Royal Boskalis Westminster N.V.	Ordina N.V.
Koninklijke DSM N.V.	SBM Offshore N.V.	Royal BAM Group N.V.
Koninklijke KPN N.V.		Sligro Food Group N.V.
Koninklijke Philips N.V.		TomTom N.V.
Randstad N.V.		
Signify N.V.		
Wolters Kluwer N.V.		

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