The next steps in non-financial information reporting

Research into the decrees on non-financial information and diversity in the Netherlands in 2018 and 2017

October 2019
The next steps in non-financial information reporting | 3

Table of Contents

Executive Summary 04

Research approach 10

Conclusion 19

Introduction 6

Results 12
- Corporate reporting on NFI and diversity 13
- Assurance on non-financial information 18
Executive Summary

Corporate reporting on sustainability, including social and environmental factors, with a view to identifying sustainability risks and increasing investor and consumer trust is becoming increasingly relevant. The disclosure of non-financial information is vital for managing change in the transition towards a sustainable global economy by combining long-term profitability with social justice and environmental protection. In this context, disclosure of non-financial information helps the company to measure, monitor and manage its performance and its impact on society.

This was recognized by the European Parliament when it introduced Directive 2014/095/EU regarding the disclosure of non-financial and diversity information by certain large companies and groups. On 24 March 2017, the NFI decree came into effect for annual reports in the Netherlands covering periods starting on or after January 1, 2017, whereas on 31 December 2016 the diversity decree was entered into force for annual reports on the same date.

This research has analyzed to what extent improvements are noticeable in 2018 annual reports compared with those from 2017 for a selected group of 44 Dutch companies that fall within the scope of the decrees. Our research demonstrates that companies have improved their reporting on non-financial information since the implementation of the decrees. In addition, we learned that because these decrees are highly principle based (a directive rather than a framework) companies may present non-financial information in a limited and fairly unbalanced manner.
Based on our research, we define these five lessons companies can learn:

1. A stakeholder analysis and non-financial materiality assessment in the annual report improves understanding of how non-financial topics are selected and defined.

2. Explaining why certain non-financial topics are not applicable or material is required by the NFI decree.

3. Integrating the non-financial risks into the existing risk management framework and defining risks in terms of how companies’ business impacts society and vice versa improves NFI reporting.

4. Defining (SMART) KPIs for all the required topics or disclosing why a KPI has not been defined, is an NFI requirement.

5. Expanding the diversity disclosures both in terms of the definition and to include the greater organization (employees) improves the reporting on a company’s diversity policy.

Looking ahead, we have noted that investors and other stakeholders are showing increasing interest in understanding both the material impact of a company on the environment and society, and the impact of society and the environment on a company. The concept of ‘double materiality’ was already embedded in the EU Non-Financial Reporting Directive, and the EU’s non-binding guidelines on climate-related reporting have made this more explicit. In addition, the Taskforce for Climate Related Financial Disclosures (TCFD) provides guidelines for the financial materiality of climate change. Taking this double materiality approach enables companies to identify those topics that truly define the environmental impact value of their company, to define and manage relevant KPIs to put them in control of those topics and to disclose their performance externally in an effective manner.
01 Introduction
A growing global trend is the increasing importance of non-financial (risk) management and corresponding information needs. In KPMG’s CEO Outlook 2019, 1,300 CEOs identify environmental and climate change as the biggest threat to their growth. Stakeholders and society as a whole have been increasingly recognizing the significance of non-financial information in addition to financial information needs in for many years.

This is further demonstrated by Eumedion’s call in its 2019 Focus Letter¹ to integrate long-term value creation, or a sustainability strategy for the long term, into the business models and strategy of listed companies and to have listed companies report on value creation for all their stakeholders in a meaningful way. The main findings of the Eumedion report are described below:

The increased focus on non-financial information is being formalized in regulations on corporate reporting. The need for better non-financial information and more scrutiny has been recognized by the European Parliament, which introduced Directive 2014/095/EU regarding the disclosure of non-financial and diversity information by certain large companies and groups. Ultimately, better reporting results in allocating capital to sustainable development and more sustainable companies,² which also tend to be more financially successful and the allocators of capital require more transparent disclosures to make those decisions.

This EU Directive came about because the European Parliament recognized the importance of businesses divulging information on non-financial topics, including social and environmental factors, with a view to identifying sustainability risks and increasing investor and consumer trust. Indeed, the EU considered disclosure of non-financial information vital for managing change towards a sustainable global economy by combining long-term profitability with social justice and environmental protection³. The EU Directive has been translated into Dutch law as the “Besluit bekendmaking niet-financiële informatie” (Royal decree on the disclosure of non-financial information – hereafter NFI decree) and the “Besluit bekendmaking diversiteitsbeleid” (Royal decree on the disclosure of diversity policy – hereafter the diversity decree). The decrees came into effect for the annual reports of large⁴ listed entities and/or of Organisaties van Openbaar Belang (OOBs: public interest entities as defined by Dutch Law) in the Netherlands, covering periods starting on or after January 1, 2017. The diversity decree applies solely to listed entities.

² https://www.sustainability-academy.org/eight-8-surprising-trends-sustainability-reporting
³ EU Directive 2014/95/EU consideration (3).
⁴ A large entity as defined in Book 2, title 9 of the Dutch Civil Code.
The current NFI legislation is principle based as is the EU directive: companies have significant freedom to interpret the required disclosures and have the opportunity to ‘comply or explain’. With a principle based translation into law, the Dutch legislator has defined a set of requirements that aims to improve reporting on societal topics, rather than defining a compliance driven regulation in line with the EU directive. In the Netherlands, the decree explicitly states that the required information is to be disclosed in the management board report.

Two reporting years have passed since the decrees were implemented in March 2017. The AFM has already conducted research into the implementation status for the first reporting year (financial year 2017) and concluded that overall the implementation status was inadequate. According to the AFM, the vast majority of companies did report on their policies on the various aspects of non-financial information. However, the translation of policy into risks, KPIs and results fell short of the desired standard.

In order to support companies that would like to improve the implementation process of the decrees, this report presents a number of lessons learned from our research that could be considered recommendations.
The overall goal of this research is to guide companies to improve their reporting on non-financial information and diversity, in the context of the implementation of the decrees, by taking into account the lessons learned as defined in chapter 4.

We followed a five-step approach to conduct the research and extract the results presented to readers in this report:

1. Developed two research questions, related to the impact of the implementation of the EU decrees on non-financial reporting and diversity over 2017 and 2018 and assurance on non-financial information.

2. Performed a desktop review of the annual reports from 2017 and 2018, focusing on coverage of mandatory non-financial information aspects, topics and diversity.

3. Designed an assessment framework to score the annual reports from 2017 and 2018 on the required disclosures.

4. Developed threshold criteria to qualify the level of corporate reporting from the target population of annual reports (e.g. high-quality corporate reporting vs bare minimum reporting), based on the scoring parameters from the assessment framework.

5. Applied the threshold criteria to the target population to achieve results in terms of answering the research questions.
We have analyzed what has been reported and assessed to what extent improvements are noticeable in the 2018 annual reports compared to the 2017 reports for a selected group of 44 Dutch companies that fall within the scope of the decrees on NFI and diversity. The selected companies are all audited by a Big Four audit firm and have been equally divided between the Big Four firms. In addition, we have investigated to what extent assurance on any non-financial information in the same reports is correlated with the companies’ scores.

The research focused on the following key questions:

1. To what extent have companies reported on the non-financial disclosures on environmental, social, personnel, human rights, anti-bribery & corruption matters and diversity over 2017 and over 2018?

2. Does the quality of disclosures of annual reports differ if assurance has been provided on non-financial information?

To be able to answer the research questions, we performed a desktop review of the annual reports of 2017 and 2018 of each selected company and assessed:

- the extent of reporting on the mandatory non-financial information aspects (policy, KPIs, risk identification and management, and performance) with respect to each of the mandatory topics (environmental matters, human rights breaches, social matters, personnel matters and anti-bribery & corruption);

- the extent of reporting on diversity;

In order to score the annual reports based on the above-mentioned focus areas, we developed an assessment framework in which we included the questions. For each of the questions, we defined scoring parameters, meaning a score of yes or no (in certain cases partly) with the aim of qualifying the level of corporate reporting. In our research, we consider corporate reporting to be high quality - in line with the decrees – if a company describes in detail the requirement or if the company states and explains why they have chosen to omit the disclosure. For example – a company has no policy on human rights but does include a reasonable rationale for not having such a policy in place. We have made an additional distinction between companies that report the (bare) minimum as requested by the NFI decree and those companies that have really used the business model, stakeholder analysis and the risk assessment to increase transparency, and in doing so have provided the readers of their reports with even more insightful reporting. These kinds of threshold criteria made it possible to assess the degree of non-financial disclosure in the reports.

Assurance on non-financial information is not required other than the auditor’s responsibility to assess compliance with the decrees. We have researched whether there is a correlation between a company’s score on corporate reporting and assurance on non-financial information.

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7 Other than the auditor’s responsibility to verify compliance with the decrees and the requirements of ISA 720 The Auditor’s Responsibilities Relating to Other Information. © 2019 KPMG Advisory N.V.
03 Results
In this chapter, we describe the results based on the research questions. We have identified lessons learned per topic when applicable, as well as a practical tool for companies.

3.1 Corporate reporting on NFI and diversity

3.1.1 Stakeholder analysis and materiality assessment

Most companies provide a stakeholder analysis in their annual report describing their stakeholders and the influence on stakeholder assessments and decisions. This is followed by a materiality assessment, which defines non-financial material (societal) topics that may reasonably be considered important in terms of reflecting the organization’s economic, environmental and social impacts, or in terms of influencing the decisions of stakeholders. Even though these are not explicitly required by the NFI decree, these are the basis of the required disclosures. This means that companies should assess the risks of adverse (societal) impact that stem from the company’s own activities or may be linked to its operations and full value chain, i.e. impact risks. Companies should assess whether the information disclosed covers all material matters where principal risks of severe impact (may) materialize. If matters other than environmental, social and employee-related matters, respect for human rights and anti-bribery and corruption are identified as material, it is important that the company discloses the information required by the NFI decree (policies, risks, outcomes, KPIs) on those matters as well.

Figure 1 shows whether a stakeholder analysis and materiality assessment has been performed (yes/no) and shows the correlation between quality corporate reporting (compliance %) when a stakeholder analysis/materiality assessment has been performed and/or disclosed compared with companies that have not done this. This shows a significant difference. When a company conducts a stakeholder assessment and a materiality assessment, its scores are on average 23% higher on all the required topics, which increases the quality of its non-financial disclosures. We do recognise that companies that have a strong focus on providing non-financial information are more likely to have a materiality assessment and as such the causality may be contrariwise.

We ascertained that in 2017 75% of our selected annual reports included a materiality assessment and a stakeholder analysis. In 2018, this increased to 80% for both topics. Even though the materiality assessment is technically not a NFI requirement, it is a key step in setting the scope of the NFI disclosures.

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**Figure 1:** Average compliance (%) for reports with or without stakeholder analysis and materiality assessment

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**Lesson Learned #1:**

A stakeholder analysis and materiality assessment in the annual report improves understanding of how non-financial topics are selected and defined.

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8 Definition from GRI 101 Foundation from the Global Reporting Initiative.

9 We present the average of the relevant required disclosures as stated in the Decree under Article 3.1 sub b-d.
3.1.2 The business model

The first requirement of the NFI decree is that companies should provide a brief description of their business model. In our view, this description is sufficient when it provides enough information to understand the company’s operations, which in turn enables readers to understand the business context under which activities take place and severe impacts may arise. The vast majority of the companies disclose this: 93% in 2017 and 95% in 2018.

3.1.3 The policies, the results of the policies, the impact risks and the KPIs

The non-financial statement should include a description of the policies pursued by the company, including due diligence processes implemented and the impact of these policies in the financial year. When a company does not have policies on one or more of those matters, the non-financial statement provides a clear and well-founded explanation for not doing so. In addition, the statement includes the key risks with regard to the policies, including the business relations, products or services of the company that are likely to have adverse societal effects (i.e. impact risks).

In addition, it will include KPIs that are relevant the company’s activities with regard to the five areas: environment, human rights, personnel, social and anti-bribery.

In figures 2 and 3 below, we have summarized our findings for 2017 and 2018.

The results are as follows:

- These figures show the outcome per topic and a comparison between the two years. The majority (72%) of the companies report on the policies, especially in terms of disclosing their environmental and personnel policies. We also note an increase in 2018 compared to 2017 (2017: 68%). Policies related to human rights and anti-bribery & corruption are among the topics least disclosed. We also note that it is common practice to disclose that the company “does not have a formal policy on human rights / environment.” The decree states that this can be disclosed.
The next steps in non-financial information reporting

Figure 4: Average existence of policies and their effects, impacts, risks and KPIs for five NFI decree topics in annual reports

if a company provided an explanation for not having such a policy. We note that most companies do not provide such an explanation. However, this did improve in 2018. We also note that it is common practice to refer to an external source for some policies, such as the company website.

- When companies generally disclose policies, the results of these policies are often not mentioned in disclosures. The link between the policy and performance is lacking. In 2018 and 2017, on average only 53% and 47% of our selected companies disclosed the results of policies in an adequate manner. As in the policy disclosure, environmental and personnel results score the highest, while anti-bribery & corruption disclosures are particularly low.

- The disclosures on the impact risks of the selected companies differ to some extent: while some companies integrate these into their risk management section, most companies briefly mention these separately. This finding might be the result of the growing interest companies are showing in integrated reporting, which results in less explicit disclosures on compliance with the decrees. In line with the other topic, we noted that personnel and environmental risks are disclosed the most among our selected companies.

Risks related to anti-bribery & corruption and human rights are once again on the low end of the scale. On average, companies disclose 50% (2017) and 54% (2018) of the required statements. In addition, we note that companies present how risks impact them rather than how they impact society.

LESSON LEARNED #3:

The existing risk management framework will improve if non-financial risks are sufficiently taken into account. Integrating the non-financial risks into the existing risk management framework and defining risks in terms of how a company’s business impacts society and vice versa improves NFI reporting.
• KPIs show an even larger distinction between the five required topics: while approximately 75% of our selected companies report on environmental and personnel KPIs, less than one third of the companies have defined KPIs on human rights and anti-bribery & corruption, without providing an explanation for this omission. A human rights policy calls for commitment, due diligence, assessment and disclosure on salient issues. Those salient issues (like material topics) are to be defined with input from stakeholders, and they vary from company to company and will change over time.

Defining a KPI for all these topics can show how the policy is in place and how the company can improve its performance on these topics.

3.1.4 The diversity policy

In line with the diversity decree, most selected companies include the mandatory description of their diversity policy for the management board and supervisory board – over 90% in our selected reports. This includes (often briefly) the goals of the diversity policy and the results of same. We note that the majority of the companies do not meet the legal Dutch target figure ("streefcijfer") of a balanced distribution of seats between genders in the boards.

All companies report on the male-female ratio, whereas less than 50% also report on other elements such as nationality, age and professional background i.e. the broader definition of diversity. As stated by the European Commission, stimulating diversity results in management decisions being challenged more effectively and creates more room for innovative ideas.

3.1.5 Added value to the readers of the annual reports – additional considerations

The current NFI legislation is principle based: companies have significant freedom to interpret the required disclosures and have the option to ‘comply or explain’. This results in major differences in the quality and the level of detail and depth of disclosures. As such, it seems that most companies perceive the decree as a checklist, based on the fact that disclosures often miss context and integration. In addition, a more critical and balanced view of itself would improve the company’s credibility. For example, the AFM shows two best practices: firstly, DSM with their overview of ‘what (still) went wrong’, and secondly, Arcadis, which developed a ‘connectivity matrix’ in 2017.

Dutch Civil Code Book 2 Title 9 article 166 states that a balanced management board and supervisory board should include at least 30% females and 30% males (therefore being a legal requirement not in scope for the diversity decree).


We have also taken a slightly more judgmental view on the adequacy of the disclosures provided. In other words, this means that for disclosures that are technically in compliance with the degree, we have assessed whether these provide the added value and the relevance for the readers of the reports. As a fictive example, a construction company discloses its CO₂ emissions as a lump sum as their environmental KPI, whereas a relative amount (for example, related to production levels) would be more relevant and comparable. In addition, there is no disclosure of information related to the planetary boundaries framework where this would be valuable information for stakeholders looking to assess environmental performance. In another fictive example, a company is in compliance when it uses one paragraph to state that it has a human rights policy based on the standards of the ILO. A reader would be better informed if the company were to describe how this policy is implemented in practice. As a result of the above-mentioned observations (regarding the added value of non-financial disclosure), we have assessed to what extent the reporting provides the relevant and balanced insights required for the readers of the annual reports. We have defined ‘insightful reporting’ as the degree to which companies have reflected in a critical and balanced manner on non-financial information disclosure towards their readers.

Our analysis shows that there is still a gap (on average 25%) between minimum compliance and providing the insightful information that we believe would be beneficial for management boards and stakeholders based on our desktop research.

![Figure 5: Compliance to NFI decree](https://www.stockholmresilience.org/research/planetary-boundaries/planetary-boundaries/about-the-research/the-nine-planetary-boundaries.html)

13 The International Labour Organization is a UN agency that sets international labor standards.
3.2 Assurance on non-financial information

Assurance is a means to enhance the level of confidence on non-financial information provided in annual reports and is mostly provided by the Big Four audit firms. Of the reports in the scope of this research, 50% include an assurance report (on non-financial topics) in 2017 and this increased to 52% in 2018. In figure 6 below, we present the assurance on non-financial information for the selected companies. We have analyzed the scores of the reports of the population of companies that involved an external auditor for non-financial information.

In our research, we see a positive correlation between how companies score on average depending on when they involve an assurance provider, as stated in figure 7: 84% versus 53%. This means that on average a company that includes assurance on their non-financial information is in compliance with 84% of all requirements. We have not analyzed the difference between limited and reasonable assurance. There are only a handful of companies with reasonable assurance. The vast majority of the companies have a limited assurance report.

Even though correlation does not equal causation, we can argue that having a team of external assurance providers that includes subject-matter experts and non-financial reporting specialists will contribute towards the quality of the disclosures. As part of providing this assurance, the non-financial assurance provider works closely with companies to support the structure of their reports, to ensure that material topics are covered, and to make sure their reports are a balanced representation of their organization’s non-financial performance. In addition to issuing an assurance statement, the assurance provider draws up lessons learned for improvement - based on findings and future developments - in the form of a management letter. In addition to this, assurance has a preventive effect: companies that receive assurance on their non-financial reports tend to step up in terms of the quality of their information and processes to meet the standards required to obtain an unqualified report. On the other hand, we argue that the opposite can be true: companies that are devoted towards disclosing high quality non-financial information tend to involve an assurance provider.

15 For this research, we have not distinguished between the respective assurance scope of the reports. The scope ranges from a few KPIs to assurance on a broad spectrum of KPIs and texts in scope.
16 Due to the limited differences between the 2017 and 2018 reports, we only present 2018 reports in figure 6.

Figure 6: Assurance on non-financial information in reports (2018)
04 Conclusion
We have performed a desktop review of 44 annual reports that are required to comply with the NFI decree. All of these companies are registered in the Netherlands, fall under the OOB (PIE) definition, and have at least 500 employees. We performed our review of the 2017 and 2018 annual reports of each company in scope, and using a checklist approach, we attempted to answer the following questions:

1. the extent of reporting on the mandatory non-financial information aspects (policy, KPIs, risk identification and management, and performance) with respect to each of the mandatory topics (environmental matters, human rights breaches, social matters, personnel matters and anti-bribery and corruption);

2. the extent of reporting on diversity;

3. whether assurance on the non-financial information is provided by an external auditor.

In addition, on the topics, we find that reporting on human rights and anti-bribery is lagging compared to environmental, personnel and social matters. A stakeholder analysis and materiality assessment may be an additional tool for the selection and prioritization of the material topics that form the basis of the requirements on non-financial information. More specifically, KPIs for these aspects are often lacking. The disclosure of SMART defined KPIs would improve this.

Furthermore, we found that companies often state that certain required topics are not material or relevant to them, without clearly defining why. In addition, we note that diversity is often still just about gender, whereas this could also include age, nationality and professional background.

Our results show that companies having a team of external (non-financial) assurance providers that includes subject-matter experts and non-financial reporting specialists score higher on the quality of the required disclosures. As part of providing this assurance, the non-financial assurance provider works closely with companies (selecting claims, performing site visits and interviews and checking underlying documentation) to support the structure of their reports, to ensure that material topics are covered, and to make sure their reports are a balanced representation of their organization’s non-financial performance. In addition to issuing an assurance statement, assurance providers provide lessons learned for future improvements - based on findings and the developments in the market – in the form of a management letter.

The fact that companies score highly on policies and low on risks and KPIs is an indication that they understand the road they are taking, but not yet why they are taking it, nor the direction in which they are walking. Without an understanding of impact and risk, and without clearly defined KPIs, policies may not have the impact that the company was hoping for. This underpins the importance of...
our lessons learned on the integration and clear definition of KPIs. It will take further development of (reporting) frameworks to create truly insightful value and/or business models and to truly understand impact.

In our research on the first two reporting years of the decrees, we noted some improvement regarding companies’ performance on the implementation of the decrees, but at the same time also note that most companies need to make an effort to catch up and to provide high-quality corporate reporting going forward.

In our report, we have defined five key lessons learned, which we have also summarized below:

1. A stakeholder analysis and materiality assessment in the annual report improves understanding of how non-financial topics are selected and defined.

2. Explaining why certain non-financial topics are not applicable or material is required by the NFI decree.

3. Integrating the non-financial risks into the existing risk management framework and defining risks in terms of how your business impacts society and vice versa improves NFI reporting.

4. Defining (SMART) KPIs for all the required topics or disclosing why a KPI has not been defined, is an NFI requirement.

5. Broadening the diversity disclosures both in the definition of diversity and on an increased scope on all employees of the organization improves the reporting on the company’s diversity policy.

We do acknowledge that the decrees in their current form leave room for interpretation, as well as a ‘comply or explain’ option. Furthermore, we note that when companies are required to have a separate non-financial statement, they tend to disclose all these requirements in an isolated section of the report, rather than integrating these into the existing annual report. This is also linked to the requirements in the Dutch corporate governance code for listed companies, which has a strong focus on long-term value creation. The business models and value creation models used are still under significant development. There are still more than 100 different frameworks on the NFI topics available. This is why companies are still struggling with what to report. It will take further development to create truly insightful value and/or business models and to truly understand impact.

We believe one of the biggest challenges in non-financial reporting in the upcoming years will be in the shift away from that companies seeing the decrees as a minimum standard for NFI-reporting they need to comply, and seeing this as an opportunity to communicate transparently to stakeholders about the company’s vision on their long term value creation in a balanced way.

One development we could see in the near future is that assurance being made legally binding as the European Parliament steps up efforts to realize the goal that led to the NFI decree. The European Commission is already evaluating the EU directive and the (non-binding) guidelines that accompany it.

Looking ahead, we have noted increasing interest among investors and other stakeholders in understanding both the material impact of a company on the environment and society, as well as the impact of society and the environment on a company. The concept of ‘double materiality’ was already embedded in the EU’s Non-Financial Reporting Directive, and recent developments, such as the TCFD and the EU’s non-binding guidelines on climate-related reporting, have made this more explicit. Taking this approach enables companies to identify those topics that truly define the value of their company, to define and manage relevant KPIs to put them in control of those topics and to effectively disclose their performance externally.

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