



SUSTAINABILITY

## Better assurance starts with better understanding

How KPMG sees assurance on sustainability reports



# Table of Contents

	<b>Prologue</b>	2
	<b>Introduction</b>	3
<b>1</b>	<b>What are the main developments in sustainability reporting?</b>	5
<b>2</b>	<b>What is the value of professional assurance on sustainability reports?</b>	7
<b>3</b>	<b>Which parties can provide assurance?</b>	11
<b>4</b>	<b>What information is covered by assurance?</b>	14
<b>5</b>	<b>Which checks and analysis does KPMG Sustainability perform?</b>	18
<b>6</b>	<b>What rules govern assurance on a sustainability report?</b>	23
<b>7</b>	<b>Looking to the future of assurance on sustainability reports</b>	26
	<b>About KPMG Netherlands</b>	30

## Prologue

Companies increasingly recognise their key role in society and that sustainable success requires sound policies with respect to their relationship with society. It is becoming more common for companies to publish a sustainability report that provides a picture of their social performance and their impact on the environment.

To underline the reliability of this social and environmental information, a growing number of companies consider the inclusion of a third-party statement in their sustainability reports. This so-called assurance on these reports is a relatively new field of work, which in itself demands greater transparency and clarity regarding the character and the development of this type of assurance.

As an assurance provider, we believe that we have a role in the development of this field of assurance, and a responsibility to clearly communicate with both the companies and the various target groups. This publication is our response to this need, and is aimed at highlighting and clarifying some key elements of sustainability assurance. We focus specifically on people who do not come into contact with assurance on a daily basis:

- Organisations that want to understand what's possible, what's not possible, and the consequences.
- NGOs and other interested parties that use – or want to use – assurance reports and discuss sustainability assurance with the corporate sector.
- Corporate CSR professionals responsible for managing the assurance process.

Chapters 1 to 6 of this booklet provide a 'user manual' that explains how to use an assurance report by taking a look behind the scenes. In chapter 7 we present the key elements of our vision of the future development of sustainability assurance and role in this.

I hope you enjoy reading this publication.

Amstelveen, October 2006  
Wim Bartels, Partner KPMG Sustainability

## Introduction

Successful business requires more than a sound financial return. Only companies that accept their responsibility towards society and the environment, can be sure of a sustainable future. External parties can call them to account on this and use companies' sustainability reports, among other things, to do so. In their sustainability report, companies account for the various social aspects of their operations and the impacts the company has on its environment. In contrast to financial statements, it is not a legal requirement to produce a sustainability report. This is one of the reasons that the depth and scope of these reports vary so much. The audience for these reports also includes a wide variety of users, ranging from specific pressure groups and company staff to pension funds and other investors.

The companies that strive to present a good and reliable picture of their performance in their sustainability reports, also want the users to take their information seriously. An important contributing factor is independent confirmation that the report deals with the relevant topics and that the information contained in the report is accurate. This is reflected in the continuing increase in companies asking third parties (accounting firms but also engineering and independent advisory firms) to verify the report. In accounting jargon, this is known as providing assurance on a report. In some cases people or organisations with specialist knowledge, such as non-governmental organisations (NGOs) or academics, are also asked for their professional opinion about the reports and their content.

KPMG Sustainability is the market leader in the field of assurance in The Netherlands and has a team of environmental and social professionals and auditors. However, as well as positive feedback on the effects of assurance, we receive (critical) questions from interested parties and clients. These questions, which cover issues such as the depth of our work or our independence, reveal that there is some uncertainty about our work as an assurance provider for sustainability reports. For instance, our work goes much further and deeper than many people would expect, and contributes in numerous areas to the development and improvement of sustainability efforts within organisations.

This does not change the fact that these questions are justified and understandable. A contributing factor is that the field of assurance on sustainability reports is still relatively new, and different assurance providers have different approaches. The readability of the assurance reports in sustainability reports also varies, and the reports issued by the different assurance providers also differ from each other. In short, it is not always clear to the reader exactly what an assurance engagement involves.

**What can we learn from the previous?**

Firstly, that it is essential to clearly explain what we do when we perform an assurance engagement for a sustainability report. We owe it to ourselves to explain how we go about an assurance engagement and how we arrive at the specific wording of our assurance reports. By doing this, we provide the user of the sustainability report with a manual for our assurance report. You will find this user manual in chapters 1 to 6 of this publication. We hope that it will clarify matters for you and we are convinced that this look behind the scenes will provide better understanding of assurance practice.

Secondly, we also believe that transparency around assurance on sustainability reports should be improved. The parties involved in this, must accept their responsibility and work together to achieve a consistent and transparent approach. Chapter 7 highlights the key elements of our vision of the future development of sustainability assurance and our role in this. The years ahead will see further development in this new field. We look forward to it with enthusiasm and confidence.



## Section 1

### What are the main developments in sustainability reporting?

#### **More than half of the 250 major companies (G250) issue a sustainability report**

More and more companies are seriously investing in sustainability reports. In this context, the figures of the 2005 KPMG International Survey of Corporate Responsibility Reporting say it all<sup>1</sup>. Of the 250 largest companies in the world, more than half are now reporting on their social performance and/or the company's impact on the environment. This was 35 per cent in 1999. This increase in attention reflects the current social climate. Members of the public are becoming more assertive in their role as consumer, employee or external stakeholder. The number of NGOs keeping a critical eye on the corporate sector, have more than doubled over the last ten years. Whether or not via pressure from NGOs, the public expects the corporate sector to be transparent about the way they treat society and the environment.

#### **Corporate social responsibility is no longer the domain of trendsetting companies**

Companies respond to the wishes of interested parties and recognise the importance of optimum transparency and corporate social responsibility as building blocks for a sustainable future. The financial world is also providing an impulse to this development. Financial analysts and credit rating firms attach ever more value to non-financial information. This is because they can use this information to identify the risks a company faces, or because they can obtain insight into the opportunities the company develops to create sustainable value for all the stakeholders. This is compounded by the fact that while, expectations concerning the social role of the corporate sector have increased, confidence in the corporate sector has diminished. Together, these trends ensure that sustainability reporting is becoming a regular aspect of the management of a wide range of companies.

#### **More integrated approach to social accountability**

Ten years ago, sustainability reports often focused on a single issue, such as the environment or social policy in a particular field. However, more and more companies are now presenting integrated reports, offering a summary of their impacts and performance in all areas. Sometimes this information is included as part of the annual financial report. The development of standards is contributing to this trend. The best known of these are the guidelines of the Global Reporting Initiative,<sup>2</sup> which are becoming an internationally accepted standard for sustainability reports, and the framework and guidelines for sustainability reporting and assurance developed by AccountAbility (see also chapter 6).<sup>3</sup>

<sup>1</sup> KPMG International Survey of Corporate Responsibility Reporting 2005, KPMG Global Sustainability Services, June 2005.

<sup>2</sup> The G3 guidelines were published on 5 October 2006; please refer to [www.globalreporting.org](http://www.globalreporting.org).

<sup>3</sup> See, for example, AA 1000 Framework, 1999 and AA 1000 AS (Assurance Standard), 2003 at [www.accountability.org.uk](http://www.accountability.org.uk).



**Interested parties want to know whether they can trust companies to account for their social responsibility**

With sustainability reports becoming an increasingly important source of information for parties with an interest in organisations, there is also an increase in the need for assurance that the information is reliable. Stakeholders want to be sure that the report presents a fair picture and that it is actually more than just a PR instrument. The corporate sector is responding to this by engaging third parties to review the reports. Currently, 30 per cent of the G250 companies that publish a sustainability report, engage an assurance provider to this end.<sup>4</sup> This independent party confirms the reliability of the information contained in the report based on an agreed protocol and professional standards.

## Section 2

### What is the value of professional assurance on sustainability reports?

#### **There is a difference between providing assurance and being assured**

Before discussing the value of professional assurance, it would be useful to explain the concept of assurance and the difference between providing assurance and being assured. Assurance generally provides certainty about a statement made by someone else. The users of a sustainability report are provided with confirmation from an independent third party that the information contained in the report is accurate (and sometimes also that all the relevant information is in the report). The user can also obtain a view on the progress and performance of the company in the areas of social and environmental responsibility.

What is important in this context, is the difference between 'being assured' and 'providing assurance'. When we talk about 'being assured', we look at assurance from the user's perspective. The key question here is, which party is reliable and credible enough for the user to trust that party's views and opinions (whether or not in writing). When we talk about 'providing assurance', we look at assurance from the assurance provider's perspective. The key question here is, *according to which method and standards* can the insurance provider give his or her professional conclusions with a certain degree of decisiveness to the reader of the sustainability report. This distinction is very important for the further understanding of assurance.

#### **Assurance ensures that users can use the information with confidence**

The aim of corporate social responsibility is to improve social performance and to minimise the impact on the environment – and thus ensure a sustainable future. Accountability is an essential part of this. The corporate sector is very quickly at a disadvantage when it comes to accountability – after all, nobody can be trusted to be independent about their own performance.

When an independent third party verifies the information, it is a sign for the users – the readers of the report – that the information is reliable and relevant. Readers can confidently base their decisions on this information. For organisations such as KPMG, independence is actually strictly defined: both in the Code of Ethics of the umbrella organisation of accountants and in internal codes of conduct and processes. Before KPMG Sustainability accepts an engagement, another (independent) department explicitly checks our independence. The need for this is clear: if we can no longer be independent, we lose our *raison d'être*.

Assurance on a sustainability report therefore increases the credibility of an organisation's sustainability policy and improves communication with the outside world. The assurance provider does not express a view or opinion on the company's sustainability performance as such. However, the assurance provider can provide an opinion about whether the company reports honestly to the outside world.



### **Organisations can boost their image on the capital markets through assurance**

Many companies consider it very important to be included in sustainability indexes (such as the Dow Jones Sustainability Index or the FTSE4Good Index) on the financial markets, especially now that the share of sustainable investments is growing solidly year after year. A clear and reliable sustainability report is of major importance in achieving this, as is assurance on that report.

In general the various parties involved in the financial markets are recognising the value of non-financial information. One of the arguments for this, is that companies that operate with social responsibility in mind, and properly account for it, run fewer risks and can exploit new opportunities for value creation. This is attractive from an investor's point of view because investors are always looking for the maximum return with the minimum risk.

### **An assurance provider contributes to better embedding in the management processes**

The end product of an assurance engagement, is a report in the sustainability report which provides an opinion about the reliability of the information contained in the sustainability report. As well as this main product, however, there is also a by-product which readers of sustainability reports hardly notice: in almost all the instances, assurance engagements produce recommendations on how the management of social and environmental issues can be better embedded in the organisation and how internal information systems about these issues can be improved. This is an entirely natural outcome of an assurance engagement: an assurance provider can only judge the reliability of information by obtaining a proper picture of the internal processes and controls that lead to this information. Assurance providers who take a critical look at these processes – including interviews, document checks and random samples – automatically come across opportunities for improvement.

In practice, the first years of an assurance engagement often result in enormous internal improvements. Companies 'discover', for example, that their monitoring processes are not entirely reliable and set about improving them. In addition, external assurance contributes to raising awareness within the company of the importance of sustainability issues and their management.

In recent years, KPMG Sustainability has also included a number of important recommendations for improvement in its assurance reports. It requires a certain amount of persuasion to convince some companies that this is the right thing to do. In our view, however, it is completely natural that companies need time to go through this process before their organisation is properly prepared to accept this point. By exercising transparency and exposing their weaknesses, they become more credible to the outside world.

### **Assurance often improves the information contained in the sustainability report**

When the internal processes and systems around sustainability performance improve, the information also improves. Assurance engagements often also have an immediate effect on the quality of the information in the report. The final version of the sustainability report is often a considerable improvement on the first draft offered to the assurance provider. Throughout the assurance process, discussions take place between the assurance provider and the company about the scope of the information, the completeness of the issues dealt with and the exact wording. The resulting changes remain invisible to the public, but behind the scenes they produce a quality impulse for the sustainability report.

### **Assurance has its limits**

Assurance on sustainability reports obviously also has its limits. We are realistic enough to know that it is not a magic potion for improving corporate social responsibility and reporting about it.

Our assurance report does not, for instance, imply:

- that the company is intrinsically making a good job of corporate social responsibility; whether or not that is the case, has to be determined by the user based on his or her own criteria and the information that we have verified;
- that no incidents have occurred within the company or that no laws and/or codes of conduct have been breached. We only check and verify claims in this respect if the company explicitly refers to it in the report;
- that all the important issues for all the stakeholders are reported. A company doesn't always know exactly who all its stakeholders are; of course, the main stakeholders from the company's perspective must be known. Moreover, there are numerous other ways of informing stakeholders, for example through one-to-one communication by letter or telephone. In these cases, the specific topic raised by the stakeholder is not necessarily dealt with again in the sustainability report;
- that the risk of incorrect information appearing in the report is excluded. We do not provide absolute assurance – that would be too time-consuming (see also section 6 for the types of opinion that we can issue).

## Case 1

### **“We produce the cleanest refrigerators”**

*Suppose a manufacturer of domestic appliances claims in its sustainability report that they ‘produce the cleanest refrigerators’. How does KPMG assess this claim as an assurance provider?*

The first thing our professional will want to know, is what this claim is based upon. Perhaps the company has a survey from an external party that draws this conclusion. We then carefully consider whether the wording in the survey corresponds with the claim made in the manufacturer's report. We also investigate whether the survey contains other relevant information. For instance, it is possible that ten different product categories were investigated – in addition to fridges, for example stereo systems, TV sets and suchlike – and that the manufacturer in question had far lower scores in these other categories. The company is then using information selectively, so we raise this issue with them. Finally, we also look at the competence and the reliability of the firm that conducted the survey.

If there are differences between the survey and the claims in the report, we discuss these with the client. The final outcome following discussions between KPMG and the client will be that the claim is removed altogether or is changed in order to present a better picture of the reality. KPMG can then confirm in the assurance report that the information contained in the sustainability report is correct.

Depending on the exact findings, the text in the example could for instance be adapted to read: “Research agency x concluded this year that the materials used in our fridges are the best for the environment compared to other brands. For other products in our range, we achieved an average position in this survey.”

## Section 3

### Which parties can provide assurance?

#### **Many different parties can provide assurance**

The law requires that financial statements be audited by an accountant. However, this requirement does not apply to sustainability reports, so other parties can also act as assurance providers. These may range from specialist firms or experts in the field of corporate social responsibility to rating agencies and NGOs.

Basically everyone is free to offer an opinion in a sustainability report about that report or about parts of it.

The meticulousness, independence and accountability of the assurance provider play an important role. An assurance provider that is not bound by professional standards or that is not trained in assurance methodology, may use inferior quality work as a basis for claims that cannot be substantiated or for which he or she cannot be held accountable. This party may be credible in the eyes of the user, but when it comes to a critical assessment by the outside world, this can also backfire on the credibility of the company and the report.

From this perspective, an accounting firm would be an obvious choice to provide assurance on a sustainability report. Auditors are, after all, specifically trained to verify information professionally and independently, and are also bound by strict quality standards, legislation and regulations.

It is all about the user trusting the conclusions (the opinion) of the assurance provider, and this can only be achieved if the relevant party has a credible position and a good reputation in the eyes of the user. In this context, it is therefore important for a company to know, with respect to its sustainability report, which assurance provider adds the most value for the user for each part of the report and to select the right assurance provider to achieve it.

## Case 2

### **Professional assurance is not suitable for all issues**

Suppose an organisation issues a report on the environmental impact of its operations on residents in the immediate vicinity of one of its sites. Assurance by a professional assurance provider that the information in the report is true, may have little benefit. The neighbours do not know the assurance provider, and may be far more interested in what those who are directly involved, think of the company's efforts. An opinion by a pressure group about the company's efforts could therefore be far more valuable for people living in the immediate vicinity.

An integrated sustainability report covering the worldwide activities of a multinational, has a totally different character. In these cases, the users can be further removed and the information focuses on the company as a whole. The reliability of the information can often only be ascertained by taking a critical look at the internal processes and systems. Then the selection of a professional assurance provider – for example, an accounting firm with sustainability specialists – is far easier. Auditors have such a wealth of experience in that field and can confirm that the performance or efforts presented in the report are correct.



**Only parties with specialist knowledge can provide assurance on sustainability reports**

A sustainability report usually covers a whole range of complex issues. An assurance provider will therefore have to deal with a multitude of topics – from CO<sub>2</sub> emissions and human rights in China to water consumption and a scheme for protecting whistleblowers. Specialist knowledge is absolutely essential in order to be able to assess the reported information on these aspects.

Assurance providers therefore not only require knowledge about how to perform an assurance engagement, but also specific knowledge about the topics on which assurance is provided. This could be because the assurance provider is a specialist in a particular field and can give an opinion about that in the company's report; it could also be that the assurance provider has a broad experience with, and an understanding of, the area of sustainability and is therefore qualified to issue a credible report.

For accounting firms such as KPMG, this means that sustainability assurance engagements are performed by teams of specialists with different backgrounds. Financial auditors usually do not have the required knowledge and therefore cannot properly perform an assurance engagement involving a sustainability report. Many professionals in these specialist departments have a background in environmental or social issues; a considerable number of them are not actually accountants. This mixed background is a basic requirement for assurance on sustainability reports.



## Section 4

### What information is covered by assurance?

#### **Assurance can relate to part of a report**

According to a KPMG survey<sup>5</sup>, only 22 per cent of the organisations that have their sustainability reports assessed by an assurance provider, instruct the assurance providers to assess the entire report. In most cases, assurance is only provided on specific information or on specified pages in the report. Sometimes this can confuse the users, particularly because many of them will be accustomed to the fact that an auditor's report covers the financial statements as a whole.

In addition, assurance that does not cover the entire report pose a certain risk: that the organisation in question only has those parts assessed that best suit it. At the same time, there are often valid reasons for having only part of the report verified. For some information, for example case studies, assurance may require a disproportionate amount of time and money. In other cases the organisation's processes may not be developed enough to enable a cost-effective assurance process.

Assurance providers therefore have the duty to ensure that clients use the right arguments for determining the scope of the assurance engagement, and also to assist clients in not being over-ambitious when starting with assurance. Assurance providers also have to keep a close eye on ensuring that the engagement covers important issues: if an oil company asks for assurance, only on the human resources information in their sustainability report and excludes the environmental performance, the assurance provider should not accept it.

In every case it is essential that the assurance provider clearly states in the assurance report which parts of the report were covered by the assurance work, to ensure that there can be no misunderstanding amongst users on this aspect.

#### **Assurance provider has a duty with respect to the completeness of the report**

One of the main requirements of users of a sustainability report is the completeness of the issues dealt with. Or, in other words: users are interested in what they should have been told, but which does not appear in the report. A report is only valuable if the readers know that it contains all the issues that are relevant to them. One of the problems in this context, is that the emphasis will be slightly different for every stakeholder. A nature conservation organisation, for instance, may like to know about biodiversity and environmental aspects while a trade union would probably be more interested in social aspects. Ideally, a sustainability report would address the information requirements of all the stakeholders. However, that is wishful thinking because it is practically impossible to identify the wishes of all the individual interested parties and to address them in the report, if only because it would result in an enormously voluminous report.

The best solution to arrive at a report that addresses all the right issues, is to set up a group that is representative of the stakeholders and that identifies and puts together all their wishes. This panel can then define its information requirements and present them to the organisation. A group of front runners in the corporate sector have already adopted this approach to reporting.

In our view, an assurance provider at least has a duty to decide whether the important issues are addressed in the report, regardless of whether it is strictly required by rules and regulations. AccountAbility's AA 1000 Assurance Standard offers some guidance in this field (see also section 6). KPMG Sustainability establishes in advance whether the main topics – the material issues – have been included, with reference to an internal minimum set of criteria based on the '5-part materiality test' of AccountAbility<sup>6</sup>. Any issues missing from the report are raised with the client and should then be included. In practice this doesn't usually cause any problems but, if necessary, the assurance provider can decide to mention the missing topics in the assurance report.

#### **Assurance is about data and text**

Data without a context have little meaning. The work of an assurance provider therefore not only focuses on establishing whether the reported data correspond with the accounts and whether they are reliable, but also – and perhaps even especially – on establishing whether the claims made in relation to the data are true. The remaining text in the report can also be included in the scope of the assurance engagement. This text could, for instance, address internal governance, the policy and management of a sustainability issue or the results achieved by the company.

Text creates a context for the reader and is therefore a vital part of our assurance work. For example: most of the discussions between KPMG and its clients are not about the figures in the report, but the exact wording of the claims made in the report. The ultimate goal is to establish that the report as a whole presents a proper picture of the activities and performance of the company in the field of corporate social responsibility.

### Case 3

#### **An oil company that 'forgets' to address the CO<sub>2</sub> emissions**

*Suppose an oil company prepares a comprehensive sustainability report that addresses a range of issues, but that does not address the environmental impact of its CO<sub>2</sub> emissions. And suppose that KPMG was asked to provide assurance on this report. What does KPMG do about the lack of information concerning CO<sub>2</sub> emissions?*

Officially, KPMG can provide assurance on this report because there are no rules that strictly define the issues that have to be addressed. However, KPMG undertakes an initial assessment to ascertain whether the report addresses the main issues with reference to a number of minimum criteria. Our assessment is based on our sector knowledge, a media search and the views of stakeholders, among other things.

In this case it is clear beyond doubt that the report would not satisfy the criteria. In the worst case, KPMG will not accept the engagement as CO<sub>2</sub> emissions are one of the most essential elements of an oil company's sustainability report. In practice, we would discuss this with the client and information about CO<sub>2</sub> emissions would then be included in the report.

In most cases, in fact, it is far more difficult to determine whether a sustainability report provides a complete picture. This then depends on professional judgement.

#### **A professional assurance provider restricts itself to the reliability of the information**

When KPMG performs an assurance engagement for a sustainability report, we do not offer an opinion on the performance of an organisation – in other words, whether it is good or bad. Our assurance report says something about the reliability of the information contained in the sustainability report. However, the information in that report may present an opinion of the organisation itself, for instance, about the achievement of certain objectives. In that case, we check whether the company can substantiate that claim.

As a professional assurance provider, we actually have no opinion about the sustainability performance of the company. We leave that to parties whose own background qualifies them to issue such an opinion.

These parties can include NGOs or pressure groups. They are specialised in the issue on which they focus and have the credibility to give their opinion on the social performance of a company, because of their specific knowledge of the subject matter. At the same time they tend to focus less on the reliability of the information they are given because that is not their main objective and they usually do not have the professional background to do this. They therefore usually do not assess the information gathering processes or the associated internal procedures and controls.

Both the opinion of the NGO concerning the performance and the opinion of the assurance provider concerning the reliability of the information, are relevant to the users of a sustainability report. It is precisely the combination of these two aspects that is important.

## Case 4

### Assurance addresses information rather than performance

*Suppose a manufacturer of chemicals claims in its sustainability report that CO<sub>2</sub> emissions have been cut by 25 percent in the past two years. How does KPMG rate this claim?*

Our professionals will first of all check whether these figures have been correctly derived from the company's administration systems and whether the internal controls on these figures are sufficient. This will usually include a number of on-site procedures to check whether the data have been calculated and recorded correctly. All this effort is aimed at ascertaining whether the figures are accurate.

The fact that emissions have dropped by a quarter, however, says nothing about the sustainability performance of the company. The drop could, for instance, simply be the result of production cutbacks. If production has in fact dropped by more than a quarter, the company may actually have performed very poorly in relation to CO<sub>2</sub> emissions. KPMG ensures that this explanation is also included in the report. In this case, we leave any conclusions about the company's performance to environmental groups or other interested parties.

There is also another version: What if the manufacturer of chemicals claims in its sustainability report that the CO<sub>2</sub> emissions have dropped by 25 per cent in the past two years and that Greenpeace sees this as a step in the right direction?

In that case, our professional will go about their work in exactly the same way to establish whether the figures are accurate, but will also ascertain whether Greenpeace has indeed made these observations. In doing so, KPMG still gives no opinion about the performance, but only about the information provided by the company.

## Section 5

### Which checks and analyses does KPMG Sustainability perform?

In the previous sections, we focused on assurance in general. In this section, we use a case study to look at how KPMG carries out an assurance engagement.

#### **We check whether we can accept the engagement**

For every request for assurance on a sustainability report, we must first assess whether we can accept the engagement. There are different reasons why an engagement may not be feasible, and therefore will not be accepted.

For example, if a company is not prepared to commit sufficient resources to the assurance engagement to enable us to perform sufficiently detailed work for our report, KPMG Sustainability will not accept the engagement.

It could also be the case that it is clear from the outset that the company does not wish to include specific critical issues in its report, or that it only asks us for assurance on a number of minor issues. In these cases too our professional and quality standards would prevent us accepting the engagement.

#### **The assurance engagement starts with a risk analysis and media search**

Every company is confronted with a range of sustainability issues and risks. For an energy company, for example, these risks arise in completely different areas than for a financial service provider. An assurance engagement therefore starts off with a risk analysis in which we identify the elements that require particular attention during the engagement. We also assess whether the company's processes and systems are good enough to ensure that the information generated for the report is accurate and reliable. If the processes and systems are up to standard (with internal checks and controls being performed by different people), there is a lower risk of mistakes in the information, which allows us to shift the focus of our work.

In the first phase of an engagement, we also carry out an in-depth media and internet search to try and identify the environmental or social issues facing the client. This external investigation is essential for determining whether the report provides information about the relevant issues, and it gives an indication of where the risks lie for the assurance process.



### **Materiality is a guiding principle**

The term 'materiality' is used a lot in the world of assurance providers. It means:

1. that an assurance provider must recognise and assess the most important issues;
2. that if the assurance provider discovers an error in the information, the error only needs to be corrected if it is significant enough to potentially change the opinion the reader has about the company.

The consequence of applying this meaning is that we do not check all the data and information in a sustainability report, if only because the cost of assurance would be unacceptably high. We focus on the overall picture presented in the report and do not verify every detail. This means that we at least establish which parts of the report are the most important, for example, the claims by the organisation about its performance or objectives that have been achieved.

If a claim or a figure contains an error, we ask the organisation to adjust it. If it is a minor error and the organisation does not adjust it, we would not withhold our assurance report. However, if it concerns a 'material' error, we will. The exact interpretation of materiality differs for each topic and requires a high level of professional judgement. For example, for data (such as emissions), we can consider the percentage error, usually in relation to the performance trend; with a claim about human rights (which is far less tangible to verify), we use our knowledge and the available information to consider what stakeholders find important. We balance all the available information and discuss the conclusions in the team and with the client.

### **There are numerous techniques and tools to obtain assurance**

Accounting methodology offers us a range of techniques for checking whether a report speaks the truth. The exact combination of tools and techniques used to implement the assurance engagement depends on the scope of the investigation, the required opinion (see section 6) and the client's organisation. We can do the following:

- Assess underlying documents to substantiate the information in the report (research reports, minutes of meetings, inspection reports and suchlike).
- Ascertain whether the information in the report has been correctly derived from the client's administration systems, and whether these systems are set up properly.
- Review the organisation's processes and systems and confirm that these ensure that the right information is generated for the report. This not only involves checking the description of processes and systems, but also whether the organisation has actually functioned in the way described in a manual.

- Site level sampling to assess whether the information supply is reliable. In the case of major clients with numerous locations, this usually involves more than ten site visits each year worldwide.
- Requesting reports from business sites that we have not visited. In these reports, local management confirms whether there have been any major changes in the organisation or the information. This could result in additional checks.
- Interviews with key personnel and policy makers about social and sustainability issues and the information contained in the report.
- Statistical analyses, for example, to highlight connections in the figures and to assess whether trends in the figures are correct.

Finally, we ask the senior management of an organisation to confirm in a so-called Letter of Representation that they have given us all the relevant information and that, to the best of their knowledge, the information in the report is correct and no information is missing. This again emphasises that management is responsible for the report, and so we ask them one more time to explicitly consider it.

## Case 5

### What exactly does KPMG Sustainability do?

*A lot of what you have read so far in this publication, is theoretical and abstract. Experience shows that people from outside the profession mostly want to understand the depth and the approach of an assurance engagement. We therefore offer you a look into an assurance engagement involving the 2005 sustainability report of an industrial concern with dozens of production locations across the world:*

- The KPMG team, consisting of two environmental specialists, an assurance specialist and two management consultants, spent some 500 hours on this assurance engagement. Prior to the actual assurance work, the team spent 40 hours on research in the media to obtain a good picture of the risks and dilemmas.
- The KPMG team visited eight locations this year. These visits lasted two to three days and were mostly carried out by a team of two KPMG staff.
- In the context of specific parameters (such as energy and emissions), the onsite visits had to cover at least 60 per cent of the total figure reported in the sustainability report.

- During the visits, assessments were made for a number of parameters (such as CO<sub>2</sub> and NO<sub>x</sub> emissions) to ascertain whether the management and information systems were adequate and whether the information about the parameters in the report was accurate. At the end of the site visit, special issues were discussed with the plant manager.
- All the sites visited by KPMG over the past three years prepared a so-called disclosure letter, which contained questions about possible changes in the organisation and the follow-up of recommendations. KPMG analysed this information to obtain an additional picture of the reliability of the data supplied by these sites.
- Information was checked with the baseline accounts both during the site visits and during the interviews at corporate level. At local level, our work with respect to energy, for example, went as far as checking meter readings and/or the bills of the supplier/client.
- The major text components were checked with reference to documentary evidence to substantiate the claims made. This evidence was discussed with the responsible people within the organisation.
- There were four draft versions of the report before the final version was published. Dozens of textual adjustments were made during the assurance engagement. It concerned both minor issues (textual adjustments) and major issues (adjustment of objectives that had in fact not been achieved after analysis by KPMG, or claims that could not be proven).
- KPMG also made recommendations about the wording in the report to avoid incorrect interpretation by the readers.
- Our letter to the management included recommendations to define specific and easily measurable objectives for social issues and to disclose in the report whether these objectives have been achieved and, if not, what the reasons are for this.

### The assurance report has several parts

The ultimate tangible result to the outside world of all the work is an assurance report by KPMG Sustainability. This report has a number of fixed components to explain to readers the nature of our engagement, what we have done and what our conclusion is. A typical assurance report issued by KPMG has the following components:

- The **introduction**, in which we explain that the company is responsible for the report, and we are responsible for conducting our work such that we can confirm whether the report is true.
- The **scope**, in which we identify those parts of the report that we were asked to provide assurance on.
- The **standards** that we applied (see also section 6). These are the quality standards that the reader may refer to our work and challenge us about. This aims to guarantee that we carry out our work with the necessary care.
- Any applicable **limitations**, for example, that it is not always possible to determine precise data about chemical substances or only at unnecessarily high costs.
- The **activities**, to give the reader general insight into what we have done to reach our conclusion about the report.
- Our **conclusion** – confirmation whether or not the information we checked as part of our engagement is correct. We use two different formulations for the conclusion, which we discuss in section 6.
- **Commentary**. This is a specific KPMG addition to offer the reader greater value and explain the main recommendations we made to the company.

In addition to the recommendations made in the Commentary section, we generally also produce a so-called management letter. We use this advisory letter to the management to summarise what we have observed during the engagement, particularly concerning the processes and systems, the embedding and the management of corporate social responsibility within the organisation, the structure of and topics included in the report and the reliability of the information. Each observation is accompanied by a recommendation.

## Section 6



### What rules govern assurance on a sustainability report?

#### ISAE 3000 applies to all accounting firms

When an accounting firm carries out an assurance engagement concerning a sustainability report, the firm is governed by ISAE 3000, a guideline from the accounting world<sup>7</sup>. This guideline does not apply to assurance providers with a different background.

ISAE 3000 is a generic standard that applies to assurance on non-financial information (including, therefore, sustainability reports). This means that the standard does not focus on content as much as it sets the requirements for the steps in the engagement process, from acceptance to completion.

ISAE 3000 is part of a whole framework of international standards for accounting firms. For example, these standards also deal with independence and integrity, and also include measures that can be taken if an accounting firm does not comply with the standards.

Work is currently underway in The Netherlands on a standard specifically for assurance on sustainability reports, which will be published in 2006. These standards also focus in detail on the specifics of assurance, such as the depth and scope of the work and the methods to be applied.

#### The 'double negative' opinion comes from ISAE 3000

According to ISAE 3000, two types of opinion (or conclusion) can be issued by assurance providers:

- The essence of a positive opinion is that 'the information in the report is correct'.
- The essence of a double negative opinion is the 'we have not been able to establish that the information is not correct'.

The latter opinion in particular can cause confusion: what exactly does it say? The two types of opinion express two different levels of assurance that result from the depth of the work performed:

- For a positively-formulated opinion (in accounting terms, 'reasonable level of assurance') the assurance provider performs an in-depth investigation in order to properly conclude that the information in the sustainability report is correct. The risk of errors in the report is low, which is why a positively-formulated opinion is possible.

<sup>7</sup> This guideline is called International Standard on Assurance Engagements 3000 "Assurance Engagements other than Audits or Reviews of Historical Financial Information" in full, and was published on 1 January 2004 by the International Federation of Accountants.

- For a negatively-formulated opinion (in accounting terms 'limited level of assurance'), the work done by the assurance provider is not as detailed (incidentally, it is still detailed enough and in any event critical and meticulous). Because the investigation is less detailed, the assurance provider cannot confidently say that the information in the report is correct. It could be possible that the report contains errors that remained undetected or that certain elements are missing, because the work was not as detailed as that for obtaining a 'reasonable level of assurance'. To express this accordingly, the assurance provider uses a double negative opinion.

The exact wording of the opinions is laid down in ISAE 3000.

## Different opinions explained on the basis of a children's ballpool

*To illustrate the difference between 'reasonable level of assurance' (a positively-formulated opinion) and 'limited level of assurance' (a negatively-formulated opinion), imagine that you are asked to go to a random branch of IKEA to check whether the ballpool in the kid's play area contains only red balls. You can do this with different degrees of detail and then issue different opinions:*

1. You ask the person who filled the ballpool with balls to confirm whether the ballpool only contains red balls and to show you the delivery note for the balls as evidence. You also take a look in the ballpool to check whether there are only red balls as far as you can see.
2. You do the same as in 1, but you also get into the ballpool and pick a number of balls at random down to the bottom of the pool and check whether they are all red.

The first approach can be compared with a 'limited degree of assurance': because you limit your personal inspection and do not know for certain whether there may be a few blue balls underneath. The second approach is an example of a 'reasonable level of assurance': you have seen enough of the ballpool that you can almost certainly say that it contains only red balls. Of course, this is a simplified example. In practice it involves a lot more.

### **What does this mean for the opinion?**

In the first instance, you are not entirely sure that the pool only contains red balls. At best you can say that "you have not seen that the pool does not contain only red balls". This is the double negative opinion. In the second instance, you are reasonable certain that the pool only contains red balls. You can say that "you are reasonably sure that the pool only contains red balls".

### **AA 1000 AS is a specific standard for providing assurance on sustainability reports**

Guideline AA 1000 AS<sup>8</sup>, developed by AccountAbility in the UK, is a valuable standard developed for assurance providers in general. This standard describes how a company should deal with sustainability issues and what the assurance provider should focus on.

The essence of the standard is the demonstrable involvement of the stakeholders of an organisation in identifying and addressing the major sustainability issues. The standard assumes that the management of, and accountability for, corporate social responsibility mean that:

- the company addresses the issues that stakeholders find important (the principle of *materiality*);
- the company recognises these issues in all the relevant places within the organisation and accepts them as part of its management tasks (the principle of *completeness*);
- the company engages in a dialogue with the stakeholders and responds to their wishes (the principle of *responsiveness*). The latter does not actually imply that the company is obliged to do what the stakeholders want; however, it does mean that the company responds to the needs of the stakeholders.

Standard AA 1000 AS offers the assurance provider guidelines to assess these three aspects. To this end, the standard sets criteria, for instance in the field of independence and integrity, but also prescribes what the assurance provider should include in the assurance opinion. Although we realise that the application of this standard needs further refinement, KPMG has already applied it in several engagements.

## Section 7



### Looking to the future of assurance on sustainability reports

Assurance of non-financial information will be more and more in demand during the years to come. This is not only because more businesses are starting to take their social responsibilities more seriously, but also because this non-financial information is gaining importance in the financial world. Analysts, credit providers and rating agencies are apparently all paying increasing attention to this topic and information about it. The recent new European regulations concerning CSR information in companies' annual reports is contributing to this.

The demand for assurance on non-financial information will therefore increase and also probably become more comprehensive. In order to satisfy this demand, we suggest a number of necessary developments for assurance providers.

#### Greater standardisation of assurance reports

The current practice in assurance reports demonstrates a proliferation of formulations, and these are sometimes hard to fathom. Some assurance reports provide extensive notes, whereas others state in just a few sentences that the sustainability report presents a proper picture. This proliferation is a world apart from the auditor's report that accompanies the financial statements each year: the opinion varies very little in 'taste' from firm to firm and is consistently formulated. Also the 'double negative' opinion invites questions from the readers. At the very least, it is unclear what the exact meaning of the wording (incidentally mandatory) is.

One of the factors that plays a role in this, is that the parties that perform assurance engagements come from different sectors. There is no licensing or legal expertise requirement needed to perform an assurance engagement. Auditing firms are, however, constrained by internationally harmonised legislation and regulations for this assurance, which also have their effect on the formulation of their conclusions. Other parties are not restricted by specific guidelines and can therefore produce an opinion with no specific format. The challenge is to all come together and reach clear agreements about an understandable formulation of the assurance opinion. This is in everyone's interest.

Part of the solution, in our view, lies in including more explanatory notes in the assurance report. In the so-called 'long form' reports, accountants worldwide increasingly take the opportunity to explain what they have done and what approach they used. The issues that they encountered and the important observations are also reflected in their reports.

This is a step in the right direction to create greater transparency and to respond to expectations of the reader.

KPMG is very aware of the current diversity and wants to maintain the credibility of our assurance reports. We therefore do everything in our power to pursue consistency by standardising the format and structure of our assurance reports.

**International legislation and regulations concerning assurance provided by accountants on sustainability reports will have to develop further**

We are convinced that accounting firms (with the use of specialists) are perfectly equipped to provide assurance on sustainability reports. Independence – a key requisite – is in their genes because it traditionally forms their *raison d'être*. In addition, these firms work with strict quality systems and have the expertise to judge the reliability of processes and information systems. The quality system of KPMG includes strict rules for the competences of staff, mandatory review by a second partner, systematic quality reviews and specific requirements for the documentation of the work.

The current rules were partly designed – in consultation with representatives from the accounting profession itself – from the financial audit perspective and, as such, do not yet do full justice to the specific issues raised by a sustainability report. ISAE 3000, the international standard that also applies to assurance on sustainability reports, is also generic. The standard primarily describes the steps in the engagements, but does not provide tools for the content.

The challenge for the coming years is to improve the legislation and regulations for accounting firms on this point. This will ensure clear guidelines for assurance reports by accountants for all the parties involved and make their work more transparent. The Dutch accounting organisation NIVRA has recognised the need for improvement and has been busy in recent years with the development of standard 3410, among other things. The desired effect will be reached only once a similar standard receives international support – also among users.

**The information needs of users are given a more central position**

An assurance provider given the instruction to verify a sustainability report, also has the responsibility to ascertain whether the report as a whole presents a true picture of the company's performance. Assurance therefore goes further than merely checking that certain figures or claims are true. What really counts for a stakeholder – the user of a sustainability report – is whether or not the report addresses the right topics.



In theory, a company is now free to prepare a sustainability report entirely according to its own wishes and to include issues that only shine a positive light on the organisation. In our view, the assurance provider then has the duty to convince the company to also include other topics. For example, last year KPMG started to formally ascertain in every engagement whether the most important issues are actually addressed in the report. As already mentioned, we use the '5-part materiality test' of AccountAbility to do this.

The only people who can really determine whether the right issues are addressed and their information needs are satisfied, are the users of the sustainability report themselves. We therefore also believe that setting up a panel of users – stakeholders – complemented with experts if required, can contribute to improving sustainability reports. By identifying their information needs and translating them into the report, companies – and assurance providers – know for certain that the report addresses all the relevant information needs.

#### **The assurance needs of users must be given a more central position**

At present, the assurance engagement is primarily agreed in dialogue between the assurance provider and the company, based on their joint assessments of what the user would like to see verified. The set-up and implementation of the assurance engagement are obviously tailored to the needs of the client: if the client wants an opinion offering a 'reasonable level of assurance', the work will have to be more detailed. That produces a clear statement from the assurance provider on what has been found, but it also means that the assurance engagement will cost more. The company can also ask for a 'limited level of assurance'. Furthermore, a company can instruct an assurance provider to only verify certain components of their sustainability report and decide to exclude other elements from the assurance engagement. The question is whether this meets the assurance requirements of the users.

According to KPMG, therefore, the arguments for assurance are identical to those for the report above: ideally the users should determine which components they would like to see verified and what level of assurance should be provided. Setting up a stakeholder panel, which formulates its wishes in consultation with the company, is therefore an excellent option for the future. It is even conceivable that this panel – and not the company itself – commissions the assurance provider. That would provide better guarantees for the independence of the assurance provider.

### **The growth in assurance must be stimulated**

Assurance on sustainability reports is a fairly new area of work. This means that both the companies and the assurance providers are sometimes looking for the correct interpretation of their responsibilities. This theme has developed strongly over the past ten years. There is now a clear trend of assurance providers providing an opinion on certain aspects of the sustainability report, such as the comprehensiveness of the issues covered. The development of AA 1000 AS has provided a significant impulse and is a step in the right direction, according to KPMG.

It is essential to keep on stimulating this development. Especially now that more parties are beginning to value the information in a sustainability report, it is important to ensure confidence in assurance. We realise that confidence is more easily lost than won. We owe it to ourselves, just like our clients, to listen to the stakeholders when it comes to sustainability reports and assurance.

You can therefore be assured that KPMG accepts its responsibility. In this publication, we have explained our vision of assurance. We are already actively involved in setting future developments on the right track. This means, among others, that we are contributing to the development of reporting guidelines by supporting the Global Reporting Initiative, that we support the development of the ideas of AccountAbility by sitting on their Board and Council, and that we are represented in working groups in the field of assurance on sustainability reports (including the development of the NIVRA Standard 3410).

## About KPMG Netherlands



KPMG offers services in the field of audit, tax and advisory. We work for a broad group of clients: major domestic and international companies, medium-sized enterprises, non-profit organisations and government institutions. The complicated problems faced by our clients require a multidisciplinary approach. Our professionals excel in their own specialist fields while, at the same time, working together to offer added value that enables our clients to excel in their own environment. In doing so, we draw from a rich source of knowledge and experience, gained worldwide in the widest range of different organisations and markets. We provide real answers so that our clients can take better decisions.

## Contact

We hope that you have enjoyed reading this publication. We would like to receive your feedback on this publication and your views and ideas about the developments we have identified. You can give us your reaction in person, but you can also phone us or send us an e-mail.

### **KPMG Sustainability**

Tel. +31 (0)20 656 4503  
Fax +31 (0)20 656 4510  
sustainability@kpmg.nl

### **Wim Bartels**

Partner KPMG Sustainability  
bartels.wim@kpmg.nl

## Contact us

### **KPMG**

Burgemeester Rijnderslaan 10-20  
1185 MC Amstelveen

P.O. Box 74500  
1070 DB Amsterdam  
The Netherlands

Tel. +31 (0)20 656 7890  
Fax +31 (0)20 656 7700

The information contained herein is of a general nature and is not intended to address the circumstances of any particular individual or entity. Although we endeavor to provide accurate and timely information, there can be no guarantee that such information is accurate as of the date it is received or that it will continue to be accurate in the future. No one should act on such information without appropriate professional advice after a thorough examination of the particular situation.

© 2006 KPMG Business Advisory Services B.V., a Dutch limited liability company and a member firm of the KPMG network of independent member firms affiliated with KPMG International, a Swiss cooperative. All rights reserved. Printed in the Netherlands. 660\_0906