

**EXPLANATORY MEMORANDUM
to new Dutch Exposure draft
Assurance Standard relating to Sustainability Reports (NR. 3410)**

A working group of the Assurance Standards Board of Royal NIVRA has drawn up two Exposure Drafts for assurance standards relating to non-financial information, namely:

- (1) Assurance Standard NR. 3410 “Assurance engagements relating to Sustainability Reports”; and
- (2) Assurance Standard NR. 3010 “Practitioners working with subject matter experts from other disciplines on non-financial assurance engagements”.

Royal NIVRA is the professional body for accountants in the Netherlands.

The Standards are based on the IFAC Framework for Assurance Engagements and ISAE 3000 “Assurance Engagements other than audits or reviews of historical financial information”.

Given the importance of the issues, and the fact that this Standard is among the first in its field, the Board of Royal NIVRA would welcome comments on these exposure drafts from all interested parties in the Netherlands and other countries.

Expression of interest from IAASB in comments from a wide range of international respondents

The International Auditing and Assurance Standards Board (IAASB) has expressed an interest in guidance for assurance on sustainability reports, and has established an external panel to advise it on possible next steps. This is an area where IAASB may wish to build on the efforts of other standard-setters. The IAASB has not reviewed this exposure draft and therefore is not in a position to endorse it in any way. However, IAASB staff has indicated that if this exposure draft is well received and results in comments from a wide range of respondents, the resulting standard may be one upon which IAASB would be able to build for wider international use. National auditing and assurance standard-setters and other interested parties from countries beyond The Netherlands are therefore encouraged to respond to Royal NIVRA on this exposure draft.

Both exposure periods end on 31 July 2005.

This explanatory memorandum sets out the main backgrounds and considerations of the Assurance Standards Board and its working group with respect to this exposure draft.

At the end of this memorandum, we include some specific points for your consideration.

Readers are kindly invited to send their comments to:

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General

- 1 The Standard is the first application of ISAE 3000 concerning assurance on non-financial information and addresses a subject matter that is of growing importance for practice. It acknowledges that sustainability reporting and sustainability assurance are still “under development” and that they are voluntary. For this reason, the draft Standard intends to respond to market needs, to be flexible and to allow clients to have a significant input in the key issues of the engagement, for example its scope definition and the level of assurance to be obtained by the practitioner. At the same time, however, the draft Standard requires the application of strict procedures by the practitioner.
- 2 While the draft Standard is primarily an Assurance Standard, it also includes a few *accounting* requirements. In particular, paragraph 9 contains some requirements with respect to minimum disclosures to be made by responsible management in the organisation’s sustainability report. Point 3 below elaborates on this issue and provides arguments with respect to stakeholder needs and the existing GRI Sustainability Reporting Guidelines.
- 3 Stakeholder information needs are the starting point for the reporting company and the assurance provider as well. The GRI Guidelines are very important, but they are considered not yet sufficiently clear for audit or review purposes. The draft Standard acknowledges that it is hardly possible to meet all the information requirements of every single stakeholder. For that reason, it introduces the expression “*targeted groups of stakeholders*”, and it refers to the “*legitimate information needs*” of an “*average representative*” of each group. See the definition in paragraph 7 and the explanatory notes on that definition. It is the responsibility of the reporting organisation to be very specific about this and for that reason the draft Standard requires the reporting organisation to disclose its intended groups of stakeholders. The draft Standard also requires a few other minimum disclosures such as an explanation of reporting policies and materiality considerations. See paragraph 9.
- 4 For pragmatic reasons, the working group has chosen to use the traditional terminology “audit” and “review” engagement, which is used respectively for audit and review engagements relating to financial information, instead of “reasonable assurance” or “limited assurance” engagements, which are used in ISAE 3000. The main reason is that in Dutch there are no good and short alternatives available.
- 5 The difference between an “audit level” and a “review level” has unsurprisingly been an important topic for the working group. Definitions are given in paragraph 7. The key characteristic of a “review” is the examination of the plausibility of the subject matter information in the sustainability report. However, the working group concluded that a review level engagement on a sustainability report should include more types of procedures than a review of financial statements according to the current international (and Dutch) auditing Standard ISA 910. This means, among other things, a relatively greater emphasis on system-based procedures for a review of sustainability reports than for a review of

financial statements. However, the operating effectiveness of controls need not be tested for a review engagement. The differences are summarised in paragraphs 105 to 108.

A sustainability report as the subject matter of the engagement (see paragraphs 3 to 5 and 8 to 10)

- 6 It is possible to use the concepts for the audit of financial information as they are explained in the International Auditing Standards (ISAs). Dutch auditing standards (RAC) are comparable to the ISAs with only a few exceptions. This draft Standard starts by identifying the differences between a financial statement and a sustainability report and the consequences for the assurance engagement. One consequence is the need to acknowledge the importance of existing market circumstances. In other words, the draft Standard should be realistic and provide added value at a reasonable price. However, the draft Standard stresses at the same time that the practitioner should exercise strict professional care and should communicate matters concerning the engagement and the conclusions adequately and understandably.

Engagement acceptance (see paragraphs 11 to 15)

- 7 All issues and problems for the assurance provider that could be encountered during the engagement process should be discussed with the client in the initial stage of the engagement acceptance. The draft Standard accepts that it is realistic to accept limitations in both the sustainability report itself (e.g. the report does not address all possible information) and in the scope of the assurance engagement (e.g. the engagement does not audit or review all aspects). Clear disclosure of such limitations is required, however.
- 8 It is left to the client to decide between an audit and a review engagement. It is also acceptable to audit one part of the report and to review the remainder.
- 9 In practice, the practitioner engaged to provide assurance on the sustainability report might be different from the auditor of the financial statements. Accordingly, the draft Standard makes several references to communication with the financial statements auditor, including remarks with respect to actions when fraud is discovered.
- 10 The subject of fraud is mentioned without going into great detail. The draft Standard refers to ISA 240 and related guidance. Actions, if any, will be taken in cooperation with the auditor of the financial statements (paragraph 45).
- 11 Appendix 1 summarizes the issues that should be included in the engagement letter.

Materiality (see paragraphs 25 to 36)

- 12 A definition of materiality with respect to sustainability reporting has not yet been fully developed, neither in practice nor in theory. Various parties, including the GRI and AccountAbility, are considering this issue further. The draft Standard deals with reporting aspects of materiality (“reporting materiality”) and the aspects for the assurance provider

(“tolerance”) separately. This part of the draft Standard is partly inspired by the UK document that addresses the practitioner’s evaluation of materiality considerations by management for its Operating and Financial Review (OFR) section in the annual report. Thus, the quality of the process of taking materiality decisions by the reporting organisation is to be evaluated by the auditor of the sustainability report. However, determination of “tolerance” remains primarily a matter of the practitioner’s professional judgement.

Review of the reporting criteria (see paragraphs 46 to 50)

- 13 Suitability of reporting criteria is a vital issue. To some extent, the draft Standard is pragmatic in that respect. It acknowledges the activities for the further development of reporting guidance and criteria, for example by GRI and AA1000. However, as long as these criteria are not yet “generally accepted” there is a need for the reporting entity to be as transparent as possible with respect to its policies and choices for reporting (see also points 2 and 3 of this memorandum). In certain cases, the practitioner should explicitly state in the assurance report whether it considers that the criteria used are suitable, or what constitutes a problem for engagements and how such problems have been resolved (for example through a specific qualification in the assurance report).

Expertise and working with other experts (see paragraphs 51 to 70)

- 14 Given the importance of working with experts in multidisciplinary teams for assurance engagements relating to Sustainability Reporting, it was decided to address the *general* aspects of collaboration between practitioners and experts from other disciplines in a draft Standard for a separate “umbrella” Assurance Standard Nr 3010. The paragraphs 51 to 70 of this draft Standard 3410 draw on ED 3010. Basically, two models for cooperation are available: (1) working under undivided responsibility and (2) working under joint responsibility. A third model is added for pragmatic reasons: (3) separate engagements. For details see ED 3010.
- 15 The specific issues for a sustainability assurance engagement include the requirements for the knowledge and skills of the practitioner and of the subject matter expert with respect to auditing or reviewing sustainability reports. They are specified in paragraph 51. Provisions on quality control have also been issued for the model 1 and 2 situations. Reporting consequences are dealt with separately in the paragraphs 62, 69 and 70, as well as in the separate paragraph on reporting, 120 to 141.
- 16 A legally binding “Agreement on the allocation of work and responsibilities” is important. ED 3010 contains an appendix with points to consider for that agreement. We did not want to provide an “example”, as firms need to discuss these issues with their legal counsel in detail. Appendix 2 of this draft Standard 3410 gives a summary of the allocation of work and responsibilities when working with experts in the case of a sustainability assurance engagement for the models 1 and 2.

Planning and performing the engagement (see paragraphs 71 to 108)

- 17 The draft Standard is in line with the new Audit Risk Models ISA 315 and ISA 330. This means that the “knowing the business” and “risk analysis” modules and substantive testing have been combined. Both an audit and a review involve a certain amount of system-based work. On the other hand, it is recognised that the systems underlying sustainability reports play a different role than those for the financial statements. The differences between an “audit” and a “review” have been addressed separately (see above).

Multi-location examinations (see paragraphs 109 to 116)

- 18 Multi-location examinations were an issue that needed to be separately addressed. This subject is based principally on draft Standard for Attestation Engagements from AICPA “Reporting on an entity’s internal control over financial reporting” (summer 2003). A distinction is made between:
- a full scope approach;
 - a limited scope approach.
- In this situation, the procedures to be performed are largely determined by the internal control procedures at group level (“entity wide controls”).

Reporting (see paragraphs 120 to 141)

- 19 The draft Standard clearly opts for flexibility in its requirements for the assurance report. Long-form reporting may be the best way to communicate the professional’s conclusions, while avoiding any possible misunderstanding on the part of stakeholders or expectation gaps. The draft Standard does not prescribe standardised wording. Seven examples of assurance reports are provided in Appendix 3. However, these examples should not be followed like a recipe. The example reports are designed to illustrate the necessity of flexibility, which is one of the key characteristics of the draft Standard. Example report no. 7 is for a combined engagement (partly audit and partly review level engagement).
- 20 The requirements on assurance reports follow the structure and contents of ISAE 3000, paragraph 49, while also drawing on the recent ED for a revised ISA 700 to a certain extent. Certain parts of ISAE 3000 have been made more specific in comparison with ISAE 3000, especially ISAE 300 paragraph 49 c, “identification and description of the subject matter information and, when appropriate, the subject matter”. This draft Standard makes a distinction between:
- a description of the subject matter and its inherent limitations; and
 - b description of the scope of the assurance engagement and its inherent limitations.
- 21 The assurance report will be addressed “to the stakeholders”. This is in line with our views on the fundamental importance of the assurance report for the public at large.
- 22 The draft Standard tries to avoid lengthy and largely unintelligible or complex and standardised texts in each assurance report. Accordingly, it suggests also using the web

sites of Royal NIVRA and/or the audit firms for providing additional background information to the public (for example an explanation of the difference between an “audit level” and a “review level” engagement and the description of the fundamentally inherent limitations of the assurance process).

Note: In the future, IFAC could also be asked to take part in this.

- 23 Description of the work performed: some members of the working group believed that the description of the procedures should be as short as possible, if in fact it is needed at all. Other members support the inclusion of more detailed description of the procedures. The draft Standard currently permits both possibilities. See Appendix 3.1 for a “comprehensive description” versus a “short description”.
- 24 The draft Standard argues that even the provision of so-called “negative assurance” could be an appropriate element in a conclusion paragraph, not only for a review, but also for an “audit level” engagement. This depends on the auditability (verifiability) of the concrete parts of “subject matter information”. Some information can theoretically never be checked positively (verified), but can only be tested for not being false. See paragraph 135, and footnote 18. For example, the example audit level engagement allows the inclusion of a sentence, in addition to other positive conclusions, that reads as follows: “During our investigation, however, we did not find that any significant breaches of the codes of conduct had occurred in the year under review”. See Appendix 3.3 under conclusion b.
- 25 It is not the intention for the Standard to provide prescribed wording for qualified conclusions, adverse conclusions and disclaimers of conclusion. Tailor made communication with intended users of the assurance report is considered to be more important for their understanding of the situation. See the example reports in Appendix 3.
- 26 The assurance report can contain various and differing conclusions. In practice it will often arise that an unqualified conclusion can be given on part of the sustainability report, while the remainder is subject to a qualification. The expression “true and fair view” is not used. This expression is reserved for financial statements (see footnote 6 to paragraph 13). The seven example reports offer various suggestions. In Appendix 3.1, the following sentence is proposed: “In our opinion the report is a reliable and sufficient representation of the policy, the performance and the business activities and the events in the year under review in accordance with xxx criteria”. Other terminology is also acceptable for the conclusions, because tailor-made reporting is considered necessary.

Points for consideration

The above will undoubtedly give rise to comments. However, we would like to structure your feedback by asking you to consider six specific points:

- 1 Please give your views on the key considerations and ideas that are explained in this memorandum in paragraphs 1 to 26. Please specify in detail with which key considerations and ideas you agree or disagree. In the case of disagreement, please give your reasons.
- 2 Please give your comments on the definitions used in this draft Standard in paragraph 7 and the notes thereto (if not addressed earlier by your comments under 1).
- 3 Please give your comments on the detailed procedures in this exposure draft in its various sections or paragraphs. Please refer in your comments to the sections or paragraphs.
- 4 Please give your views on the contents of the example assurance reports (Appendices 3.1 to 3.7).
- 5 Please give your views on the other Appendices.
- 6 Terminology: in this draft Standard, we used the name “Sustainability report” as that name is used in the GRI Guidelines. An alternative we meet in practice is “Corporate Social Responsibility Report”. What name do you prefer and why? (The Dutch version of this draft Standard uses the name ‘Corporate Social Responsibility Report’).

Thank you in advance for your comments.

Fred Drieënhuizen
Chairman of Royal NIVRA’s Working Group
Amsterdam, January 2005