Case Study: Auditing the Earth – Danone, ESRS E4, and the Assurance Challenge

Relevant disciplines: Financial Accounting, Auditing

Level: Undergraduate

Time allotment: 60-minute session

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1. Introduction

The global landscape of corporate reporting is undergoing a seismic shift. With the introduction of the EU's Corporate Sustainability Reporting Directive (CSRD), large companies are now mandated to publicly disclose their sustainability performance and, crucially, to have this information assured by an Independent Assurance Service Provider (IASP). This moves sustainability reporting from a voluntary, often marketing-driven exercise to a regulated, audited, and legally significant one.

This case study places you in the role of a graduate trainee at a major Statutory Audit firm. Your firm has been responsible for the Statutory Audit engagement for Danone S.A., the French multinational food-products corporation, for the past five years. Your team has just been appointed as the IASP for Danone S.A., engaged to form conclusions on the appropriateness, in all material aspects, of the client's disclosures in relation to compliance with the standards mandated under CSRD. Your first task is to conduct a preliminary analysis of how Danone reports on a critical environmental issue: biodiversity and ecosystems. This analysis will form the basis for planning your audit engagement, specifically focusing on compliance with the new European Sustainability Reporting Standard (ESRS) E4.

1.1. Learning Objectives

Upon completion of this case study, you will be able to:

1. Interpret a company's sustainability disclosures against the specific requirements of a mandatory reporting standard (ESRS E4).
- Identify potential risks of "greenwashing" or selective disclosure in corporate sustainability reports.
- Analyse the challenges an auditor faces when verifying qualitative and forward-looking information on biodiversity.
2. Evaluate the interplay between financial and sustainability audits in a mandatory assurance context.

- Understand the importance of maintaining professional scepticism as an auditor of sustainability statements.

2. Background Context: The New Assurance Reality

Your manager has provided you with an excerpt from recent academic research to frame your thinking. The key takeaways for your audit planning are:

- **Mandatory Assurance:** The CSRD requires a mandatory audit (starting with limited assurance) of sustainability reports. Sustainability Assurance Providers are now directly responsible for validating compliance with the ESRS, a significant shift from the past.
- **Litigation Risk:** Audit failure in either the financial or sustainability audit can expose the audit firm to litigation from investors. This creates a complex decision-making environment for auditors regarding how much effort to allocate to each audit task.
- **Limited Assurance:** The CSRD mandates for limited assurance of sustainability reporting. In a limited assurance engagement, the practitioner's primary focus is to understand the process used to compile the reported information and identify areas where a material misstatement may occur. The practitioner then conducts inquiries, observations, and analytical procedures, e.g., reviewing data at a more aggregated level. If the practitioner identifies a potential material misstatement, additional work is performed to obtain limited assurance.
- **The Effort Allocation Problem:** The research suggests that introducing a mandatory sustainability audit does not simply mean adding more work. Where the same audit firm is conducting both the financial and the sustainability audit, it may lead to a substitutive effect, where an auditor might (if one audit is cheaper to perform) reduce effort in one area (e.g., financial audit) to manage the increased workload and litigation risk from the other (e.g., sustainability audit), and vice versa. Alternatively, under certain conditions, a complementary effect can occur, where effort in both areas increases.
- **Credibility is Key:** The primary driver for the requirement for assurance of sustainability statements is investor concern about the quality and credibility of sustainability information, including fears of greenwashing through selective disclosure or exploiting discretion in standards.

3. The Case Task: Analyzing Danone's ESRS E4 Disclosures

Your specific assignment is to examine Danone's Annual Report for FY 2024. Visit Danone's official corporate website and navigate to the "Investors" or "Sustainability" section to download their latest Universal Registration Document (i.e. Annual Report).

3.1. Understanding the Standard - ESRS E4 (Biodiversity and Ecosystems)

Before looking at Danone's report, familiarize yourself with the core requirements of ESRS E4 (Set 1) and its interaction with the cross-cutting standards on General Requirements (ESRS 1) and General Disclosure (ESRS 2). The standards require companies to disclose:

1. **Impacts, Risks, and Opportunities (IROs):** How the company affects, and is dependent upon, biodiversity and ecosystems.
2. **Strategy and Business Model:** How biodiversity is integrated into the company's strategy and model.
3. **Targets and Policies:** Quantitative and time-bound targets related to biodiversity, and the policies to achieve them.
4. **Value Chain:** Impacts and dependencies throughout the entire value chain (e.g., agricultural sourcing).
5. **Action Plans and Resource Allocation:** Specific actions taken and financial resources allocated to protect and restore biodiversity.

3.2. The Analyst's Review - A Pre-Audit Assessment

Analyse Danone's report, guided by the following questions. For each, provide evidence from the report and assess its quality. Note that these are indicative questions, and you are free to identify other relevant issues as you see fit.

1. **Disclosure Mapping:** Where in the report does Danone discuss biodiversity? Is it a separate section, integrated into the strategy, or mentioned only in passing? Does the disclosure feel comprehensive or selective?

- **Materiality Assessment:** The IASP determination of materiality is based on professional judgment and considers the needs of sustainability information users. A misstatement is considered material if it could reasonably influence users' decisions taken based on the reported sustainability information. How does Danone identify biodiversity as a material issue? Do they clearly explain why it is important to their business and stakeholders?
- **Targets and Metrics:** Identify any specific, measurable, achievable, relevant, and time-bound (SMART) targets related to biodiversity (e.g., % of key ingredients sourced sustainably, commitment to regenerative agriculture practices, water stewardship in high-stress areas). Are these targets ambitious? Are the metrics used (e.g., "hectares under regenerative agriculture") clearly defined and verifiable?

2. **Value Chain Transparency:** Does Danone provide sufficient information about biodiversity impacts in its upstream supply chain (e.g., milk, almonds, soy, packaging)? Is the disclosure generic ("we work with suppliers") or specific ("XX% of our palm oil is RSPO certified")?
3. **Financial Connectivity:** Is there any attempt to connect biodiversity activities to financial investment? For example, is there discussion of capital or operating expenditure in sustainable sourcing, potential liabilities, or R&D costs for sustainable packaging? This relates to the obligation incumbent on CSRD reporting entities to disclose their EU Sustainable Finance Taxonomy alignment / eligibility.

3.3. The Auditor's Dilemma - Planning the Assurance Engagement

Based on your analysis in Part B, answer the following questions from the perspective of an audit manager planning the nature, timing and extent of required planned procedures for the ESRS E4 assurance work.

1. **High-Risk Areas:** Based on your review, what aspects of Danone's biodiversity disclosures would you flag as high risk for audit? Why? (e.g., reliance on supplier data for sourcing claims, difficulty in verifying on-the-ground impacts of "regenerative agriculture," subjectivity in defining "sustainable").
2. **Evidence Collection:** What kind of audit evidence would you need to gather to obtain limited assurance over Danone's biodiversity disclosures? If reasonable assurance is required in future reporting periods, how might your approach change? What additional measures could be taken to provide this higher standard of assurance? Consider supplier site visits… etc.
3. **The "Greenwashing" Risk:** Using the concept from the research, identify one example from Danone's report that could be perceived as selective disclosure or "greenwashing." For instance, do they highlight positive initiatives while omitting discussion of significant negative impacts or lagging performance areas?
4. **Interplay with the Financial Audit:** Considering the research findings on auditor effort allocation, discuss the potential interaction between the financial audit and the sustainability audit for Danone.
5. Would you expect a substitutive or complementary effect? Justify your reasoning.
6. How might the potential for litigation from investors if Danone fails to meet a biodiversity target (e.g., facing fines or reputational damage that affects share price) influence your audit effort on ESRS E4?

- **Maintaining Profession Skepticism:** Considering the requirement for auditors to plan and perform an audit with professional skepticism, consider the factors that impact on IASP professional skepticism recognising any existing circumstances that may cause the subject matter information to be materially misstated.

3.4. Submission Requirements

Prepare a professional report (max. 1,500 words) addressed to the Audit Partner. The report should include:

1. **Executive Summary:** Brief overview of your findings.

- **Analysis of Danone's ESRS E4 Disclosures:** A structured response to the questions in Section 3.2.
- **Audit Plan Highlights:** Your professional assessment and answers to the questions in Section 3.3.

2. **Conclusion and Recommendations:** A concluding statement on the overall readiness and credibility of Danone's biodiversity disclosures and your key recommendations for the audit approach.

4. Instructor's Guide & Debriefing Points

4.1. Expected Outcomes:

- Students should identify the interconnected nature of biodiversity and ecosystems with other environmental topics like climate change and pollution, as acknowledged in Danone's report.
- Deforestation and Conversion Free (DCF), regenerative agriculture, and watershed preservation / restoration targets are shown in the report. There may be debate around the level of ambition incorporated into these targets; progress appears strong, but is this enough? Encourage groups to critically evaluate the targets.
- Students should identify the inherent uncertainty in disclosures related to complex topics such as biodiversity and ecosystems, and the lack of external consensus on key indicators and best practice.

4.2. Key Debriefing Themes:

- **Role of accounting information** in supporting the sustainable transformation. It is key to emphasise the need for robust, reliable data that can help investors and consumers to make more sustainable decisions.
- **Subjectivity.** There is a degree of subjectivity in the disclosures companies make when assessing environmental and social impacts, risks and opportunities. Accounting students, graduates, and professionals must remain cognisant of this challenge.
- **Professional Judgment**. A consequence of the abovementioned subjectivity is the growing need for sound professional judgment. Auditors and accountants must maintain professional scepticism when exercising their judgment, in areas where uncertainty and complexity are unavoidable.
- **Expanding role of auditors**. Auditors now require skills that range far beyond traditional financial accounting expertise.
- **External expertise.** The necessity for external subject experts, such as ecologists, is evident when we consider the extent of the expansion of the profession in line with changing reporting requirements.

4.3. Conclusion:

This case study develops students' critical thinking skills, demonstrating both the value and the inherent challenges of corporate reporting on biodiversity and ecosystems. The necessity for the exercise of professional judgment in evaluating complex, uncertain topics is crucial, combined with an understanding of the need for external expertise to support auditors as they navigate this challenging reporting landscape.

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