

Introductory remarks to the panel “Financial reporting and connectivity”

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Verena Ross

Chair

European Securities and Markets Authority (ESMA)

Good afternoon, Ladies and Gentlemen,

I would like to thank EFRAG and the President of the Administrative Board, Hans Buysse, for the invitation to join this conference today.

Before I introduce the topic of “financial reporting and connectivity” that will be addressed by the next panel, I would like to lean for a moment on today’s festive atmosphere to join the previous speakers in congratulating EFRAG on their 21st birthday and the new incoming chairs of the two reporting boards, Wolf Klinz and Patrick de Cambourg, on their appointment.

EFRAG has certainly come a long way during the past two decades, but I believe that the past four years have been critical in establishing EFRAG as a reference point for various European stakeholders with an interest in corporate reporting and to help bringing sustainability reporting to the same level of rigour and maturity as financial reporting.

Today, therefore, we not only celebrate your longevity and success as an organisation, but we also recognise Europe’s ability to join forces in delivering on an ambitious sustainable finance agenda to support the much-needed transition towards a more sustainable economy.

It is with this constructive spirit in mind that, while having different mandate, objectives and working methods, since the establishment of EFRAG’s European Corporate Reporting Lab in 2018, ESMA has actively contributed to the new sustainability reporting workstream in EFRAG. This workstream was formalised earlier this year with the creation of a new pillar led by a

Sustainability Reporting Board where ESMA is represented, alongside other public bodies, as an official observer.

Our participation in this work aims at ensuring that the European Sustainability Reporting Standards (ESRS) that EFRAG is developing are conducive to investor protection and that they do not undermine financial stability. This dual objective will form the basis of the opinion that, at the end of January 2023, ESMA will deliver to the European Commission on the draft ESRS, as envisaged by the Corporate Sustainability Reporting Directive (CSRD).

One area, amongst others, that our opinion on the ESRS will touch upon, is precisely the issue of connectivity between sustainability information, most notably climate-related information, and financial information which lets me move to the topic of the next panel.

In my view, the issue of connectivity relates to at least three main aspects:

- First, the consistency of different pieces of information conveyed through different parts of the annual financial report, most notably the financial statements, the management report and the non-financial statement (whether or not presented separately from the management report).
- Secondly, the use of cross-referencing and digitisation to better understand the interconnections amongst different pieces of information.
- Thirdly, the rules, controls and supervisory measures aimed at promoting connectivity across an issuer's annual financial report.

Let me briefly touch on each of those points.

Reporting of financial information and consistency with climate-related disclosures

On the first point of consistency of content, in the past years, ESMA has progressively strengthened its work to promote a careful assessment by issuers of the effects of climate-related matters in their financial statements and greater consistency between these disclosures and the information provided elsewhere in the annual financial report. This

increased focus responds to the growing scrutiny of investors who want to know more about the financial effects of climate-related matters on issuers.

In order to be able to take informed investment decisions, in fact, users of financial statements are increasingly requesting more information to better understand how the year-on-year financial performance and position of an issuer matches the strategic commitments made to embrace the climate transition. Such a transition is expected to require, depending on the sectors, significant investments in greener plants, equipment and processes and changes to existing business models.

ESMA, therefore, recognises that it is urgent to bring financial reporting up-to-speed with these emerging needs of investors. We also acknowledge that, in embracing this change, issuers will need to go through a learning curve which may affect the speed at which transparency improvements can be observed.

In this respect, particularly in the last two years, ESMA has called for due consideration by issuers and their auditors of the educational material¹ published in November 2020 by the IASB. This material explained how the different IFRSs would require the reflection of the impacts of climate-related matters on an issuer's reported performance, financial position and cash flows.

More recently, in the 2022 European Common Enforcement Priorities (ECEP)², ESMA highlighted the importance of reflecting climate-related matters in the accounting for impairments of non-financial assets and provisions. These are two of the accounting areas that are most exposed to the impacts that climate-related physical and transition risks may have on the reporting undertakings.

We also stressed that the degree of emphasis given to climate-related matters within the non-financial statement should be consistent with the extent to which these matters are reflected within the financial statements.

¹ IFRS Foundation, Effects of climate-related matters on financial statements, November 2020, available at <https://www.ifrs.org/content/dam/ifrs/supporting-implementation/documents/effects-of-climate-related-matters-on-financial-statements.pdf>

² [ESMA32-63-1320](#), Public Statement, European common enforcement priorities for 2022 annual financial reports, 28 October 2022

This is particularly relevant taking into account that ESMA and European enforcers have encountered situations where issuers have put in their public communications to the market significant emphasis on climate-related objectives, with no (or very little) information on the related impacts within the financial statements.

Cross-referencing and digitisation to support transparency on connected information

Let me move to the second aspect relating to cross-referencing and digitisation.

The increased consistency in assumptions, methodologies and claims between the management report and the financial statements is not *per se* sufficient to provide full transparency on the interlinkages between climate-related matters and financial statements. Therefore, it is important that this consistency in substance is further supported by practical measures to make the interconnections across information more visible and easier to retrieve.

In this respect, the first Set of draft ESRS certainly includes requirements to explain in their sustainability statements the consistency between the expected financial effects of sustainability-related impacts, risks and opportunities and any corresponding information from the financial statements, including cases in which such consistency does not exist and the reasons for that. Furthermore, the draft ESRS will also allow for the use of cross-referencing to amounts presented within the financial statements.

On the other hand, while disclosures on connected information are not necessarily required in the financial statements prepared on the basis of IFRS, the digitisation on both sides of the annual financial report – i.e. the financial statements and, in the future, the sustainability statements – will further support the understanding of how sustainability claims in the front-end of the annual financial report relate to information disclosed in the back-end of the report.

It is, therefore, essential to accelerate the work to extend the European Single Electronic Format (ESEF) requirements also to the sustainability statements. The cooperation on this front between ESMA and EFRAG staff is quite close and I am confident that a digital sustainability reporting taxonomy will be available in the near future.

Rules, controls and supervisory measures

Before joining the panel, for what I am sure will be an interesting discussion, let me spend a few last words on the third aspect of connectivity relating to how existing rules and controls and, in particular, supervisory practices can foster the development of more and better-connected information in the issuers' financial reports.

In response to the strong investor demand for more meaningful financial statements with respect to climate risks, ESMA has actively engaged in discussions with National Competent Authorities, but also with auditors and non-governmental organisations, to better understand the perceived shortcomings in the current reporting landscape and the possible hurdles preventing improved consistency and connectivity.

Based on these interactions, our understanding is that the principles-based nature of IFRS already caters for the reporting of material information on risks and opportunities relating to climate. In other words, in our view, the existing requirements today already allow, if not even require, issuers to build such connectivity in the financial statements.

Nevertheless, it is definitely good to see that the IASB has planned to add to its workplan for the horizon of 2022-2026 a limited scope project on "Climate-related Risks in the Financial Statements" which will consider whether and, if so, what narrow-scope actions might be needed in relation to accounting for climate-related risks in the financial statements.

Against this background, ESMA's intervention at this stage has been to develop recommendations that give the clear message to issuers and their auditors that we believe that IFRS already have all it needs to reflect climate-related matters risks. We have channelled these recommendations through our public statements on the 2021³ and 2022 European Common Enforcement Priorities, which I have briefly touched upon already.

Going forward, I believe that the role of the supervisors needs to be one of gradual, but continued and steady "push" to improve the level of transparency on the financial implications of climate-related matters in the financial statements.

³ [ESMA32-63-1186](#), Public Statement, European common enforcement priorities for 2021 annual financial reports, 29 October 2021

Lastly, let me emphasise the key role of two important groups of actors in the corporate reporting process (not in order of importance) to foster connectivity.

One group relates to the members of the administrative, management and supervisory bodies of issuers. These bodies should keep a close eye on the connectivity and consistency between sustainability and financial reporting, since this is key to ensure that they can properly discharge their obligations under the Transparency Directive. In particular, the management's obligations to ensure that the financial statements give a "true and fair view" and that the management report includes a "fair review" of the development and performance of the business should not be seen as separate ones, but rather as closely inter-connected obligations.

In this respect, I would like to highlight that from initial research in our ongoing project to better understand and conceptualise the issue of greenwashing in the financial system, it is already clear that one important contributor to originating and spreading greenwashing is the lack of consistency across sustainability claims in different sets of information communicated to the market. Issuers should therefore keep this issue in mind when assessing the importance given to the proper connectivity of information across their annual financial reports.

The other group is represented by the external auditors. Here, I want to emphasise and encourage the key educational role that this profession can play vis-à-vis their clients to stimulate efforts to properly reflect climate-related matters in the financial statements.

Thank you.