

## Issues paper

### Proposed deliverables for the connectivity project

#### Objective

- 1 This agenda paper includes suggestions for the content and structure of a comprehensive deliverable (i.e., a Discussion Paper) for the EFRAG research project on connectivity between financial reporting and sustainability reporting information (i.e., the connectivity project or the project). The current goal is to publish the Discussion Paper in H2 2024.
- 2 We seek EFRAG FR TEG and SR TEG members' input on the Discussion Paper and any other possible interim deliverables. The proposals in this paper will also be discussed by the EFRAG CAP at an online meeting to be held in either late October or early November<sup>1</sup>.
- 3 As noted in agenda paper 05-01, whilst developing examples, it will be necessary to build on (rather than duplicate) the numerous available reports<sup>2</sup> describing the state of play in the reporting of climate-related risks within and outside the financial statements. Of note, many of these reports also include illustrative examples.
- 4 We also note that both the IASB and ISSB are progressing on several connectivity-related workstreams. For instance, the IASB decided on the direction of the 'Climate-related Risks and Other Uncertainties in the Financial Statements' project. This will entail multi-pronged actions including the exploration of targeted amendments to IAS 1 *Presentation of Financial Statements*, clarification via the IFRS Interpretation Committee of some requirements (i.e., IAS 36 *Impairment of Assets* and IAS 37 *Provisions, Contingent Liabilities and Contingent Assets*), and the possible publication of several articles in the coming few months. Similarly, in 1H 2024, after considering the feedback to the ISSB agenda consultation, the IASB-ISSB will redeliberate on the feedback on management commentary and a decision will be made on the direction of that project. Furthermore, the ISSB will decide whether to include a possible project on integration<sup>3</sup> in reporting in its agenda. Such a project may address issues that were

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<sup>1</sup> Due to time constraints, the EFRAG CAP discussion of this paper could not be held at the 10.10. 2023 CAP meeting.

<sup>2</sup> September 2023 [EFRAG Secretariat Briefing: Climate-related Risks in Financial Statements](#). The briefing summarises reviews of EU companies' reporting by AMF, ESMA, Mazars, MAB, and the Norwegian regulator.

ESMA is expected to publish a report with examples on the reporting of climate-related risks in the financial statements (possibly in Q4 2023).

UKEB, September 2023, [A Study in Connectivity: Analysis of UK Company 2022 Annual Reports](#)

<sup>3</sup> Paragraphs A40 and A41 of the May 2023 ISSB [Consultation on Agenda Priorities Request For Information \(RFI\)](#) state that "Integration in reporting takes the concept of connectivity a step further. Integration in reporting not only encompasses where, what and how information on value creation can be connected through conceptual and operational linkages (for example, in terms of compatibility of language and assumptions), but also includes the collective consideration of the interdependencies, synergies and trade-offs between: a) the various resources and relationships reported on in general purpose financial reports; and b) how the value that an entity creates for itself and for its investors is inextricably linked to the value the entity creates for other stakeholders, society and the natural environment."



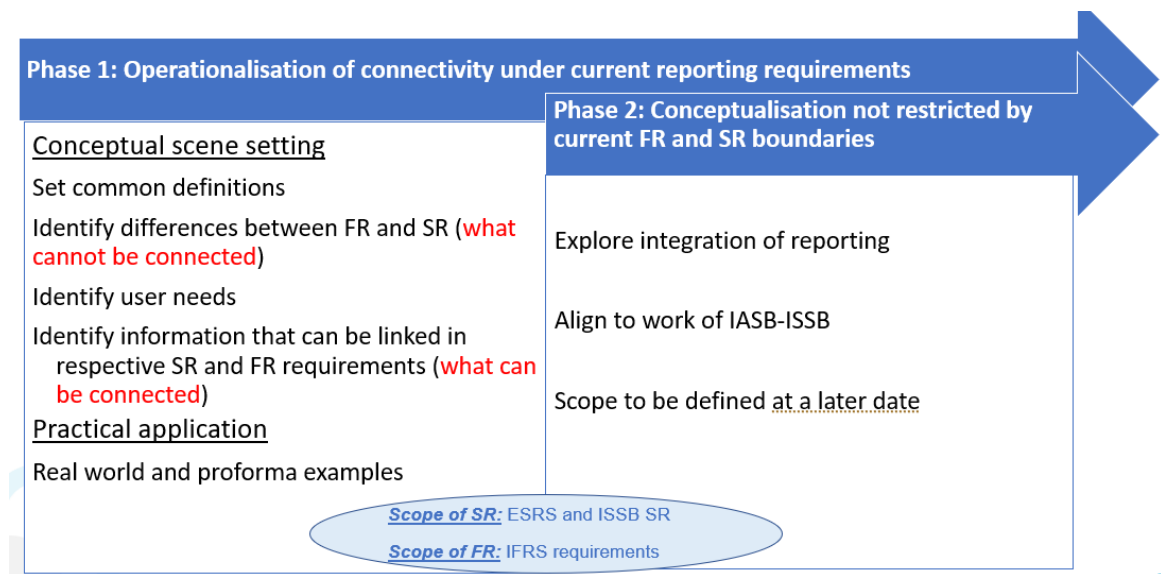
earmarked as being within the possible scope of the second phase of the EFRAG research project (see paragraphs 7 and 8 below).

- 5 Hence, with the rapidly evolving developments, the involvement of multiple actors, and the multiple publications on this topic; to have timely and relevant content, it will be necessary for EFRAG to aim to have its Discussion Paper published in 2024, and to also consider if interim deliverables (e.g., Briefing papers that serve as educational material, literature reviews) can/should be published before the issuance of the Discussion Paper.

## Recap of project objectives, scope, and approach approved by EFRAG FR TEG and the EFRAG FRB

- 6 As previously agreed, the connectivity project will fulfil the following objectives (with points a) and b) being the most important objectives):
  - (a) influence the ongoing jurisdictional and international SR and FR standard setting including serving as an input to the ongoing IASB narrow-scope project on climate-related risk in financial statements.
  - (b) support practice through identified good reporting practices. Examples that will be identified during the research can enable companies to benchmark themselves and improve their reporting practices.
  - (c) contribute to research/thought leadership on the topic of connectivity, which is a nascent and high-priority area for stakeholders.
  - (d) serve as an educational resource for a diverse range of stakeholders.
- 7 On the scope and approach;
  - (a) the project will be conducted in two phases as outlined in Figure 1.
  - (b) the first phase of the project will focus on the connectivity between sustainability reporting information disclosed based on ESRS and IFRS Sustainability Disclosures Standards; management commentary/management report; and financial statements information under IFRS Accounting Standards. As the fieldwork (i.e., collation and development of examples) will predate the availability of reports based on mandatory sustainability requirements, mock-up examples and examples of good practices of sustainability reporting information under current guidance will be considered. Due to resource constraints, the connectivity between sustainability reporting and local GAAP accounting requirements is not in scope.
  - (c) the full range of sustainability matters (i.e., environmental, social and governance matters) will be in scope.
  - (d) the first phase will have a practical orientation and focus on assessing user needs and operationalising connectivity under existing reporting boundaries. In the context of this paper, current financial reporting and sustainability boundaries connote existing legislative, regulated reporting, scope, and placement requirements with respect to financial reporting and sustainability reporting information. A clarification of what the term “connectivity” means for the purposes of this project should also be provided.
  - (e) EFRAG will monitor other connectivity-related initiatives (National Standard Setters, Regulators, and other stakeholders) to ensure the scope and outcomes of the EFRAG research project are distinctive and complementary to the work done by others.



**Figure 1: EFRAG connectivity research project approach**

- 8 The precise scope of the second phase will be determined at a later date. The preliminary view is that this latter phase could address the integration of reporting<sup>4</sup>.
- 9 To avoid confusion on the objectives of the project, the EFRAG research project will clarify its application of the term connectivity. To this effect, the ESRS and IFRS Sustainability Standards requirements for the connection of information will guide what the EFRAG research project considers<sup>5</sup> to be connectivity. We mainly refer to sustainability requirements for the connection of information because currently, other than IAS 1 *Presentation of Financial Statements*<sup>6</sup>, there are no explicit IFRS Accounting requirements for the connection of information. We note that the draft ESRS 1 (delegated act published at the end of July) makes a distinction between direct<sup>7</sup> connectivity, indirect<sup>8</sup> connectivity, and where there is neither<sup>9</sup> direct nor indirect connectivity (i.e., consistency).

<sup>4</sup> For this project, the term integration of reporting connotes a yet-to-be-realised state of integration of reporting. It could entail a rethink of current FR and SR boundaries including after the possible development of a conceptual framework for SR information. The use of this term is not referring to the mandatory adoption of the International Integrated Reporting Council (IIRC) IR framework and its six-capital framework.

<sup>5</sup> We describe rather than define the term connectivity as it has multiple dimensions and connotations and does not lend itself to an all-encompassing definition.

<sup>6</sup> IAS 1 requires the disclosure of assumptions made about the future and other sources of estimation uncertainty at the end of reporting period if they have a significant risk of resulting in a material adjustment to the carrying amounts of assets and liabilities within the next financial year.

<sup>7</sup> **Direct connectivity** between information disclosed in the sustainability statement and that within the financial statements occurs when the sustainability statement includes monetary amounts or other quantitative data points that exceed a threshold of materiality and that are presented in the financial statements). For such information, cross-referencing of the financial statement information is required.

<sup>8</sup> **Indirect connectivity** between information disclosed in the sustainability statement and that within the financial statements occurs when the sustainability statement may include monetary amounts or other quantitative datapoints that exceed a threshold of materiality and that are either an aggregation of, or a part of, monetary amounts or quantitative data presented in the undertaking's financial statements). In this case, an explanation of how the information in the sustainability statement relate to the most relevant amounts presented in the financial statements is required. This disclosure shall include a reference to the line item and/or to the relevant financial statements' paragraphs. Where appropriate, a reconciliation may be provided, and it may be presented in a tabular form.

<sup>9</sup> Cases of **neither direct nor indirect connectivity** between information disclosed in sustainability statement and information disclosed in financial statements may occur when the sustainability statement includes: monetary amounts or other

- 10 In the development of examples/operationalising connectivity, the EFRAG project will primarily focus on connections that can be made by entities reporting within the EU reporting architecture (as depicted in Figure 2). Examples may also be drawn from connections that can be made within the IFRS general purpose financial reporting encompassing financial statements, management commentary and sustainability-related financial disclosures (see Figure 3).

**Figure 2: EU reporting placement architecture (arrows depict the connections the project will consider)**



Source: EFRAG

**Figure 3: Reporting architecture described by IFRS Foundation**



Source: Slides used at the April 2023 IFRS Advisory Council Meeting

quantitative data that are linked to monetary amounts or other quantitative data presented in the financial statements; or qualitative information that are linked to qualitative information presented in the financial statements. In this case, an explanation of the consistency of significant data, assumptions, and qualitative information across the sustainability statement and financial statement is required.



## Proposed Structure of the Discussion Paper

11 It is proposed that the Discussion Paper should consist of:

- (a) **Executive summary**
- (b) **Chapter 1: Introduction- Objective and problem definition.**

This chapter will consist of:

- (i) Objectives of the research
  - (ii) A problem definition including a summary of findings from available empirical studies and other thematic reviews on the reporting of connected information. At the October EFRAG CAP meeting, initial findings from an academic large sample study of EU companies (STOXX companies) were presented to EFRAG CAP. As pointed out below, the academic studies can operationalise complementary measures of connectivity.
  - (iii) A summary of stakeholder feedback (including EFRAG CAP) on the challenges related to the lack of connectivity of information
- (c) **Chapter 2: Underpinning concepts.**

This chapter will

- (i) describe the term connectivity as applied in the research project. This will be based on ESRS and IFRS S1 requirements for connected information. As noted, there are no requirements for connected information within IFRS Accounting Standards. It is noted that even with the definitions provided in ESRS and IFRS Sustainability requirements, several EFRAG CAP members still raise questions of what connectivity means and it not being clear why it is important. And it was noted that the examples will help refine the articulation and demonstration of connectivity. The academic study also pointed to aggregate measures of alignment and dis-connectivity and members considered the notion of alignment could be additive to the EFRAG research project articulation as it could be indicative (an initial screen) of whether material information is excluded from either of the two reporting domains (i.e., FR and SR).
- (ii) describe the boundaries and expected information within the financial statements, management report and sustainability disclosures/statement.
- (iii) explain why information may not be connected, As outlined in the agenda paper 04-03 for the July meeting and EFRAG Secretariat Briefing<sup>10</sup> on Climate-related Risks in the Financial Statements- these would include a discussion and analysis of the following aspects:
  - *Differing application of materiality* under financial reporting versus sustainability reporting encompassing a double materiality perspective.
  - *Inside-out impacts cannot be reflected in financial statements* unless they have outside-in material effects.
  - *Differing reporting boundaries/scope*

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<sup>10</sup> September 2023 [EFRAG Secretariat Briefing: Climate-related Risks in Financial Statements](#).



- *Differences in typically applicable time horizon*
- *Restrictions toward recognising or disclosing potential liabilities/provisions and opportunities (potential future assets) in financial statements*
- *The extent to which forward-looking information is respectively incorporated into financial statements and sustainability-related information*
- *The extent of estimation uncertainty*
- *Input-based sustainability information versus outputs-based financial reporting information<sup>11</sup>*
- *Extent of use of non-monetary units of measurement, level of aggregation and role of accruals<sup>12</sup>*
- *Application of operational control for sustainability reporting information (e.g., for GHG emissions)*
- *The inseparability of sustainability risks from other risks: In some cases, sustainability risks are embedded within the measurement of financial statement line items. Similarly, it can be difficult to quantify some information within sustainability disclosures<sup>13</sup>.*

(d) **Chapter 3: User and other stakeholder perspectives/expectations.**

We note the following:

- (i) User needs (primary users of both financial and sustainability reporting information) will inform the prioritisation and illustration/examples of aspects of connectivity. The Discussion Paper's articulation of user needs will be informed by input from EFRAG CAP and outreach to other users (e.g., EFRAG user panel and possibly a survey to users including those that are part of EFRAG's network). At the July EFRAG CAP meeting and May 2023 EFRAG EAA Symposium on connectivity, an equity analyst presented the user perspective on why connectivity is important. And the insights

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<sup>11</sup> Alfred Wagenhofer (2023): Sustainability Reporting: A Financial Reporting Perspective, Accounting in Europe.

<sup>12</sup> Wagenhofer (2023) notes that Sustainability reporting information predominantly comprises non-monetary metrics, which in turn affects the level of aggregation that is possible under sustainability reporting, whereas financial statements information is primarily comprised of monetary metrics and easier to derive aggregated measures such as profit. Furthermore, as outlined in Wagenhofer (2023), unlike financial reporting, there is no "stocks and flows" representation of sustainability reporting information.

<sup>13</sup> IFRS S1 has guidance on when not to disclose quantitative sustainability-related information. IFRS S1.38; "An entity need not provide quantitative information about the current or anticipated financial effects of a sustainability-related risk or opportunity if the entity determines that: a) those effects are not separately identifiable; or b) the level of measurement uncertainty involved in estimating those effects is so high that the resulting quantitative information would not be useful (see paragraphs 77-82)."

IFRS S1.39; "In addition, an entity need not provide quantitative information about the anticipated financial effects of a sustainability-related risk or opportunity if the entity does not have the skills, capabilities or resources to provide that quantitative information."

IFRS S1.40; "If an entity determines that it need not provide quantitative information about the current or anticipated financial effects of a sustainability-related risk or opportunity applying the criteria set out in paragraphs 38-39, the entity shall: a) explain why it has not provided quantitative information; b) provide qualitative information about those financial effects, including identifying line items, totals and subtotals within the related financial statements that are likely to be affected, or have been affected, by that sustainability-related risk or opportunity; and c) provide quantitative information about the combined financial effects of that sustainability-related risk or opportunity with other sustainability-related risks or opportunities and other factors unless the entity determines that quantitative information about the combined financial effects would not be useful."



drawn from this presentation will be taken into account whilst developing examples.

- (ii) Other stakeholder (auditor, regulator, preparer and academic) perspectives/expectations on connected information will be incorporated. At the July and October EFRAG CAP meetings, presentations on preparer and auditor perspectives were made. At a forthcoming EFRAG CAP online meeting, a presentation on the enforcer perspective will be made. The insights drawn from this presentation will be taken into account whilst developing examples.

(e) **Chapter 4: Operationalising connectivity: Examples applying connection principles across information within sustainability reporting, management commentary, and the financial statements (see issues paper 05-01).**

We note the following:

- (i) As proposed in agenda paper 05-01, the Discussion Paper will include real-world and mock-up examples illustrating connections between sustainability reporting, management report information and financial statement information with a focus on **climate change, pollution, biodiversity, water resources, own workforce, and business conduct/governance**.
  - (ii) Also included will be real-world and mock-up examples that illustrate why connections may not be established. For each such example, we will highlight the underpinning specific reason why connections cannot be made (i.e., which of the factors noted in paragraph 11 c (iii) above are at play).
  - (iii) For each example, we will highlight the relevant IFRS Accounting requirements; ESRS and IFRS Sustainability requirements; and the connectivity technique (e.g., whether a reconciliation, disclosure of interrelated amounts, statement of consistency or any other technique) applied.
  - (iv) As noted earlier, as the fieldwork (i.e., collation and development of examples) will predate the availability of reports based on mandatory sustainability requirements (ESRS and IFRS Sustainability Standards), mock-up examples and examples of good practices of sustainability reporting information under the current largely voluntary guidance/reporting frameworks will be considered.
  - (v) As noted at the October 2023 EFRAG CAP meeting, we should be cognisant of the limitations of mock-up examples including the risk of stakeholders misinterpreting these examples as being part of the authoritative ESRS literature. In addition, mock-up examples may fail to reflect entity-specific nuances and complexities. We also note several EFRAG CAP members expressed support for examples including mock up examples as a way of supporting practice and also as an integral part of refining the articulation and demonstrating what connectivity means in practice and why it is important.
- (f) **Chapter 5: Implications of the findings for standard setters and other stakeholders within the corporate reporting ecosystem**



**Questions for the EFRAG FR TEG and SR TEG members**

- 12 Do you agree with the proposed deliverables (i.e., a Comprehensive Discussion Paper) and other possible interim deliverables (Briefing papers, articles, literature review)?
- 13 What other interim deliverables would you recommend be developed?
- 14 Do you agree with the proposed content and structure of the Discussion Paper outlined in Paragraph 11 or do you suggest any modifications?

