

CONNECTIVITY PROJECT UPDATE

EFRAG FRB AND SRB MEETING- AGENDA PAPER 03-01- COVER NOTE

28 February 2024



RECAP: EFRAG research project approach

Phase 1: Operationalisation of connectivity under current reporting requirements- **Discussion** **Paper expected in 2024**

Conceptual scene setting

Why connectivity is important

Set common definitions (**what connectivity means for EFRAG project**)

Articulate distinctive objective roles of Financial statements, management report and SR

Identify differences between FR and SR (**what cannot be connected**)

Identify user and other stakeholder needs and expectations

Identify disclosures that can be linked (**what can be connected**)

Practical application

Real world and proforma examples

Iterative process of example development and articulation of concepts

Possible Phase 2: Scope to be determined later

Monitor IASB management commentary, ISSB, other National Standard Setter and regulator connectivity initiatives

EFRAG work should be synergistic with work done by others

If undertaken, will consider learnings from Phase 1

Scope of SR: ESRS and IFRS SDS

Scope of FR: IFRS Accounting requirements

AGENDA PAPERS:

ADDRESS CONCEPTUAL SCENE SETTING & ILLUSTRATIONS OF CONNECTIVITY

APPENDIX: STEPS SINCE LAST FRB-SRB MEETING & TIMELINES

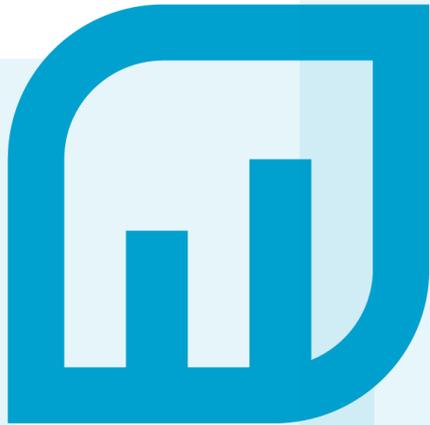
Agenda Papers

CONCEPTUAL SCENE SETTING

- Paper 03-02 Definitions, concepts, and priorities for illustrations of connectivity
- Paper 03-03 Objectives and boundaries of different sections of the annual report (**Also suggested to be an interim deliverable/publication for educational purposes on what can be reflected in different corporate reports**)
- Papers 03-02 and 03-03 should be read conjunctively, these papers have overlapping content (e.g. location of information, what is being connected), the duplication will be addressed when integrating the content into the Discussion Paper)

ILLUSTRATIONS OF CONNECTIVITY

- Paper 03-04 Examples development approach
- Paper 03-04b Background paper only: Mapping ESRS to financial statements (inventory of possible anchor points)- Slides prepared by leader of EFRAG CAP Examples subgroup leader



DEFINITIONS, CONCEPTS
AND PRIORITIES FOR
ILLUSTRATIONS OF
CONNECTIVITY (AGENDA
PAPER 03-02)

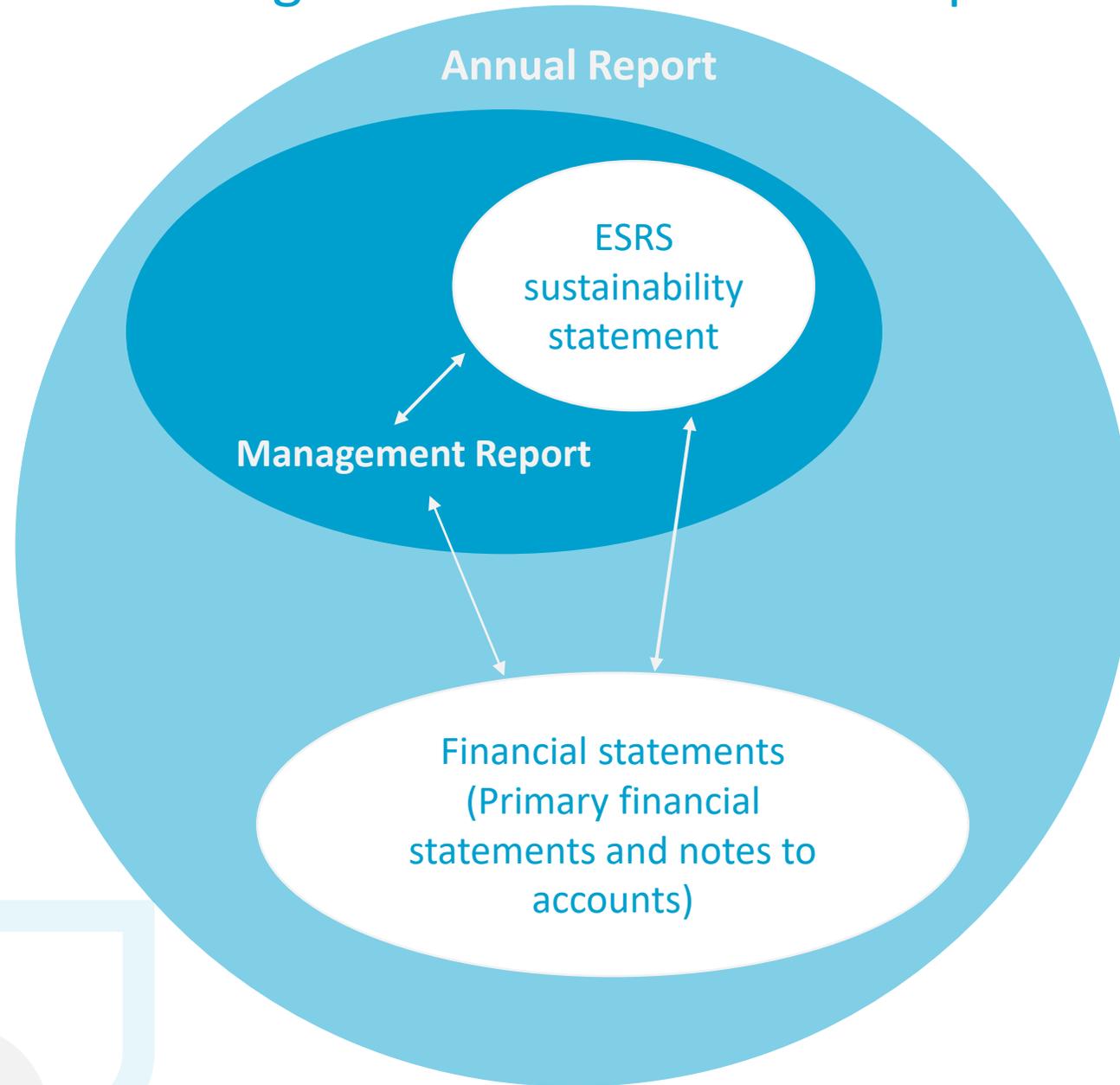
PAPER 03-02- OBJECTIVE AND CONTEXT OF DEVELOPMENT

- **Definitions, concepts, and priorities for illustrations of connectivity in Discussion Paper (not meant to be additional/alternative guidance to ESRS and IFRS SDS connection requirements)**
- **Two-way connectivity (to and from financial statements) is in the scope of project**
 - *2021 PTF-NFRS called for two-way connectivity as one of the six concepts for robust EU standard setting*
 - *With the enactment of ESRS and IFRS SDS; Need to illustrate connections of sustainability reporting to financial statements*
 - *Need to also illustrate connection of financial statements to information in management report, sustainability disclosures*
 - *There are IFRS S1 and ESRS connection requirements but there are no explicit IFRS Accounting connection requirements (can SR connection requirements be applied conversely? Needed to consider issues particular to financial statements (e.g. legal risk from cross referencing, disclosure overload)*
- **Addresses stakeholders/CAP members conceptual questions/considerations- *Why is connectivity important? How is it related to the conceptual framework principles?***

DEFINITIONS, CONCEPTS AND PRIORITIES PAPER (03-02) COVERAGE

- What is connectivity?
- What is being connected and why is connectivity important
- Types of connectivity, principles for illustrations of connectivity
- Priorities for illustration (anchor points)
- Appendix- Role of technology in connectivity

What is being connected under EU corporate reporting



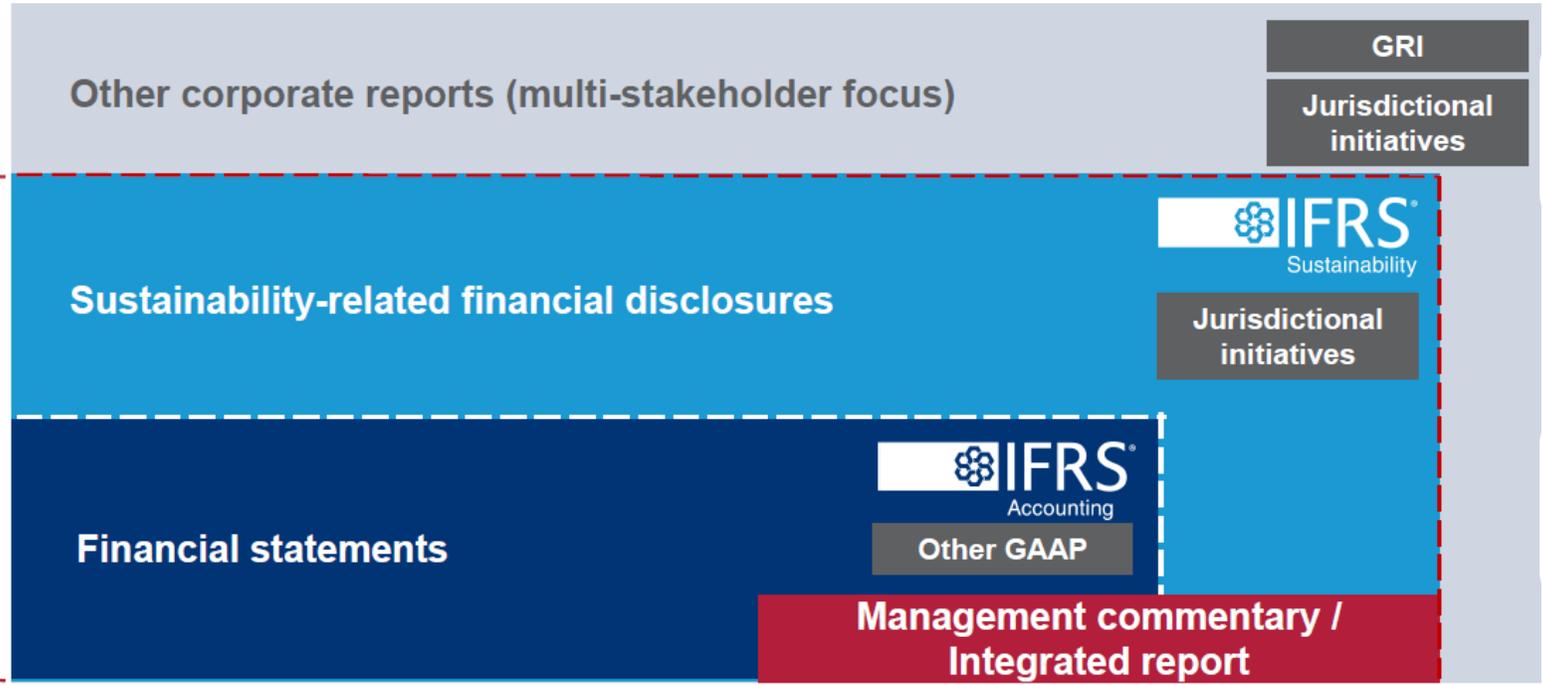
SR information (ESRS sustainability statement)

- Double materiality perspective, same definition of financial materiality as financial statements, demarcation of SR versus financial statements objectives
- Clear placement within management

Audience of SR information

- Broad set of users (including investors), investors deemed to consider financial and impact material information

What is being connected under IFRS general purpose financial reporting



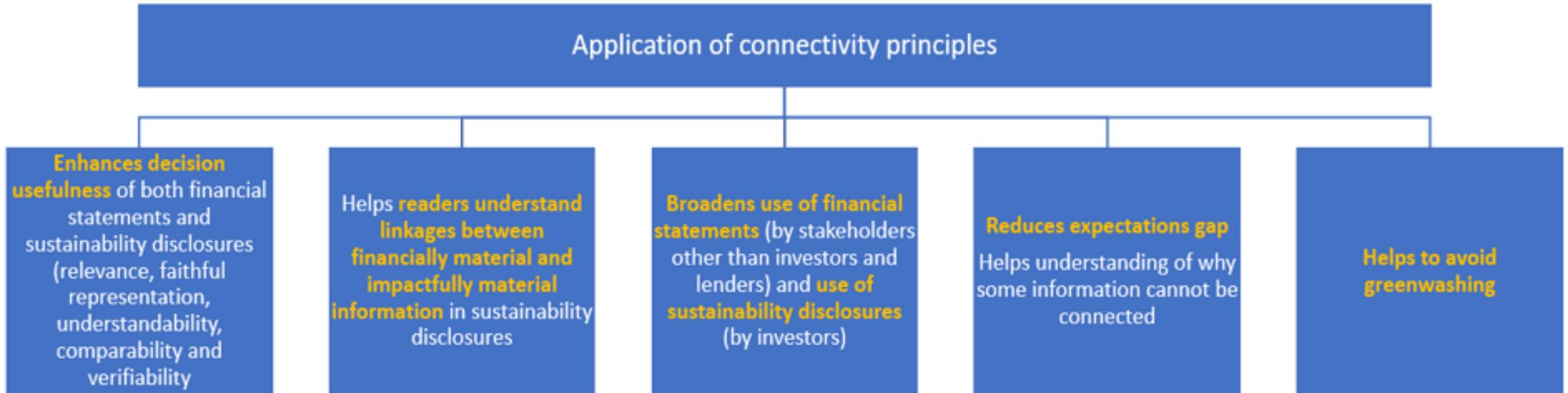
SR information (sustainability-related financial disclosures)

- Component of general purpose financial reporting, has same materiality as financial statements, management commentary
- Location agnostic (e.g., can be in notes to accounts)

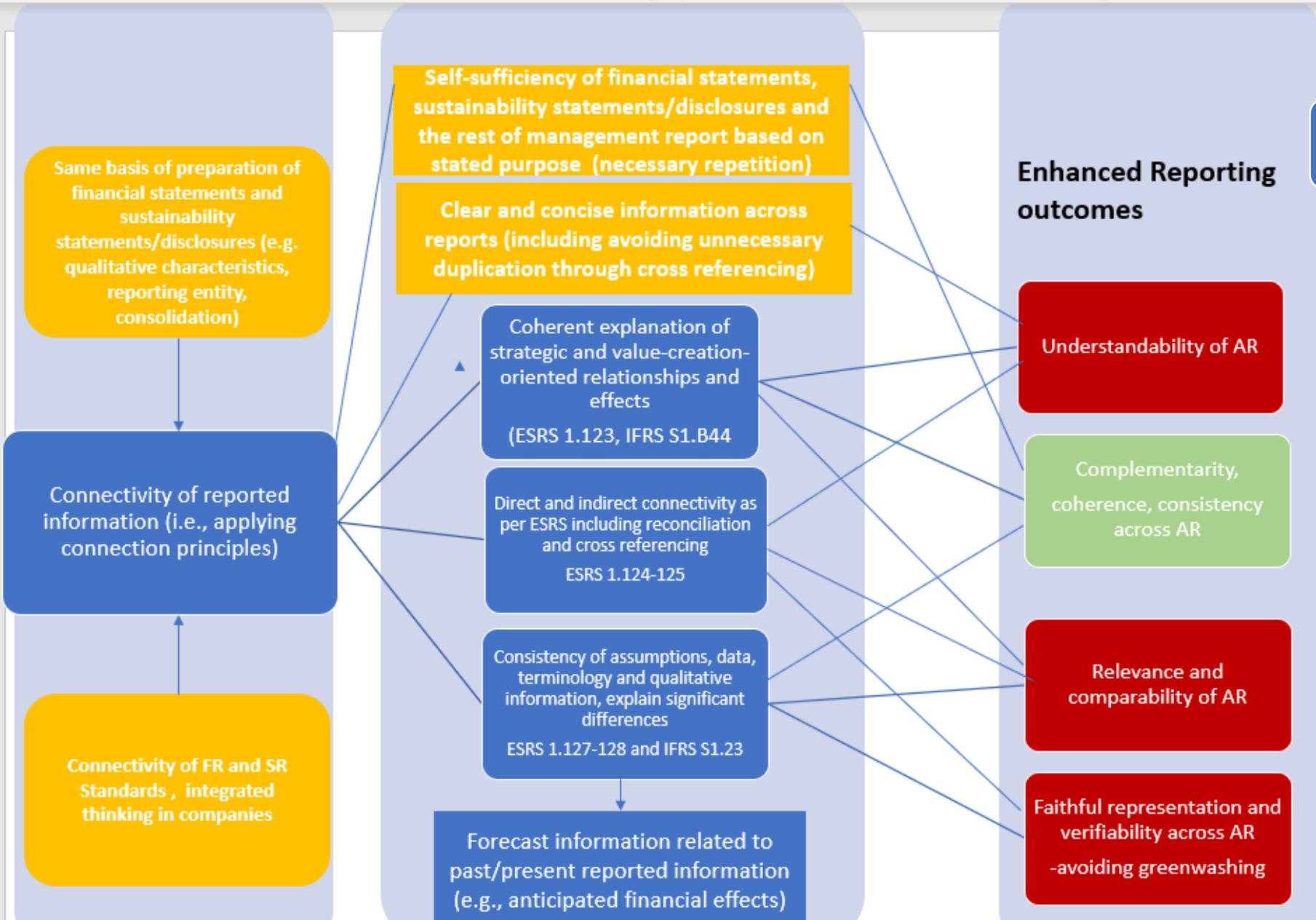
Audience of SR information

- Same primary audience as financial statements (i.e., investors, lenders)





Connectivity concepts, categories, outcomes on qualitative characteristics



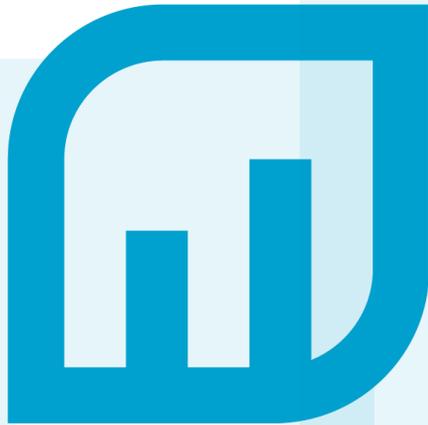
Connectivity financial statements to SR, management report- Things to consider

- Limits to cross-referencing forward looking information (legal risk)
- Possible disclosure overload/obscuring other material information
- Expectations of disclosure of trigger points of migration of items from SR to financial statements

Priorities for illustrating connectivity (starting from sustainability reporting)

- **Illustrations of SR information connections to financial statements and management report** will focus on **climate, and other environmental topics, own workforce and business conduct** datapoints. ESRS [datapoints](#) will be a key reference point (spreadsheet link <https://bit.ly/49cRxRK>). Use of current reporting that has ESRS data points and mock-up examples. A high priority will be accorded to
 - connections between **business model, strategy, risks and opportunities** disclosed in SR and the information in the financial statements and the management report
 - connection of anticipated financial effects disclosed in SR to financial statement information (will also consider description of risks and opportunities).
 - Article 8 (EU taxonomy) information connections to financial statement information
 - Human rights and employee benefits in sustainability statements/disclosures
 - Other financially material information besides anticipated financial effects in sustainability statements/disclosures

- **Illustration of connectivity of financial statements** information to that outside the financial statements will focus on the following connections
 - Significant judgments, major sources of estimation uncertainty and accounting policies
 - Whether and how valuation of non-financial assets including impairment of non-financial assets, useful lives, residual value is linked to SR information (**R&D investments in sustainability-linked products, stranded assets**)
 - Contingent liabilities and provisions (and disclosures that inform on commitments) (**net-zero commitments, environmental liabilities, and workforce-related liabilities**)
 - Qualitative materiality assessments (**climate-related risks**)
 - Connections of segment reporting and disaggregation of revenue to related SR information (e.g., **IFRS 15 disaggregation of revenue disclosure reflect sustainability-linked revenue streams, whether identified segments reflect sustainability-linked business models**).
 - Possibly considering connections related to other 2022 ESMA enforcement priorities (e.g., **measurement of investment properties, disclosures of carbon credits**)



OBJECTIVES AND
BOUNDARIES OF DIFFERENT
SECTIONS OF THE ANNUAL
REPORT
(AGENDA PAPER 03-03)

PAPER 03-03- OBJECTIVE AND CONTEXT OF ITS DEVELOPMENT

- **Articulation of the boundaries of different corporate reports is integral to understanding what can and cannot be connected**
- **Need to highlight grey areas- can help identify where accounting and/or SR requirements may need enhancement**
- **Need to expand on dynamic dimension of connectivity (i.e., items migrating from one report to the other over time)**
- **There is an expectation gap on what can be reflected in the financial statements, the content of the paper can serve as educational material**

COVERAGE

- PART 1- Objectives and audiences of financial statements, sustainability statements/disclosures in the management report, and the rest of the management report
- PART 2- Interaction of materiality and boundaries (application of materiality, dynamic/intertemporal dimension of connectivity, grey areas)
- PART 3: Illustration of distinctive nature of different sections of annual report (**why material sustainability matters may not be reflected in the financial statements**)

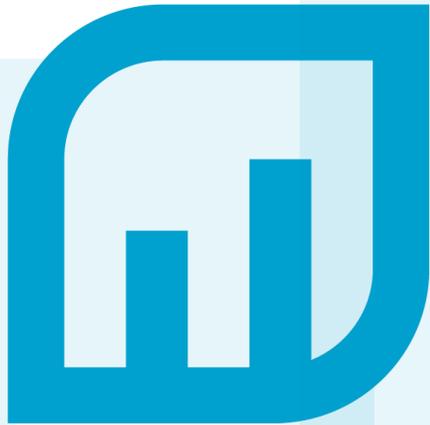
GREY AREAS

- Application of IAS 1 catch all requirements for financially material information in light of available sustainability disclosures. *Is there an expectation gap on what should be in the financial statements? How can this requirement be applied in a manner that ensures financial statements and sustainability reporting are complementary and avoid unnecessary duplication?*
- Net-zero commitments constructive obligations (Taking into account the IFRIC tentative agenda decision, *what disclosures would be appropriate for the financial statements versus the sustainability statement/disclosures? Are there any gaps- missing information from both financial statements and sustainability reporting?*)

THE RESEARCH OUTREACH AND ANALYSIS OF ILLUSTRATIONS /EXAMPLES WILL SHARPEN THE CONCEPTUALISATION AROUND THESE GREY AREAS

WHY ITEMS CANNOT BE CONNECTED

- Sustainability-related information may be embedded (and therefore not separately presented) in financial statements' line items;
- There could be differences in the level of aggregation in financial statements versus the sustainability statement;
- Certain sustainability-related information cannot be recognised or disclosed in the financial statements ([recognition criteria](#), [measurement basis](#), [value chain](#), [units of measurement](#));
- Possible gaps in IFRS Accounting requirements (i.e., IAS 1- [Disclosures of estimation uncertainty](#));
- Other factors (e.g., [qualitative materiality assessment](#), [organisational capabilities](#)).



ILLUSTRATIONS AND
EXAMPLES DEVELOPMENT
(AGENDA PAPER 03-04)

CONSIDERATIONS FOR DEVELOPMENT OF ILLUSTRATIONS AND EXAMPLES

– AGENDA PAPER (03-04)

Mix of real-world and mock-up examples
(Caveats necessary)

- Real-world examples to illustrate connectivity starting from financial statements information; and
- Mock-up examples and, where possible, real-world examples to illustrate connectivity starting from sustainability statements/disclosures

Reporting year

- Information to be gathered based on 2022 financial year
- May be updated to the extent possible with 2023 information

Country and sectoral coverage

- Predominantly EEA companies across diverse and highly impacted sectors including financial institutions

Target number of examples

- 30+ illustrations/examples but will be reassessed depending on the suitability of the examples/illustrations

DOCUMENTATION OF ILLUSTRATIONS/EXAMPLES

Overall takeaways from the review of illustrations/examples

What could be improved (requirements or voluntary practices), views on where there are location grey areas

Baseline information per illustration/example

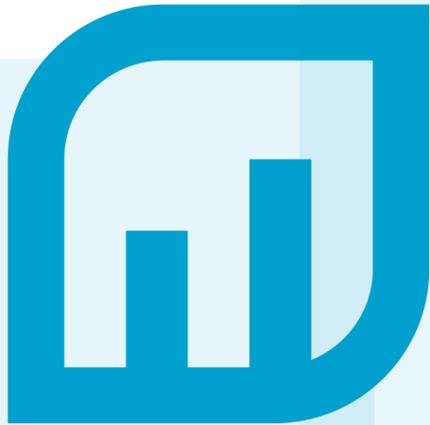
- Annual report sections being connected
- Topic (e.g. sustainability matter, FS line item)
- Connectivity principle/type being illustrated
- ESRS/IFRS respective requirements
- What cannot be connected
- Connectivity techniques (reconciliation, cross-referencing, statement of inconsistency, narrative explanation)

User and other stakeholder considerations per illustration/example

- Why illustration is helpful for users
- Potential constraints for preparers
- Potential assurance and enforcement considerations

PRESENTATION OF ILLUSTRATIONS/EXAMPLES

- To consider the same presentation as EFRAG European Lab projects on climate-related reporting and the EFRAG European Lab project task force on the linkage in the reporting of the business model, risks and opportunities (PTF-RNFRO)
- PTF-RNFRO principles described in [Towards Sustainable Business: Good Practices in Business Model, Sustainability Risks and Opportunities Reporting in the EU](#) and Examples in the Supplementary Document: [Good Reporting Practices](#))



APPENDIX- STEPS TAKEN AND TIMELINE

Where we are coming from



STEPS TAKEN

- 23-person, multi-stakeholder EFRAG CAP appointed in May 2023 (active from July 2023), Chaired by EFRAG TEG Vice Chair, Jens Berger
- EFRAG CAP Subgroups formed- Concepts subgroup led by Leo van der Tas and Examples/illustrations development subgroup led by Cedric Tonnerre
- July 2023- February 2024 EFRAG CAP MEETINGS
 - 7 meetings (4 meetings with full group and 3 meetings with subgroups)
- October 2023- FEBRUARY 2024 TEGs
 - 2 EFRAG FR TEG and SR TEG meetings in October 2023 and February 2024
- Outcomes
 - CAP members had presentation/exchanges on functional perspectives (user, preparer, enforcement, auditor and academic)
 - Discussed an approach of identifying and developing examples
 - Agreed high-level structure for Discussion Paper
 - Agreed priority topics for illustrating connections
 - Concepts and boundaries papers developed
 - Agreed interim deliverables
 - Kickstarted examples development

Going forward timeline

