

# EFRAG

## Connectivity: where we are and how EFRAG plans to contribute

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# Connectivity between financial and sustainability reporting

## What do we mean?



## Connected information

### Approaches to establish connection outlined in ESRS and IFRS

- Description of relationships between different pieces of information
- Cross-referencing or incorporation by reference
- Reconciliation to financial statements information
- State consistency of underpinning assumptions

Connected information establishes clear links between the management report, sustainability statements and financial statements and provides a holistic view between all the factors that affect value creation.

This allows information to be more useful, relevant, and cohesive and the management report to be viewed as a single, balanced and coherent set of information properly linked with financial reporting.

*Basis for Conclusions for Draft ESRS 1 (BC 42)*

# Timeline

**2021** Project identified as top priority during EFRAG agenda consultation

**June 2022-** EFRAG FRB approved addition of project to proactive agenda

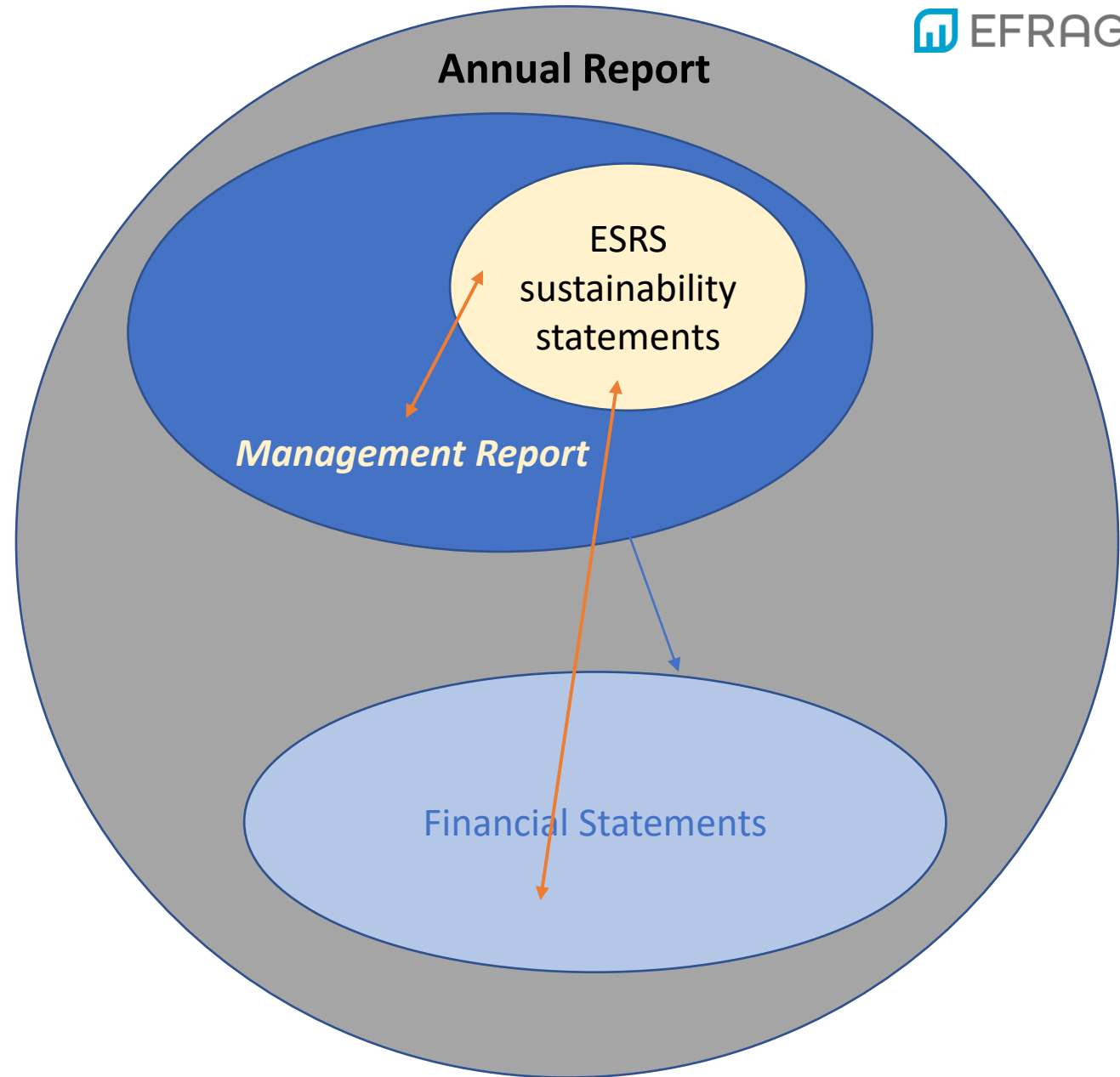
**January 2023-** EFRAG FR TEG and SR TEG discussed scope and approach of project

**February 2023-** EFRAG FRB and FR TEG approved the scope and approach of project

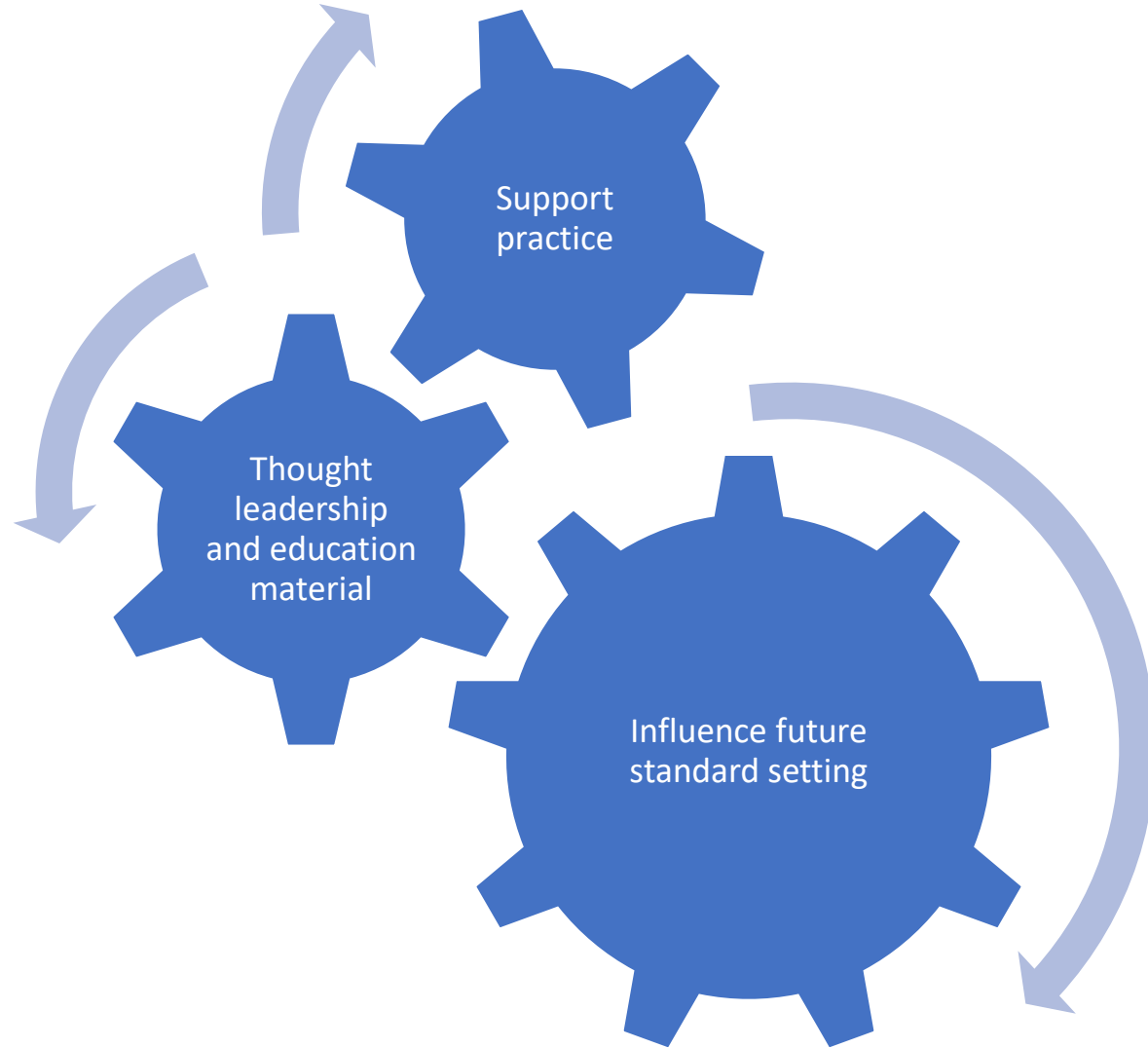
**Q2 2023** Multistakeholder connectivity advisory panel to be operational in Q2 2023

# Connecting what?

- Mandatory application of ESRS and location of sustainability information in a dedicated section of the Management Report +
- Incorporation by reference to other sections of the Management Report allowed
- ESRS sustainability statements under ‘double materiality’ lens (impact materiality + financial materiality)
- Entities in scope: large undertakings (IFRS and national GAAP applicants)



# Research objectives



# Two steps approach, start with operationalisation of connectivity

**Phase 1: Operationalisation of connectivity under current conceptual FR and SR boundaries (Systematic illustration of the possible connections between FR and SR)**

Conceptual scene setting

- Set common definitions
- Identify differences between FR and SR
- Identify user needs
- Identify anchor points

Operational techniques to foster linkage

- Real world and examples
- Pro-forma examples

**Phase 2: Conceptualisation not restricted by current FR and SR boundaries**

- Explore integration of reporting
- Align to work of IASB-ISSB
- Scope to be defined once directions of ISSB project are clear

Scope of SR: ESRS and ISSB SR

Scope of FR: IFRS requirements



## Setting the scene: conceptual boundaries of FR and SR information

- Reporting entity vs Value chain information
- Investors vs other users
- Financial control vs operational control
- Extent of application of non-monetary units of measurement
- Time horizons
- Extent of incorporation of forward-looking information
- Dynamic materiality (e.g., when sustainability risks translate into contingent liabilities)

# Setting the scene: Proposed elements of connectivity for Phase 1

## LINKAGE AND RELATIONSHIPS

- Showing the linkage between FR and SR information including by identifying anchor points
- Showing current financial effects (without duplication) and future financial effects of sustainability risks and opportunities

## CONSISTENCY

- where relevant, the same assumptions for FR and SR information are applied
- SR and FR make use of the same underlying data
- Basis of preparation of SR is consistent with FR
- Differences in the scope of FR and SR information are explained

## Complementarity of scope, outputs with other connectivity workstreams

- IASB project on climate-related risks in financial statements- **May result in IASB issuing illustrative examples, education material, application guidance and making minor amendments to IFRS Accounting Standards**
- Possible ISSB project on integration in reporting- **May affect scope of Phase 2 of EFRAG project**
- Other National Standard Setters work on connectivity between IASB-ISSB requirements
- ESMA study on climate-related reporting- **May result in illustrative examples**

## INTEGRATION IN REPORTING (ISSB AGENDA CONSULTATION)

- **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 it also includes the collective consideration of the interdependencies, synergies and trade-offs between:
  - the various resources and relationships reported on in general purpose financial reports; and
  - 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

## INTEGRATED REPORT

- Concise communication about how an organization's strategy, governance, performance and prospects, in the context of its external environment, lead to the creation, preservation or erosion of value over the short, medium and long term.
- Primary purpose is to explain to **providers of financial capital** how an organization creates, preserves or erodes value over time.
- An integrated report **benefits all stakeholders** interested in an organization's ability to create value over time, including employees, customers, suppliers, business partners, local communities, legislators, regulators and policy-makers.

## MANAGEMENT COMMENTARY E.D.

- Report that complements financial statements. It provides management's insights into factors that have affected the entity's financial performance and financial position and factors that could affect the entity's ability to create value and generate cash flows in the future.
- Prepared to meet the information needs of an entity's investors and creditors. Other stakeholders might also find it useful.

## EFRAG SRB and FRB preliminary considerations

- EFRAG considers that a project on connectivity should be given high priority to develop guidance on connected information.
- We see the integration of reporting more as a longer-term project for which, given the current resources available and immediate other needs, there is no immediate place on the agenda.

*(EFRAG VIEW WILL BE FORMED FOLLOWING ITS DUE PROCESS, DCL APPROVED ON 24 MAY 2023)*

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# Connectivity

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## Feedback from consultations – 2020 to 2022



- Stakeholders expressed strong support for the IFRS Foundation’s creation of the ISSB, in part, because of the opportunity for **connectivity** between both boards within the same organisation
- The notion of **connectivity** is reflected in the Constitution:
  - *These **complementary sets** of IFRS Standards are intended to result in the provision of high-quality, transparent and comparable information **in financial statements and in sustainability disclosures that is useful to investors and other participants in the world’s capital markets in making economic decisions.***



## What do we mean by ‘connectivity’?



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## What are general purpose financial reports?

### Audience

- Capital (**financial**) market participants (eg, investors) to make decisions about providing resources to the entity
- Others, beyond capital market participants, may find this information useful

### Components

- Financial statements
- Sustainability-related financial disclosures
- Management commentary reports / integrated reports focused on investors

### Location

- Does **not** refer to a 'location' of information
- Refers to a set of disclosures that are clearly identifiable and distinguished from other information.
- Can be a standalone report or part of another report

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# What are general purpose financial reports? *A picture is worth a thousand words*



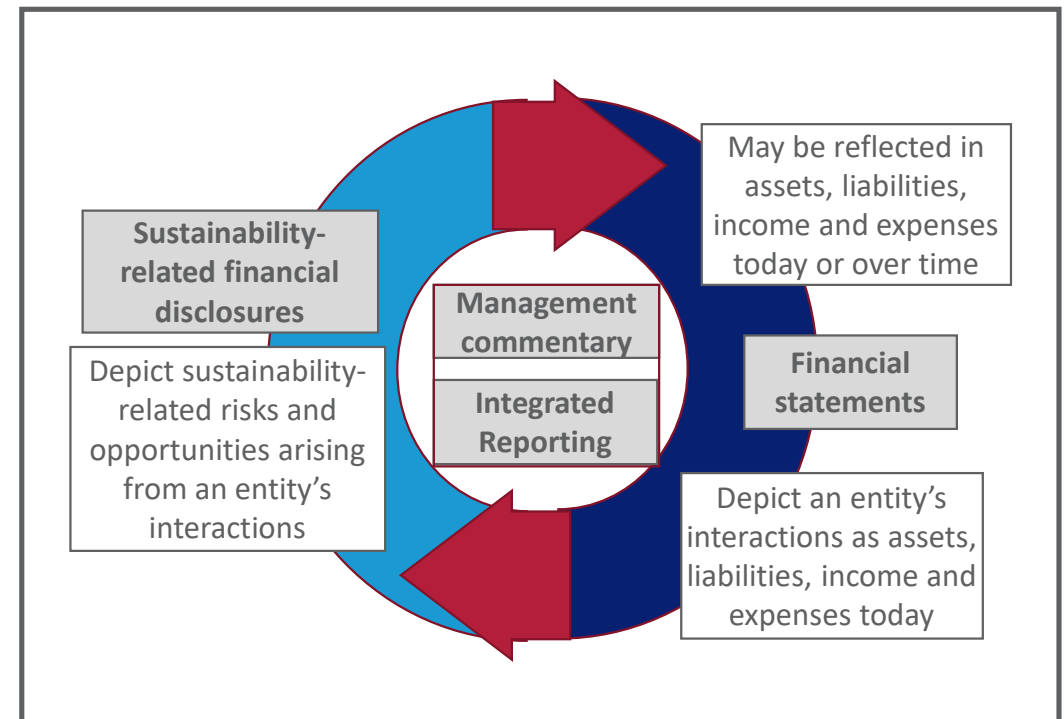
## Why is connectivity important?

### For preparers

- Increasingly the same individuals are involved in preparing financial statements and sustainability-related financial disclosures.

### For investors

- Financial statements and sustainability-related financial disclosures share the same audience
- Investors need to understand how sustainability-related matters translate into an entity's financial performance and financial position
- Investors need to understand connections in the information provided in the financial statements and in the sustainability-related financial disclosures



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## Examples of connectivity


### Connectivity in product

- Style and structure
- Concepts
- Requirements for connected information
- Other work underway

### Connectivity in process

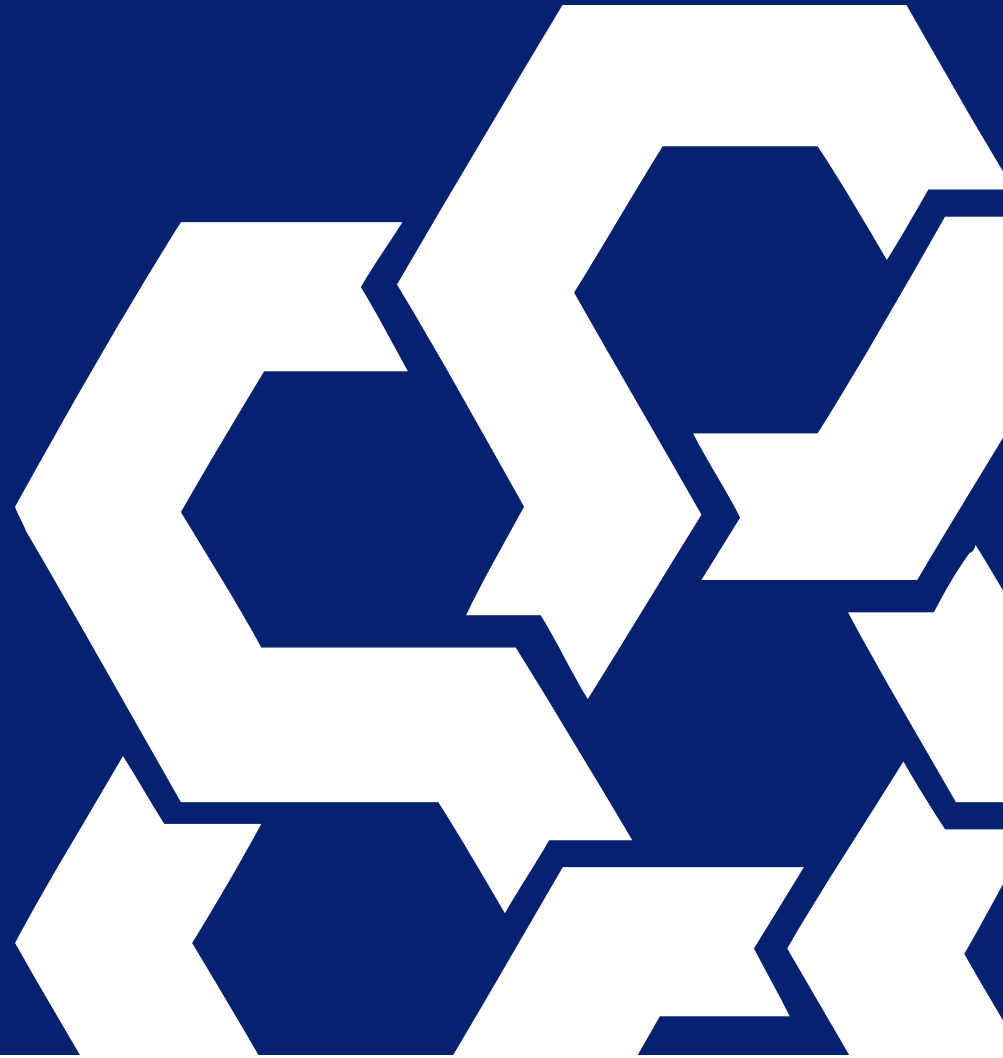
- Organisational structure
- Information sharing

# The role of digital financial reporting

<p><b>Why important?</b></p>	<p>Allows investors to extract, compare and analyse information efficiently With adoption of ISSB Standards, more information to consume so greater need for digital</p>	
<p><b>Key components</b></p>	<p>A digital taxonomy provides a list of elements (often referred to as ‘tags’) that allow disclosures to be <u>classified and structured</u> in a manner which makes the disclosures <u>machine-readable</u> A digital taxonomy is different from, for example, a green taxonomy used to classify environmentally sustainable economic activities</p>	
<p><b>Connectivity between digital disclosures</b></p>	<p>Enabled through connectivity in IASB and ISSB standards</p>	<p> Technology <b>cannot</b> address requirements that are not interoperable. Interoperability needs to happen at the Standards level. Technology could enable investors to identify common disclosures.</p>
<p><b>Connectivity between digital taxonomies</b></p>	<p>Enabled through shared digital team for IASB and ISSB</p>	
<p><b>Interoperability between digital taxonomies</b></p>	<p>Enabled through bi-lateral and multi-lateral engagement – in establishing requirements and taxonomies</p>	

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## Appendix A – Communication with stakeholders



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## Connectivity—what is it and what does it deliver?

- Read the joint article by ISSB Chair Emmanuel Faber and IASB Chair Andreas Barckow explaining the meaning of connectivity in relation to the ISSB and the IASB's work
- The article is available on the IFRS Foundation website: [IFRS - Connectivity—what is it and what does it deliver?](#)





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