Project Task Force
Non-Financial Reporting Standards

# Outreach Meeting France
# European Standard-Setting (ESS)

EFRAG
European Financial Reporting Advisory Group

European Reporting Lab
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# Introduction

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# Table ronde avec les parties prenantes

Sur les propositions de la Task Force

**Disclaimer**

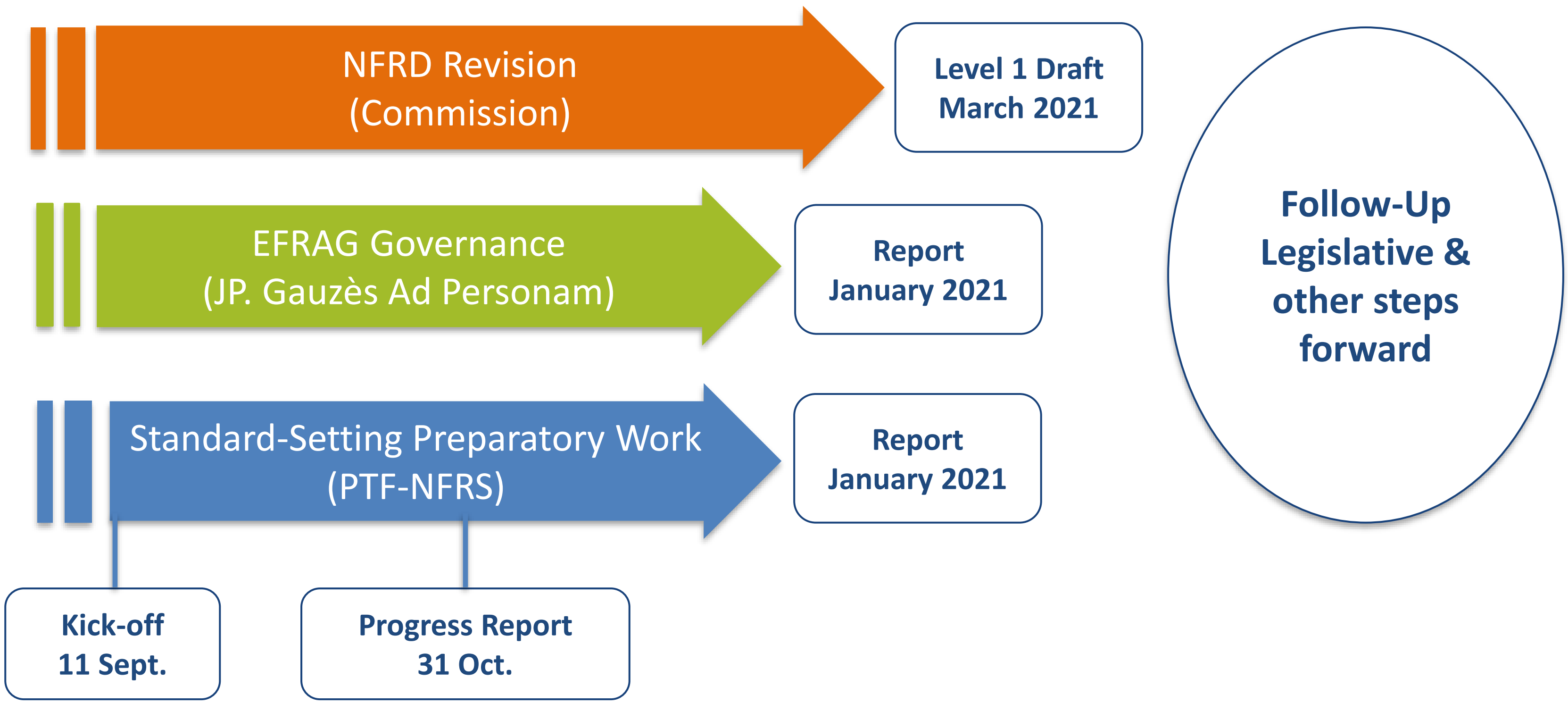
This document is a tentative summarised presentation on ongoing work-in-progress from the Project Task force on non-financial reporting standards of the European Corporate Reporting Lab at EFRAG.

The views reflected in this outreach document provide an indication of the approach followed and of the possible orientations that the Task Force may adopt, but it does not prejudge the final Proposals that will be made to the European Commission by the Task Force in its Final Report.

It is intended to gather views from European stakeholders on key preliminary views emerging from the Task Force current ongoing work.

Introduction

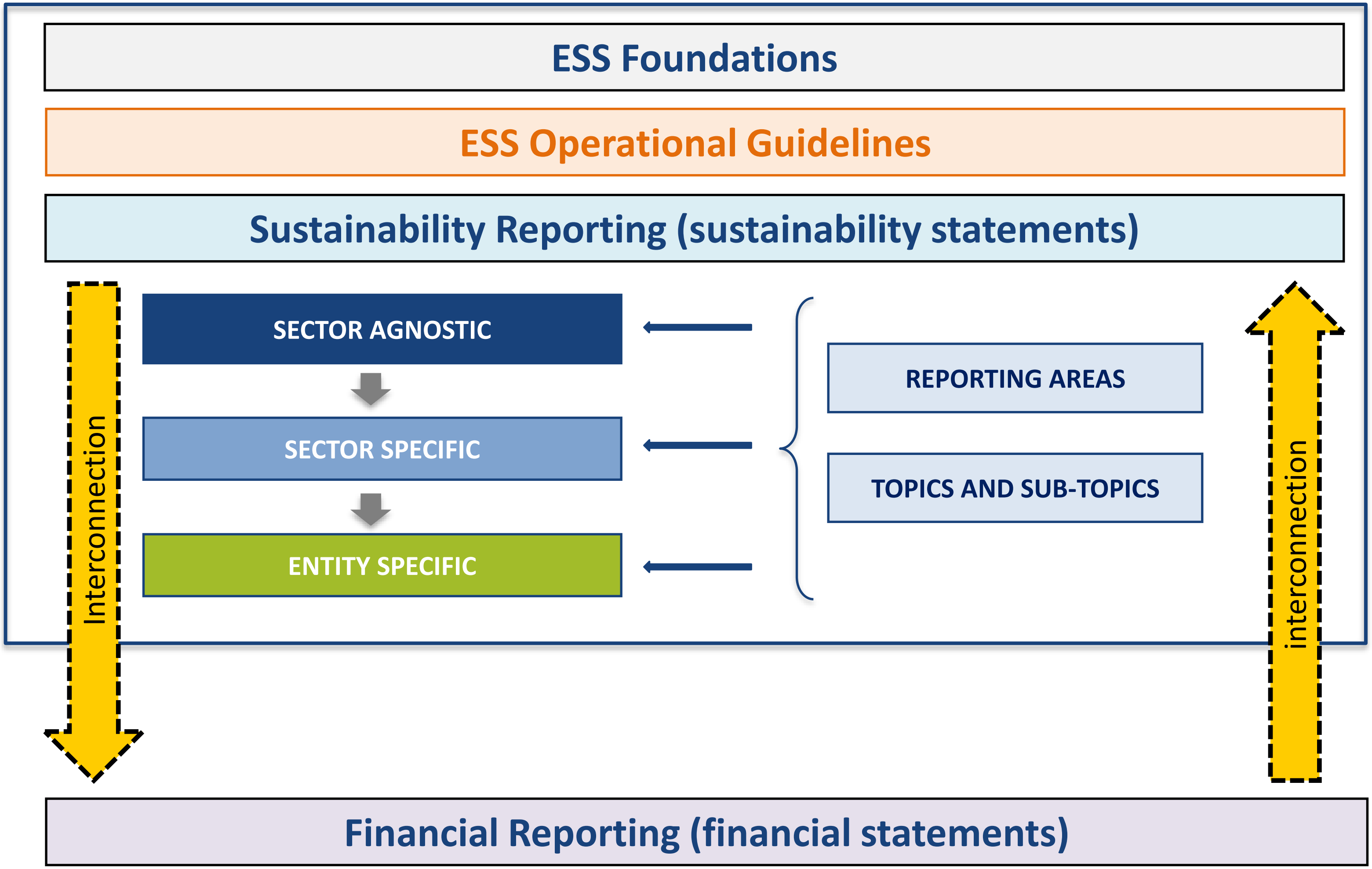
# EU sustainability reporting: 3 processes in parallel




**→ Therefore, interaction as a basis (under final coordination by Level 1)**

# Target general architecture

*Summary of the above*



**Building block #2**

*Addressing the specific challenges of **financial institutions.***

- The EU Sustainable Finance Strategy places a strong emphasis on the role of financial institutions (banks, insurance undertakings, asset managers) to stimulate and accelerate sustainability transitions.
- FIs most significant impacts are indirect impacts stemming from the products they create, distribute and manage.
- The ESS should recognise financial institutions as specific preparers and users of sustainability reporting and ensure the availability and access of data necessary to meet their own disclosure requirements.

1 ESS foundations

**Building block #3**

*Including **SMEs** in the EU sustainability reporting landscape in a proportionate manner.*

- SMEs represent a very significant part of the economy and the value chain and therefore have a critical role to play in supporting the EU sustainability goals. They will also be key recipients of sustainable investment flows, for which they still have to provide relevant sustainability information.
- The ESS should adopt a proportionate standard-setting approach tailored for EU SMEs that will integrate their size, risk profile and governance structure variety.

**Building block #4**

*Fostering **sector-specific** sustainability reporting relevance.*

- Sector-agnostic sustainability reporting is pivotal since it is the only level that provides comparability across sectors, i.e. for the economy as a whole, enabling transitions.
- However, risks and impacts may significantly vary from one economic sector to another and sector-specific information allows intra-sector comparability.
- The ESS should adopt a standard-setting approach to sector-specific sustainability reporting as a complement to sector-agnostic sustainability reporting. This level would be better understood if presented in a clear and distinct manner.
- The ESS should choose an EU compatible classification of sectors already used for other purposes and design balanced sector-specific sustainability disclosures building upon

  (i) existing sector legal requirements

  (ii) covering risks and impacts not covered, or not covered enough by sector-agnostic sustainability reporting.
- All sectors should be covered over time with an initial emphasis on higher-risk sectors.

**Building block #5**

*Acknowledging the importance of **intangibles** in sustainability reporting.*

- Financial reporting recognises intangibles in financial statements only when acquired (e.g., goodwill), as a counterpart of financial outflows at the date of acquisition. While the increase or decrease of intangibles explain the best part of increases or decreases in market values, financial reporting does not recognise, and does not envisage to recognise, (most) internally generated intangibles.
- Better understanding the impact of intangibles on financial value creation is therefore an important component of sustainability reporting. Their impact on social/environmental value creation is generally considered through topical disclosures.
- The ESS should introduce in its standard-setting processes the “intangible dimension” and develop a specific standard-setting approach on intangibles ensuring this dimension is properly reflected in disclosures.

## 2 ESS operational guidelines

**Quality of Information / Standards:**

**Auditability**

- Operating guidelines are needed to develop quality principles (characteristics) that could be set in Level 1, both at general sustainability reporting level and at disclosure level (for data points, targets,…).
- They should cover in particular how to embed faithful representation, relevance, comparability, understandability, reliability into the standard-setting process.
- They should also operationalise the intrinsic value of each relevant type of information: qualitative, quantitative non-monetary and quantitative monetary.
- **In line with an overall support for stronger assurance, guidelines would need to focus on the criteria needed to facilitate auditability of sustainability information in relation with appropriate auditing standards.**

## 2 ESS operational guidelines

**Time Horizon**

- Backward-looking
- Forward-looking

- Sustainability reporting encompasses retrospective and forward-looking information (implying setting targets, dedicating resources, establishing roadmaps, simulating outcomes, possibly under different scenarios…)
- Further guidelines are needed to support the elaboration of standards related to forward-looking sustainability information per category of information and per time horizon.

## 2 ESS operational guidelines

**Levels of Reporting**

- Operations
- Value chain

- Sustainability disclosures should primarily address the perimeter of operations under the control of the reporting entity (own operations) to foster coherence with financial information (consolidated approach).
- Sustainability disclosures should also address other levels of reporting with specific challenges:
    - Own operations segmented to reach more granular information (geography-specific, activity-specific by segment, asset specific),
    - Value chain when deemed material and as a key lever for business model transformation.
- Guidelines should consider: (i) control/influence/responsibility implied, (ii) impacts ‘severity’ and (iii) data availability and collection.

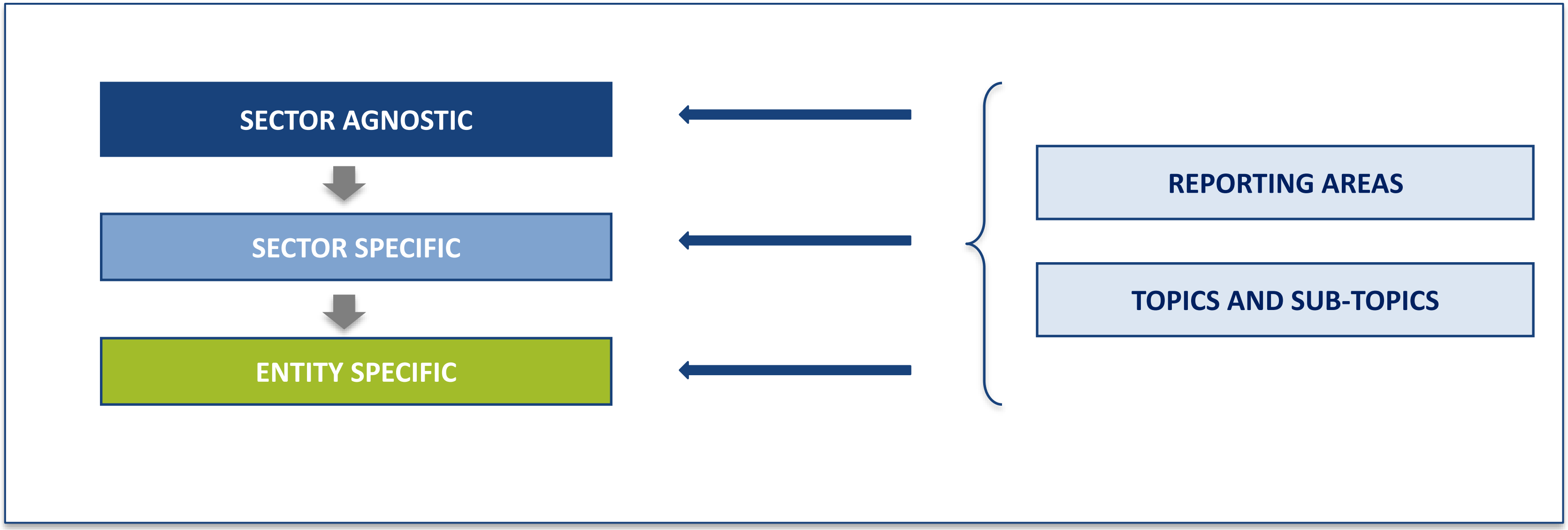
## 2 ESS operational guidelines

**Double materiality**

**Sustainability** | **Financial**

- EU legislative level establishes a double materiality approach for sustainability reporting: sustainability materiality and financial materiality. Each perspective must be considered in its own right. The ESS should operationalise the concept and clarify a ‘sum of both’ dimension (as opposed to an ‘overlap’ dimension).
- Materiality assessments should be made at each level of the sustainability reporting architecture: at sector-agnostic and sector-specific levels by the standard-setter and at entity-specific level by the governance/management (based on a standardised approach).
- The ESS should adopt a standard to disclose how reporting entities report on their own materiality assessment process. The standard should address the approach to be followed by the entity when a mandatory requirement may lead to an insignificant disclosure under its specific circumstances.

# 3 ESS architecture




The standard-setting (and reporting) **architecture** should combine **three layers** (sector-agnostic, sector-specific, entity-specific) and **two dimensions** (reporting areas and topics) in order to define the right level of sustainability information.

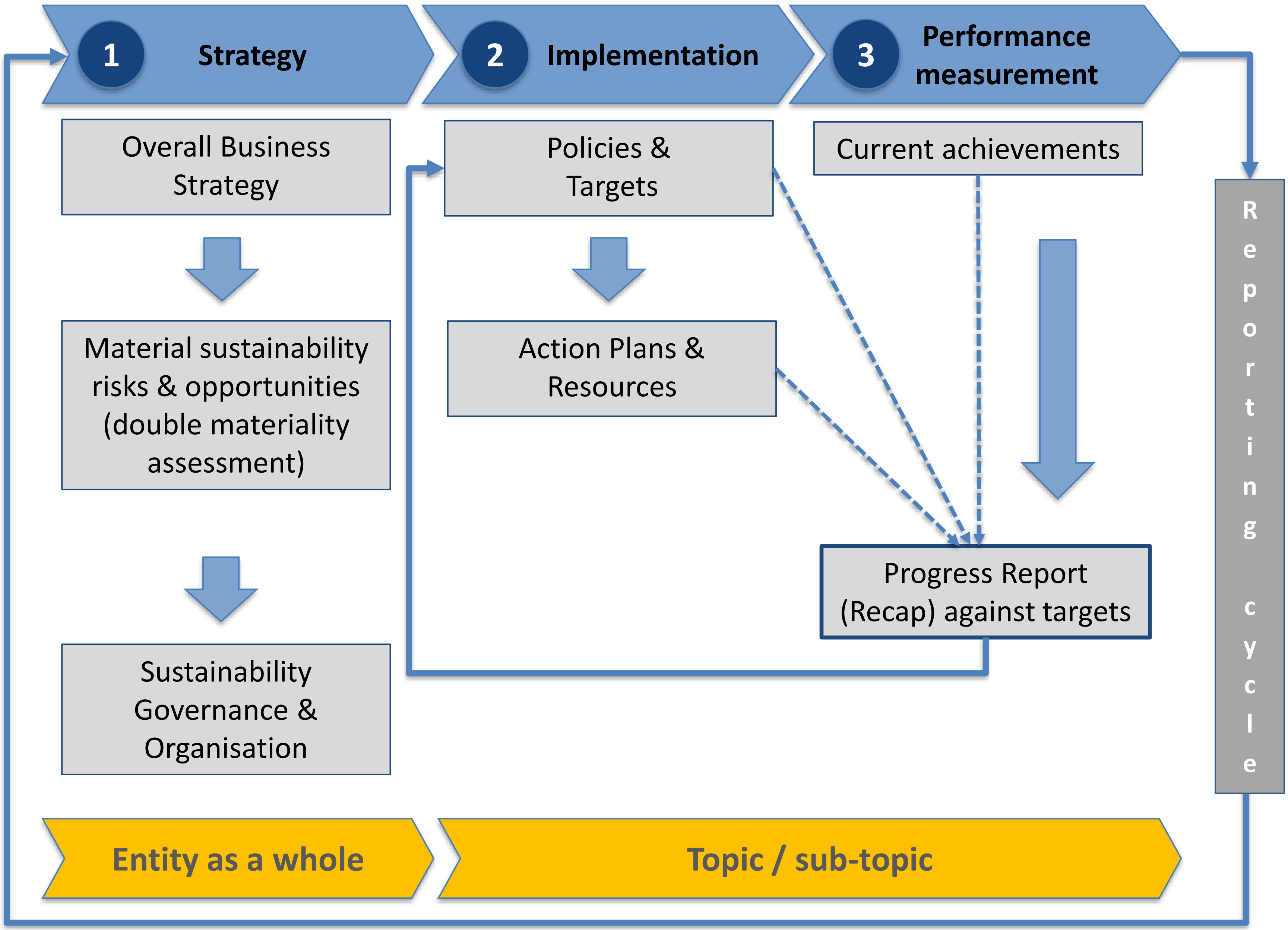
3 ESS architecture

## REPORTING AREAS

- A sustainability reporting area is associated with a specific information objective or expected content that should be disclosed. For example, there are currently 5 reporting areas within the NFRD: Business Model, Policies including due diligence processes, Outcome, Principal risks and their management, KPIs) and 4 for climate under the TCFD approach (Governance, Strategy, Risk Management, Metrics and Targets).
- Sustainability reporting areas can be applied at two different levels: entity-level, topic-level.
- Business decision-making is generally articulated as follows: (a) Strategy definition and related challenges, (b) Implementation measures (action plan to deliver the strategy), (c) Performance measurement (monitoring of action plan).

1 **Strategy** | 2 **Implementation** | 3 **Performance measurement**

- Aligning reporting areas (focused on users' expectations) and decision-making (focused on the preparer's approach) should help reflect in a comprehensive manner how the reporting entity addresses sustainability matters as a whole.


1 Strategy
2 Implementation
3 Performance measurement
Overall Business Strategy
Material sustainability risks & opportunities (double materiality assessment)
Sustainability Governance & Organisation
Policies & Targets
Action Plans & Resources
Current achievements
Progress Report (Recap) against targets
Reporting cycle
Entity as a whole
Topic / sub-topic

3 ESS architecture

# Topics & Sub-topics: Option 1

| Environmental | Social | General (incl. Governance) |
| --- | --- | --- |
| Climate | Workforce | Governance |
| Water & Marine Resources | Value Chain workers | Business Ethics |
| Biodiversity & Ecosystems | Affected communities | Organisation |
| Circular economy | Consumers / end users | Brand/Communication |
| Pollutions | [Public Authorities]? | Innovation |
| illustrative | illustrative | illustrative |

**Possible compatibility with multi-capital approach**

| | | |
| --- | --- | --- |
| Natural Capital | Human Capital | Intellectual Capital |
| | Social & Relationships Capital | |

3 ESS architecture

# Topics and sub-topics: Option 2

| Environment | People | Organisation (incl. Governance) | Relationships |
|---|---|---|---|
| Climate | Labour relations | Governance | Supply chain |
| Water & Marine Resources | Health & Safety | Business Ethics | Customers |
| Biodiversity & Ecosystems | Other Human Rights | Organisation | Public Authorities |
| Circular economy | Human Resources | Brand/Communication | Human Rights |
| Pollutions | | Innovation | Communities |
| illustrative | illustrative | illustrative | illustrative |

**Possible compatibility with multi-capital approach**

| Natural Capital | Human Capital | Intellectual Capital | Social & Relationships Capital |
|---|---|---|---|

## 4 ESS reporting structure

**MANAGEMENT REPORT**
**(SUSTAINABILITY STATEMENTS)**

- Under the current NFRD, sustainability information is presented in a number of different ways: management or separate report, information scattered in various locations hindering the status of sustainability reporting and the comparability of information.
- The general flexibility of management reports could accommodate two sections: one dedicated to sustainability statements (qualitative and quantitative information) and the other to the overarching presentation (financial and sustainability) of the reporting entity's affairs (governance and management vision, interpretation, judgements, etc…). One option is therefore to dedicate a clearly identified section of the management report to sustainability reporting (the Sustainability Statements, including both qualitative and quantitative standardised information).
- The reporting structure needs to be specifically addressed by the standard-setter, in order to establish a comprehensive and stable reporting structure organising a rational classification of sustainability disclosures per topic and per layer (sector-agnostic, sector-specific, entity-specific).

## 4 ESS reporting structure

Interconnection

Interconnection

- A consistent and all-inclusive Corporate Reporting should be based on two pillars on an equal footing: Financial Reporting and Sustainability Reporting. Therefore, interconnection between the two pillars is key.
- Connectivity implies connecting sustainability disclosures to any related financial information. Therefore, it requires when preparing sustainability disclosures to identify the relevant anchor points and their counterparts in financial information to allow reconciliations or cross-references to financial reporting.
- There should be a distinction between:
  - direct connectivity: a sustainability disclosure can be linked to or is derived from information in the financial statements or in the detailed accounts (if not deemed necessary for financial reporting purposes: e.g., training costs, taxonomy KPIs…)
  - indirect connectivity: a sustainability disclosure needs to be put in relation with other financial information (e.g., budgeted expenses, scenario analysis…)
- Financial reporting also needs to be coherent with sustainability disclosures (e.g., assumptions for impairment testing), therefore the ESS should offer anchor points for financial information in order to ensure continuity and coherence in corporate reporting.
- The ESS should provide the framework (methodologies, processes and anchor points) for proper interconnection.

5 ESS priorities

- There is general agreement that the EU sustainability momentum calls for a major step in sustainability reporting. As a consequence, the Task Force considers that (i) priorities should be taken into account and (ii) the next step should aim at delivering urgently a coherent first set of disclosures.
- Along the EU momentum, there is a large number of initiatives in relation to sustainability standard-setting, with current notable convergence efforts. The Task Force welcomes these efforts and considers of prime importance to cooperate with the leading international initiatives to ensure coherence and reciprocal input between EU and other international initiatives, in order in particular to foster a global playing-field for international companies.

# Outreach questions on the ESS priorities

The Task Force is currently considering possible roadmap options for elaborating standards corresponding to the target reporting architecture and reporting structure. The Task Force will finalise its position in the course of January.

18) In this context, the Task Force would be happy to receive input from the outreach meetings on what could be a **coherent first set of disclosures** and the **related standard-setting priorities**.

19) The Task Force would also be happy to receive input on possible **standard-setting interactions between the EU and other international initiatives.**

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# THANK YOU


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