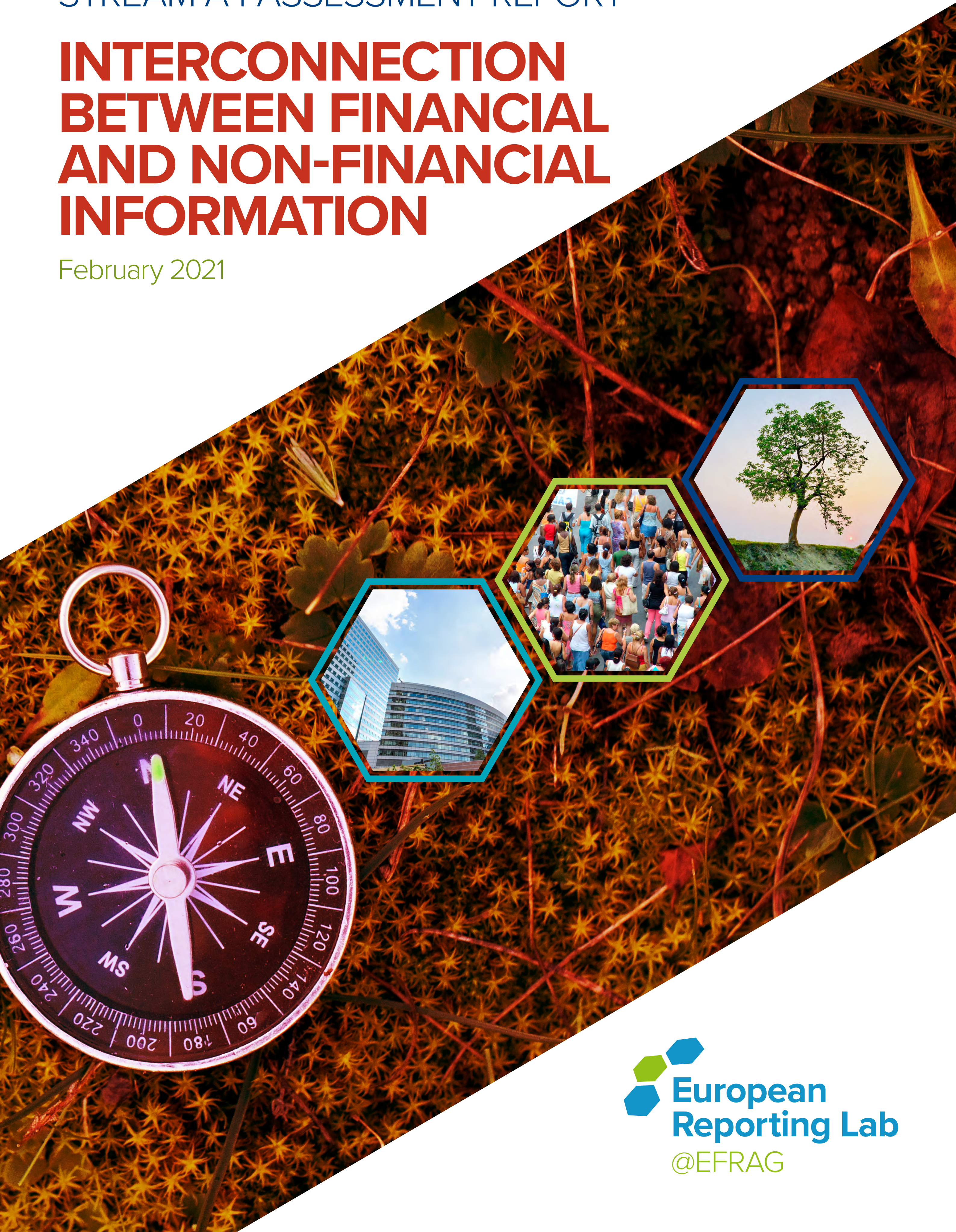
APPENDIX 4.4:
STREAM A4 ASSESSMENT REPORT

INTERCONNECTION BETWEEN FINANCIAL AND NON-FINANCIAL INFORMATION

February 2021



European Reporting Lab
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DISCLAIMER

This appendix forms part of a series of seven documents, comprising the report and its appendices prepared by the European Lab Project Task Force on preparatory work for the elaboration of possible EU non-financial reporting standards (PTF-NFRS), for submission to the European Commission in response to a mandate including a request for technical advice dated 25 June 2020.

The contents of the PTF-NFRS report and its appendices are the sole responsibility of the PTF-NFRS. The European Lab Steering Group Chair has assessed that appropriate quality control and due process had been observed to the extent possible within the context of the relevant mandate and the timeframe allowed, and has approved the publication of the PTF-NFRS report and its appendices. The PTF-NFRS report and its appendices do not represent the official views of EFRAG and are not subject to approval by the EFRAG governance bodies: EFRAG General Assembly and the EFRAG Board; or the European Lab Steering Group.

As regards the views expressed in the PTF-NFRS report and its appendices the following observations and clarifications should be noted:

- the PTF-NFRS report taken as a whole reflects a very large consensus;
- it is understood that members of the PTF-NFRS are not expected to endorse each and every one of the 54 detailed proposals in the PTF-NFRS report and may have different views on some of them;
- in addition the views expressed may not reflect the views of the organisations or entities to which individual PTF-NFRS members may belong;
- the assessment work for the different project focus areas, presented in Appendices 4.1 to 4.6 to the PTF-NFRS report, was the result of separate sub-groups of the PTF-NFRS, for which only peer review within the PTF-NFRS was performed.

Links are included in the PTF-NFRS report and its appendices to facilitate readers accessing the reference or source material mentioned. All such links were active and functioning at the time of publication.

Questions about the European Lab and its projects can be submitted to EuropeanLab@efrag.org.

EXECUTIVE SUMMARY

1 The overarching goal of Stream A4 was to assess interconnection between Financial Information (FI) and Non-Financial Information (NFI). Based on the workplan adopted by the PTF, Stream A4 focused primarily on identifying and considering FI limits and grey areas, assessing current developments on interconnection, and identifying 'anchor points' of interconnectivity between FI and NFI.

2 The work prepared in Stream A4 first included a detailed analysis of the current state of play. A detailed analysis of the limits of financial information considered issues such as double materiality and interconnection between FI and NFI as well as the 'monetary line' from ESG to financial materiality. Also, the boundaries for the reporting entity were analysed with respect to FI and NFI. In addition, the analysis performed includes a detailed assessment with regard to the recognition criteria of liabilities, provisions and contingent liabilities as well as intangible assets and possible gaps or shortcomings with regard to NFI. In this context, limitations of various IFRS Standards with regard to sustainability issues were further analysed.

3 For an analysis of gaps, the NFRD was used as reference point. It has been analysed where FI stops and where NFI starts and which overlaps ('anchor points') and gaps exist between FI and NFI. For this purpose, the starting point was to list the NFRD requirements and consider whether these requirements are included in financial reporting (IFRS Financial statements incl. notes) and/or the (revised) IASB management commentary. The analysis led to a list of requirements not included in FI, overlaps or gaps. It shows that the majority of NFRD requirements are not included in the financial statements. The IASB management commentary offers slightly more overlap, although it is voluntary. Therefore it does not address the issue of comparability, enforceability and quality (as not always audited). The identified overlaps offer opportunities for creating connectivity.

4 Also, a detailed assessment of existing major NFI frameworks on which connectivity approaches are considered for reporting with respect to interconnectivity issues has been performed. A key takeaway drawn from that analysis is that the existing non-financial reporting landscape includes various methods that could offer possible ways forward for enhanced interconnection. A basic distinction is possible between quantitative and qualitative methods.

5 The previously conducted analyses allowed identifying several anchor points, i.e. limits of financial and non-financial reporting that need to be considered when developing interconnectivity at the level of each respective requirement. Per each anchor point it was assessed whether the prevailing NFR frameworks/ standards/guidelines previously analysed offer possible connectivity solutions. Several solutions were identified as suitable for closing connectivity gaps which have to be analysed in more detail in order to make recommendations. However, the analysis also shows that the level of detail of the guidance in general needs to be further detailed in standard setting, in order to provide for the appropriate consistency in application.

6 The entire assessments performed lead to the development of five salient points, summarising the key findings:

a) **First salient point: A substantial evolution of financial reporting standards in a near future is unlikely.** The current mission of the IFRS Foundation is to deliver robust, reliable and transparent information as input for the decisions of the investors who are the primary users of general-purpose financial statements. IFRS Standards are based on the concept of financial materiality, which implies focusing on information which – if omitted – could influence the decisions of investors or other users of the financial statements. The scenario of an evolution of financial reporting standards to accommodate the need of the broader stakeholders that are users of nonfinancial information, or even to reflect financial performance measures adjusted for externalities, is unlikely.

b) **Second salient point: Benefits of interconnection between financial reporting and non-financial reporting.** Connectivity between financial and non-financial information is a key challenge to obtain a holistic and coherent view on corporate reporting. In practice, however, connectivity between financial and non-financial reporting is still emerging but presenting and developing non-financial information in close connection with financial information is vital to providing a comprehensive picture. There are several benefits that improved connectivity can provide. Thus, non-financial information complements and supplements financial information in order to place related content in context. Additionally, non-financial information should be consistent with information in financial reporting, and vice versa. Connectivity of information also reinforces coherence. Non-financial information can be more useful, relevant and coherent, when connected to financial information, and vice versa. Connectivity is also important to avoid overlaps and repetitions of the same information in different reports. However, despite the highlighted need for connectivity information, a clear interpretation of the concept of connectivity is needed. Also, while the concept of interconnectivity is highlighted in several NFI frameworks, the implementation in reporting practice lacks clear and precise guidelines as of now.

c) **Third salient point: Double materiality and rebound effect.** Materiality is a key concept in the context of the identification of the scope of FR and NFR, but materiality seems to have different meanings in each context. In FR standards, materiality is a judgement call for the management to select information that may have an impact on decision making of the primary users of the reporting. Regarding NFR, in addition to the interpretation of assisting the management in selecting the information to be presented, the so called double materiality approach allows for two different perspectives: outside-in (how ESG factors impact the entity's development, performance, position – often identified as financial materiality) and inside-out (how the entity's activity impacts on ESG factors – often identified as environmental and social materiality). A closer look shows that there is even a third perspective, i.e. some impacts of the entity's activity on ESG factors may result in the future in further impacts on the entity's development, performance, position. This third perspective is conventionally called rebound effect and is considered as conceptually pertaining to the outside-in perspective, in a broader sense and in a looking forward perspective as to the time horizon of reporting.

d) **Fourth salient point: Potential connectivity approaches (direct connectivity and indirect connectivity).** Our analysis resulted in two different interconnectivity concepts, namely direct and indirect connectivity. Under the direct connectivity concept, connectivity aims at reconciling NFI with information in the financial statements or the general ledger. The indirect connectivity concept aims at identifying links to financial reporting information, for disclosure objectives of the NFRD that cannot be directly reconciled to the financial statements or the general ledger in the current period or to accounting estimates used in the current period for preparing FR. A set of possible methods have been identified for direct connectivity as well as for indirect connectivity (qualitative and quantitative) which will be evaluated for concrete recommendations.

e) **Fifth salient point: Location of non-financial information.** Since the location of reporting is a central lever of integrating FI and NFI, the location of NFI is of key relevance. All the currently permitted approaches – such as including NFI in the management report or publishing NFI in a separate report – come along with drawbacks. The optimal location of NFI subject to the NFRD cannot be determined independently from other issues, especially related to the assumption about primary users, materiality as well as reporting boundaries, assurance and standardisation. A recommendation considering all relevant aspects needs to be developed.

7 These findings will provide valuable insights when developing specific recommendations with regard to interconnectivity between FI and NFI in a following step.

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INTRODUCTION AND OBJECTIVES

TERMINOLOGY CLARIFICATION

8 Financial reporting and non-financial reporting are terms used to refer to different corporate reports (Financial statements, Management report or other mandatory or voluntary reports). Financial reporting (FR) in the text below refers to the primary financial statements and the notes to the financial statements. When relevant the management report, as defined in the Accounting Directive, is mentioned separately. Management Commentary refers specifically to the International Accounting Standard Board (IASB) Management Commentary Practice Statement. Other documents are referred as Non-financial reporting (NFR).

9 Financial information (also referred to as FI) and non-financial information (also referred to as NFI) are the information themselves, or data points as defined in the progress report: a NFI data point is an elementary item of non-financial information which is providing, on a stand-alone basis, a single decision-useful information. Environment Social Governance (ESG) information is a subset of NFI since important aspects of NFI such as intangible resources not recognised in the Financial Statements are typically not included ESG information.

10 Based on the workplan that was presented and adopted by the Project Task Force on Non-Financial Reporting Standards during its kick-off meeting on September 11, 2020 Stream A4 focused on the following assessment objectives:

a) identify FI limits due to conceptual definitions (assets, liabilities) as well as grey areas (compulsory obligations, provisions, commitments, internally created intangibles, impairments…);

b) consider FI limits derived from the definition of control for consolidation purposes;

c) assess current developments on interconnection (principles, practical proposals / tools, transfer from NFI to FI over time);

d) identify which elements from FI should be taken into account to reinforce and prepare interconnection;

e) select which elements from the NFI should be developed to prepare the interconnection with FI.

11 The scope of A4 work in this assessment report is based on a set of fundamental assumptions:

a) FR and NFR: limits

b) Reporting boundaries in FR and NFR

c) Financial materiality

d) Financial statements

FR AND NFR: LIMITS

12 Financial Reporting (FR), either derived from IFRS Standards or from the Accounting Directive (AD), is characterised by rules about recognition and measurement that guide the elements (assets, liabilities, income and expenses) to be included in the primary financial statements or reported in the notes. Those rules limit the possibility of including supplementary elements that have value for the entity, such as certain intangibles, or that could represent a long-term risk for the entity. This limitation of FR makes it necessary to provide another set of information, the non-financial information.

13 Non-Financial Reporting (NFR) tries to cover the limitations of FR, by disclosing information on intangibles that drives wealth creation in the modern economy, as well giving more information about environmental and social risks that affect

the entity. The ESG information often tends to be forward-looking with a longer time horizon, especially around risk disclosures and targets.

14 NFR as established in the NFRD (later included in the AD) is not only trying to cover the needs of stakeholders (investors and others) but to drive changes in behaviour of entities and stakeholders which results in an important difference with FR. As stated in the IFRS Conceptual Framework, FR should be neutral (paragraph 2.13), i.e. should aim at depicting without bias the financial performance of the entity. Although it does not try to influence users' behaviour, it does not mean it would not do it. However, NFRD also serves a policy objective which is to incentivise more sustainable company development.

REPORTING BOUNDARIES IN FR AND NFR

15 FR has a clear outside-in perspective since it aims to capture how transactions and events affect the entity, while there is another complementary perspective that considers the impacts of the entity in the outside world; this inside-out perspective is followed by most of the initiatives that provide standards or recommendations on NFR.

16 In the FR domain (both IFRS and AD), for an entity to include another in the so-called reporting entity (RE), there must be an investment in that entity's equity (and then its assets, liabilities, income and expenses, and the related necessary disclosure would be included in the FR of the RE). Moreover, that investment should imply a control or significant influence over the investee.

17 As for the NFR, the so-called reporting boundary (RB) is less precisely defined and more importantly it varies depending on the initiative. The different initiatives start with the RE but then all initiatives add disclosures referred to other entities (often referred to as upstream or downstream disclosures). This broader boundary might be seen wider in GRI, followed by the GHG Protocol, since both refer to disclosure about aspects/emissions that take place/are due in other entities, and followed by SASB and IIRC that limit this second type of disclosures to those that could be relevant to investors. In any case, within this context materiality is also considered as an element for the decision to disclose or not to disclose information along the value chain.

FINANCIAL MATERIALITY

18 The concept is frequently used, but there is not a proper definition. It is useful to look at the materiality concept as stated in IAS 1 Presentation of Financial Statements: Information is material if omitting, misstating or obscuring it could reasonably be expected to influence decisions that the primary users of general-purpose financial statements make on the basis of those financial statements which provide financial information about a specific reporting entity (paragrah 21).

FINANCIAL STATEMENTS

19 According to IAS 1, financial statements not only include primary statements, this is statement of financial position (frequently known as balance sheet) and statement of profit and loss, and notes to the financial statements, but other documents (statement of comprehensive income, if not included with the statement of profit and loss, statement of changes in equity, and statement of cash flows). Examples are impairments and provision (and the related expenses) that appear in the primary statements, and contingent liabilities in the notes.

20 The management report or the management commentary are not part of the financial statements.

21 The practice statement Management Commentary (MCPS) states that management commentary is within the scope of the Conceptual Framework for Financial Reporting (paragraph IN 4).

22 Consequently, it could be argued that has to be prepared following the same qualitative characteristics, including materiality, although as it well known the document is currently in a review process. That said, the MCPS is not part of IFRS standards, so IFRS financial statements don't necessarily include this document.

DETAILED ANALYSIS OF THE CURRENT STATE OF PLAY

BOUNDARY OF FINANCIAL INFORMATION

23 As stated in the Conceptual Framework of IFRS, FR should be neutral (paragraph 2.13), i.e. should aim at depicting without bias the financial performance of the entity. Although it does not try to influence users' behaviour, there may be consequences in reality – let's think about the change in the leasing standard and how it might have affected users and even companies. However, NFRD (besides ensuring more transparency) also serves as a policy objective to facilitate a market discipline to ultimately incentivise a more sustainable development. Of course, also non-financial information needs to be presented without bias. The fact that often non-financial reporting frameworks at least implicitly include an aspect of behaviour change or transformation of business models and value chains have also to be kept in mind.

24 The idea of integrating the various dimensions of corporate reporting (reporting for investors and capital providers as well as for a broader range of stakeholders) is increasingly supported. In this regard, interconnecting financial and non-financial information appears as a key feature for quality corporate reporting.

25 As regards financial information, its major strength results from the existence of a robust and generally accepted conceptual framework. In this context, the limits of financial information are well established, based upon the following key concepts:

a) USERS: FR (including the management report) focuses on the financial performance of the entity, as opposed to the responsibility of the entity toward the broad society;

b) MATERIALITY: FR is based on the judgement assessment of financial materiality as set up in IAS 1, as opposed to the NFRD perspective (double materiality) that includes an inside-out perspective;

c) REPORTING ENTITY: FR is based on the consolidation perimeter as defined in IFRS 10 and 11, together with IAS 28 for investments in associates, with an assessment of power over relevant activities of another entity, as opposed to the non-financial reporting that generally considers a broader concept, and the so-called reporting boundary includes operations in the value chain (incl. upstream and downstream value chain);

d) TIME HORIZON: FR is normally bound by the business plan horizon of the entity and in some cases to 1-year perspective (such as for assessing going concern, or for contingent liabilities in IFRIC 21), as opposed to non-financial reporting that also considers much longer horizons (e.g. ESG factors that materialise in the long-term);

e) MONETARY CONSIDERATIONS: FR is based on monetary items (i.e. quantification of future cash flows), as opposed to:

(i) non-financial reporting covers primarily non-monetary items, and broader value creation (both for the entity and for the broader society). The management report may partially cover also the value creation perspective (such as competitive position, market, products, reputation, and/or risk profile of the organisation);

(ii) 'pre-financial' information, i.e. ESG factors that may translate in monetary items in an uncertain point in time in the future, which is in scope of the non-financial information. To a certain extent and depending on the relevance of the sectors, entities may partially comment on pre-financial information in the management report;

(iii) pure non-financial information, i.e. ESG factors that are not expected to translate in monetary items in an uncertain point in time in the future, such as negative externalities that do not and will not reasonably have a market price in the future.

f) OTHER CHARACTERISTICS:

(i) FR, and in particular recognition on balance sheet, is based on control of resources (ability to direct the use of an asset and exclude third parties from the economic resources embodied in the resource/asset), and on virtual certainty of claims and obligations, while for non-financial reporting different recognition criteria are applied;

(ii) While forward-looking information may be presented in the management report (limited to the planning horizon of the entity), FR focuses on the effects of past events and on realised performance, as opposed to the non-financial reporting which embraces not only past but also forward-looking information (in connection with its longer-term perspective, which may cover periods after the financial planning of the entity). Some investor and other stakeholder groups are currently even advocating the need for more forward-looking information like climate scenarios.

(iii) FR is based on a request/condition of high degree of reliability to measurement and recognition (assets, liabilities, income and expenses have to be reasonably measurable to be reported), or at least on comprehensive guidance on measurement techniques in order to deal with uncertainty. Part of the non-financial information is also subject to a high degree of uncertainty (due to its forward-looking and longer-term perspective), but with limited guidance on measurement techniques compared to FR. FR is aimed at producing a 'unique number' to be reported, as opposed to the non-financial reporting where different values may prevail under different scenarios;

(iv) Considering the general requirements for listed European entities, FR has normally a half-yearly frequency, with quarterly reporting under specific circumstances, as opposed to the NFRD report which is normally prepared yearly;

(v) FR is mainly numerical in nature and narrative disclosures normally are required to illustrate the basis of estimation or to provide context to the numerical information reported, as opposed to NFR, for which narrative information may have a value on its own (this is also to be put in connection with the higher level of measurement uncertainty of certain ESG factors as opposed to financial information). Of course, NFR similar to FR also includes appropriate numerical information with contextual narratives;

(vi) FR reflects historical (backward-looking) information whereas NFR, in addition, includes information subject to management decisions (e.g. the assumptions used to assess ESG risks and remediation plans) and other forward-looking information in general.

THE DOUBLE MATERIALITY

26 Materiality in this assessment report is to be understood as the approach for inclusion and prioritisation of specific information in non-financial or sustainability reports, considering the needs and expectations from the stakeholders of an organisation.

27 Three main perspectives can be distinguished on this topic:

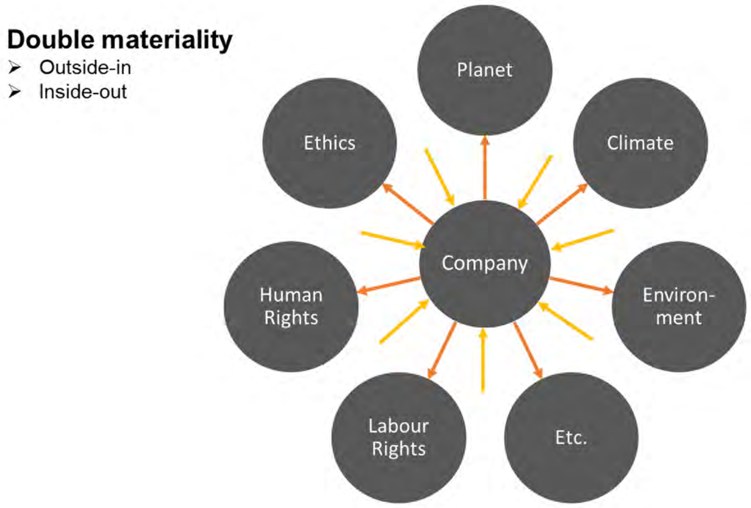
a) the first one (financial materiality) puts the emphasis on risks to the reporting entity's financial performance (outside-in, including the so called rebound effect);

b) the second one (environmental and people materiality) concentrates on the impacts on people, communities and the environment connected to a reporting entity's activities and business relationships (inside-out);

c) the third one (double materiality) recommends covering both in their own right, while recognising they overlap in part.

28 Generally, the relevance of financial information in Financial Reporting and non-financial information in Sustainability Reporting is considered from different perspectives. Companies operate within the sphere of different stakeholder's interests in addition to the interests of the shareholder, who are seen as primary financial stakeholders (providers of financial capital).

Figure 1



29 Figure 1 above illustrates the perspectives as being outside-in and inside-out for each of the areas in Reporting. Traditionally, the perspectives of the users of financial and non-financial information regarding Sustainability have been as follows:

Figure 2

PRIMARY STAKEHOLDERS	PERSPECTIVE	INTEREST
Investors, e.g. shareholders and lenders; other stakeholders that have a business relationship like suppliers, customers, employees	Outside-in	Risk and opportunities for the company, e.g. when the activities require use of limited resources, exposing the company to increased costs and possible lower margins, resource efficiency and cost savings as well as developing new products, etc.
Other stakeholders, e.g. customers, consumers, employees, NGO's, governmental or local bodies, but also investors	Inside-out	Impact of products or processes on the environment or society, e.g. micro plastic in drinking and sea water or welfare of livestock.

30 In the past few years, there has been a movement amongst investors also to consider NFR from the inside-out perspective, mainly amongst investors with a mid- and long-term or impact perspective, e.g. pension and investment funds. There is also increasing consensus that in the mid- to long-term the two perspectives of the different stakeholders are quite aligned. Only business models that are accepted by broader society will prosper causing also investors to look at the social impacts of business models.

31 According to the current NFRD, companies shall consider both perspectives. This is referred to as double materiality. For financial reporting, the outside-in perspective is, at least in part, considered in IFRS by the impact of the risks and opportunities on recognition, measurement and disclosure. Risks are considered e.g. in the measurement of assets and provisions, as a specific type of liabilities; opportunities are considered e.g. in recognition of development costs.

The analysis performed in this assessment report leads to consider that the double materiality and the rebound effect give an opportunity for interconnection.

INTERCONNECTION BETWEEN FI AND NFI AND THE REBOUND EFFECT

Financial Information

32 Under Article 2 of the IFRS Foundation Constitution, revised in 2018, the objectives of the Foundation are:

'To develop, in the public interest, a single set of high quality, understandable, enforceable and globally accepted financial reporting standards based upon clearly articulated principles. These standards should require high quality, transparent and comparable information in financial statements and other financial reporting to help investors, other participants in the world's capital markets and other users of financial information make economic decisions'.

33 Financial information is designed to provide reliable information, which is mainly retrospective, and is measured in monetary terms.

34 Thanks to its conceptual foundation and clear limits financial reporting can be verified and may continue to serve its fundamental role of informing existing and potential investors, lenders and other creditors about:

a) the economic resources of the entity, claims against the entity and changes in those resources and claims; and

b) how efficiently and effectively is the entity's management in governing the entity.

35 The content of financial reporting is defined on the basis of an assessment of material information. IAS 1 requires disclosure in the notes of information that is not presented elsewhere in the financial statements but is relevant to an understanding of them. Information will be relevant if it could reasonably be expected to influence decisions made by investors.

36 The IASB notes that the management commentary complements the financial statements. The IASB would expect management to report on environmental and social issues to the extent necessary for primary users of financial statements to form their own assessment of the company's longer-term prospects and management's stewardship of the business.

37 Financial statements do not and cannot satisfy the needs of each primary user and even less of all interested parties. Financial statements focus on common investor needs and are not intended to report to all users on all matters that may be of interest to them. However, an underlying concept generally accepted is that information of interest for primary users[1] also is of interest for other stakeholders.

Non-financial Information

38 Users of broader corporate reporting need appropriate information to identify and analyse the key risks and opportunities that will influence the company's future development and performance, including information that is relevant for both the financial materiality (outside-in perspective) and the non-financial materiality (inside-out perspective).

39 This inside-out perspective of NFI is generally not considered in Financial Reporting, except when the company's impact on environment and society may lead to a rebound effect, also called dynamic materiality[2]. Often, a rebound effect has a long timeframe and may be difficult to predict. For this reason, companies tend only to consider it in the financial reporting, when the impact shows up in the planning horizon.

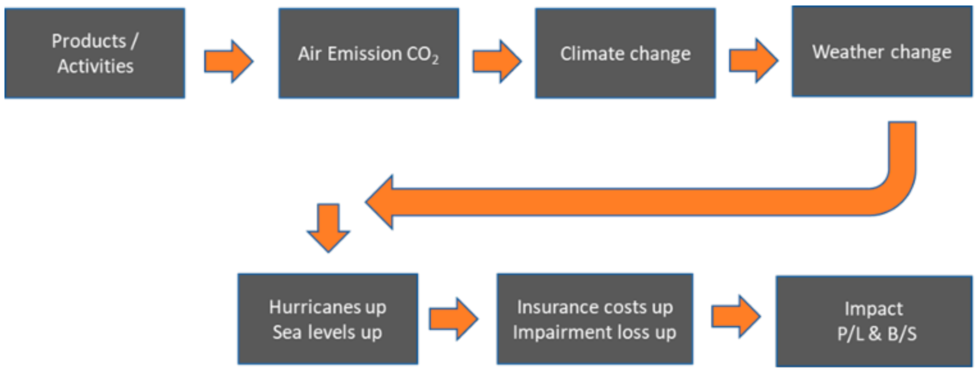
1 In the IFRS Conceptual Framework, the terms 'primary users' and 'users' refer to those existing and potential investors, lenders and other creditors who must rely on general purpose financial reports for much of the financial information they need.

2 See 'Statement of Intent to work together towards comprehensive corporate reporting' (CDP, CDSB, GRI, IRRC, SASB, September 2020) 'Dynamic Materiality' refers to the fact that the nature of sustainability topics, including their interest to different types of users of information and their influence on companies' performance, can change, sometimes slowly but sometimes rapidly

Inside-out with Rebound effect

40 An example of financial and non-financial interaction and interconnection is:

Figure 3



41 In financial reporting, the impact from climate change, and other impacts from environment or society, is captured by IFRS in the rules for recognition, measurement and disclosure, when the impact is outside – in or by the rebound effect. The latter might sometimes capture the dynamics of inside-out factors (e.g. outcome of the entity's operations on the broader society) that at a later stage clearly will be translated into outside-in factors (e.g. long-term financial implications).

From ESG to Financial materiality: the (dynamic) Monetary Line

42 The Monetary Line (Figure 4) illustrates a type of timeline from environmental and social materiality to financial materiality. The analysis followed this assessment report is structured on this way.

43 Environmental and social materiality in the context of the Inside–Out perspective is broad and related to both retrospective issues/impacts and future oriented issues/impacts. Some issues may return and hit the company.

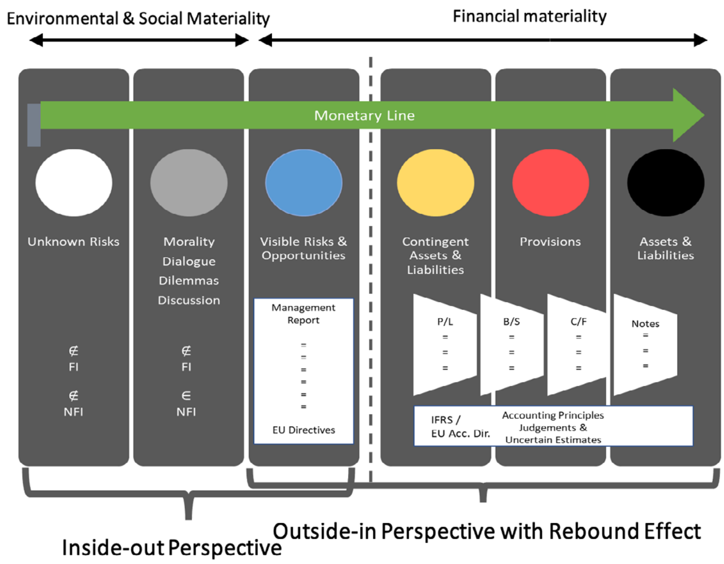
44 This 'rebound effect' usually materialises in financial statements in future accounting periods although it could hit financial statements of the same accounting period in some cases (e.g.: where GHG emissions have a direct rebound effect on the entity, such as not meeting car fleet emission targets that result in a fine).

45 Where the rebound effect from the Inside–out perspective translates into an Outside-in perspective – the user of the FR will expect information in the Management Report about the risks or opportunities in a foreseeable period, unless the impact is already captured in the financial statements. The assumptions here are that the capturing is regulated by the FR's rules or management has acknowledged the rebound effect as a risk or opportunity relevant for FR users' information.

46 The main users of the 'blue to black' as described in Figure 4 zones are decision users who may act based on reporting as to financial materiality and act because they are partners in a financial relation.

47 The main users of the grey and often of blue zone are position users who have a direct or indirect relation with the company but they do not receive information with the purpose of making economic transactions.

Figure 4: The 'Monetary Line'



48 The black, red and yellow zones are quite 'mature' (i.e. able to be meaningfully translated into monetary terms), and the IFRS standards are quite precise as to assets, liabilities, provisions and contingencies with well-defined criteria for accounting.

49 If a risk or opportunity is visible but outside the yellow, red or black zones, then a description of the risk or opportunity is normally included in the Management Report – with a certain flexibility for the scope and details. Normally means when the management has acknowledged the risk or opportunity and with a sudden financial impact. If there is a rebound effect but not acknowledged the issue is in the grey zone.

50 The grey zone is where the FR is not present, but where the NFR has a focus. NFR addresses the responsibility of a company, but in the grey zone it is not possible to estimate impacts of risks and opportunities in monetary values or in another measurable way. This relates to all issues of morality, dialogue, dilemmas and discussions of what the company ought to take responsibility of – actions, changes, paid for or to. Soft law responsibility to respect human rights is an example in the grey zone. The potential adverse impact of the company that has not been accepted by the management as risk to the company may be included here as well. If it is accepted as a risk by the management, then is moved to the blue zone with a description in the Management Report,

51 The direct connectivity between FR and NFR is placed in the blue – black zone, while the indirect connectivity is in the blue or grey zone.

52 The reporting boundary in the yellow – black zone is aligned with the power of control and significant influence over the investee (and the concepts of assets, liabilities, income and expenses are clearly stated in FR). In the blue zone the boundary also includes where the company takes soft or semisoft law responsibility in a rebound effect perspective. Here it is the management of the company who set the boundary or where standards clearly set the boundaries. In the grey zone the reporting boundary is less precisely defined. The grey zone is where the stakeholder involvement for identifying the materiality is relevant and where the boundary is a result of the materiality process or the applied standards.

53 The white zone represents the uncertain future where risks or impacts are still unknown and therefore not included in NFR or in FR. Unknown issues may be visible suddenly or during a period and become for instant dilemmas in the grey zone or risks in the blue zone or even contingent in the yellow zone.

54 Issues in the zones may change and move to the next zone or jump to another zone – from left to right. From ‘non-financial company issues’ to ‘financial company issues’.

55 Interconnection can happen along the ‘monetary line’.

LIABILITIES, PROVISIONS AND CONTINGENT LIABILITIES

56 In this section an assessment of how much liabilities, provisions and contingent liabilities (IFRS definitions) cover ESG matters was analysed. A ‘gap’ means when ESG matters are not covered.

57 Information about outflows of economic resources is relevant for financial stakeholders when forecasting future cash flows. Liabilities, provisions and contingent liabilities contain such information, if the respective definition and recognition criteria are met.

58 Against this background, the information space covered by financial reporting and respective limits when looking at ESG-related matters need to be assessed.

59 ESG-related matters may not be captured by liabilities, provisions and contingent liabilities as accounted for under IFRS (see Figure 5)[3], in the following situations:

a) If a present obligation as a result of past events does not (yet) exist;

b) If no outflow of an ‘economic’ resource would (yet) result for the reporting entity;

c) If an outflow of an economic resource is not (yet) probable or may even be remote;

d) If no reliable estimate can (yet) be made.

Figure 5

2 Probability of an **outflow of economic resources**

1 Probability of the existence of a **present obligation**

	Certain / virtually certain	Probable	Possible	Remote
Certain / Probable	Recognition of **liability** Disclosure if amount cannot be estimated	Recognition of **provision** Disclosure if amount cannot be estimated	Disclosure as **contingent liability**	-
Possible	Recognition of **liability** Disclosure if amount cannot be estimated	Recognition of **provision** Disclosure if amount cannot be estimated	Disclosure as **contingent liability**	-
Remote	-	-	-	-

3 **Reliable measurement** of amount *(addressed in individual boxes)*

3 IAS 37 does not contain specific accounting guidance as to the treatment of a ‘possible obligation that arises from past events and whose existence will be confirmed only by the occurrence or non-occurrence of one or more uncertain future events not wholly within the control of the entity’ for which the outflow of an economic resource is virtually certain. However, as a ‘possible asset that arises from past events and whose existence will be confirmed only by the occurrence or non-occurrence of one or more uncertain future events not wholly within the control of the entity’ for which the inflow of an economic resource is virtually certain shall be recognised as an asset (see IAS 37.33), an analogous approach, i.e. recognising a liability in the above scenario, seems applicable.

60 These limits of financial reporting and the resulting 'gap' are primarily the result of the current environment regarding ESG-related matters, especially due to the fact that, in most cases, a price and a market for negative externalities are missing, as well as their specific nature (e.g. long and / or uncertain time horizons). In addition, the IFRS concepts imply an outside-in perspective.

61 The 'gap' differs across IFRS preparers depending on their regulatory environment, as some information on ESG-related matters is captured by financial reporting requirements other than IFRS.

62 This 'gap' would shrink if more legal/regulatory measures were taken (e.g. pricing of negative externalities similar to the EU ETS, adoption of mHRDD laws, prohibition of activities with above-threshold GHG emissions, etc.), if entities were to commit more to voluntarily reporting, and if investors were to incorporate more ESG-related matters when making decisions.

63 This 'gap' in the information space regarding ESG-related matters can be captured by non-financial reporting as an instrument that is both interconnected with and complementary to, financial reporting in providing useful information to stakeholders.

64 A detailed assessment of location of NFI is presented in Appendix 4.

REPORTING ENTITY VS REPORTING BOUNDARY

65 The Reporting Entity /Reporting Boundary refers to the scope of entities/activities included in the preparation of corporate reporting. This section assesses how the different NFI initiatives (including the NFRD) are compared with each other and with the IFRSs reporting entity definition.

66 In Financial Reporting the Reporting Entity refers to a single entity, or a group of entities. In that case it includes not only the parent company but also those investees that are under the control of the parent (including joint control), as well as those over which any of them has a significant influence. Then, their assets, liabilities, income and expenses, and the related necessary disclosure would be included in the consolidated financial statements of the Reporting Entity, based on the accounting rules, which follow an outside-in perspective.

67 In Non-Financial Reporting, the approach to the boundaries is not precisely defined, and this is especially relevant when an inside-out materiality perspective is adopted. It is key for the NFR standard setter to be exact on the extent of the term undertaking (used in the NFRD), since it will establish the limits of the Reporting Boundary and will condition the amount of non-financial information that should be provided.

68 The implications of the differences between the Reporting Entity and the Reporting Boundary should be taken into account, and clear guidelines for the second are needed. The connectivity of Financial Reporting and Non-Financial Reporting will vary depending on the decision made about the Reporting Boundary.

69 Table 1 below is an analysis of reporting boundaries in different NFI framework relevant for connectivity purpose. A more detailed assessment supporting the table below can be found in the Appendix 1B: Reporting Boundaries in different initiatives.

Table 1: Reporting Boundary

NFI COMING FROM	GRI	GHG	SASB	IIRC	CDSB	NFRD
Reporting Entity / Undertaking	x	For scope 1	x	x	x	x
Business relationship (e.g. value chain)	x	For scope 3			Only encouraged	
Premises of purchased energy		For scope 2				
Risks, opportunities that influence the organisation's ability to create value				x		
Information to understand the effect on the entity's financial condition or operating performance			x			
Upstream supply chain		For scope 3				NFRD Guidelines
Upstream & downstream		For scope 3				Climate-related guidelines

70 In the examined frameworks, the Reporting Boundary includes the financial Reporting Entity (with the exception of WICI) and proposes additional non-financial disclosures depending on the topic reporting on upstream and/or downstream activities. But there are differences between the different initiatives that deal with Non-Financial Reporting. Although the NFRD only refers to the undertaking, its Guidelines refer to the upstream supply chain, and the Guidelines on Climate-related aspects are in line with the Greenhouse Gas (GHG) protocol.

71 This broader Reporting Boundary appears most in Global Reporting Initiative (GRI), followed by GHG Protocol (both refer to aspects/emissions that take place/are due to other entities outside the financial Reporting Entity), and followed by the Sustainability Accounting Standards Board (SASB) and International Integrated Reporting Council (IIRC) that only require NFI to the extent it could be relevant for investors to understand the organisational performance in respect to sustainability issues (recognised as being typically limited to risks and opportunities associated with these entities). The Climate Disclosure Standards Board (CDSB) does not require the provision of quantitative information originating outside the Reporting Entity, also it encourages when material to the Reporting Entity. However, it requires qualitative information about environmental impact originating from third parties on whom the reporting organisation depends.

72 The lack of precise criteria for Reporting Boundary leads to a lack of transparency, comparability, reliability and potential impression management.

73 The difference between Reporting Entity and Reporting Boundary has some implication for the double materiality. It should be highlighted that for financial materiality the outside-in perspective follows the Reporting Entity notion (IFRS perimeter), while for social and environmental materiality an inside-out perspective is adopted, which as described above considers a broader Reporting Boundary notion (and although the 'out' part is the same in Reporting Entity and Reporting Boundary, this is the society at large, the 'in' part is not).

TO WHAT EXTENT ESG MATTERS CAN BE REASONABLE EXPECTED TO BE INCLUDED IN FINANCIAL REPORTING?

74 Financial statements are directed to investors, lenders and other creditors. They focus on common investor needs and are not intended to report to all users on all matters that may be of interest to them.

75 Even for entities that operate business in sectors exposed to emerging ESG risks and in theory are or may be financially exposed to ESG factors, whether and to what extent ESG matters will be reported will depend on the judgement applied by the management when assessing the materiality (as defined by the IASB, so serving the reporting needs of primary users/investors). Key reference point is the IASB Practice Statement – *Making Materiality Judgements*, which constitutes non mandatory guidance and, as such, application thereof is not required to claim compliance with IFRS Standards. Therefore, it cannot provide the necessary comparability of information provided by different entities.

76 A specific area of emerging focus is represented by the disclosure of information about stranded assets in the sectors more at risk of negative impacts due to the climate transition risk. Investors increasingly need information of a forward-looking nature to avoid overestimation of future cash flows and properly assess investment opportunities and risks. However, such information will not be normally disclosed in financial reporting, at least not before scenario analysis is incorporated in the management strategic and risk management process. It will also not be captured by the reported performance measures, until the negative impacts are reliably measurable and incorporated in the cash-flow estimates used to calculate the recoverable amounts. This may occur too late for allowing effective investment decisions.

77 A more detailed assessment supporting the statements above can be found in the Appendix 2B. This appendix also includes an analysis of the accounting treatment of emission rights.

HOW THE ISSUE OF UNRECOGNISED INTANGIBLES IMPACTS THE RELEVANCE OF FINANCIAL REPORTING

78 Intangibles represent a fundamental difference between FI and NFI. Acquired intangibles are reported in the financial statements whereas there are limited instances where it is possible to recognise internally generated intangibles. Some say this is a limit in financial reporting and better information would be needed both for broader stakeholders (e.g. value creation) and for providers of financial capital (e.g. narrative information or specific KPIs in the notes).

79 From a financial materiality perspective, to date there seem to be no viable solution to completely solve in the near future this issue:

a) to date the IASB doesn't have an active project nor a research project aimed at modifying the recognition and measurement rules, in order to enhance the relevance of the financial information about intangibles. The IASB is instead proposing changes to its MCPS, which also would contain non-binding guidance on how to disclose narrative managerial information that would complement the information provided in the financial statements (IFRS performance measures and disclosures provided in the notes). As such, the solution identified is to improve narrative information about the resources and relationships that contribute to the entity's long-term success and do not qualify for accounting recognition or disclosure. However, the resulting information will remain voluntary in nature, thus it cannot provide for comparability;

b) several initiatives are ongoing to overcome the issue, mainly in the direction of additional and more structured disclosure that would enable users to develop their own assessment of future cash flows expected to be generated through the unrecognised intangibles. However, these works are still in a seminal stage of development and it is unclear whether and when the IASB will start a project on internal intangibles;

c) Also, assuming that a suitable solution for additional disclosure can be soon developed by the IASB, it will always be limited to the information needs of providers of financial capital.

80 While there does not seem to be an obvious 'way out' in the context of financial reporting standard setting, a high-quality standard setting solution is needed to provide for an essential element of NFI (intangibles). Market practice in this

area sees growing diffusion of practices that follow frameworks developed by private sector initiatives, which provide a good basis for further conceptualisation, however due to their non-binding nature, they cannot provide for the need comparability and high quality (including audit/assurance and enforceability). In addition, the different solutions are not converged at this stage, adding to complexity and lack of comparability.

81 A more detailed assessment supporting the statements above can be found in the Appendix 2C.

ILLUSTRATION OF ESG TOPICS OUTSIDE THE IFRS LIMITS

82 As a high-level presentation of the identified boarders of FI, a list of selected examples of information not covered by IFRS is shown in a matrix table (Figure 6). The matrix is built up to explain the main features of such information. The list is by no means exhaustive.

83 The matrix is three-dimensional:

a) In vertical, the information not covered by IFRS is grouped by the reasons for not being covered.

b) In horizontal, the various sources of monetary and non-monetary flows to and from a Reporting Entity are grouped into three main categories:

(i) Products & Services: End-to-End includes Sales, Procurement, Waste, Emissions, and Investments;

(ii) Human Resources & Management includes those mentioned; and

(iii) Funders, Equity Interests & Authorities include Banks and Other Loan Providers, Non-controlling Interests, Equity Investments, Collaborators and Public Authorities.

c) For each combination of reason by main category, the information not covered by IFRS is grouped into those concerning the Outside-in perspective (yellow) and those concerning the Inside-out perspective (orange).

Figure 6: Inside out / outside in examples

List of examples (not exhaustive)	Products & Services: End-to-End	Human Resources & Management	Funders, EQ Interests & Authorities
Not in Focus for Investors (Materiality Choice)	N/A	N/A	N/A
	Company's purpose & positive impact. Cost on nature from using or damaging it.	Precautions to prevent violations of labour/human rights. Diversity information/Mgmt. skills & experience	Precautions to prevent money laundering/ bribery/corruption.
Not Meeting Definition of Control	Revenue/costs of transactions when company is acting as an agent.	Cost of employees or mgmt's negative behaviour. Benefit from intellectual resources.	Cost of negative ethical behaviour of banks, collaborators, assoc., non-controlling interests.
	Cost of suppliers' use/damage of nature.	Cost of health problems of suppliers' employees. Benefit from suppliers' R&D activities	N/A
Not Meeting Definition of Assets and Liabilities	Cost to company from use/damage of nature. Benefit from unextracted natural resources/reuse of waste/products.	Cost to the company from health problems. Benefit from R&D activities, not recognised.	N/A
	Cost to society from use/damage of nature.	Cost to society from health problems. Benefit to society from R&D activities	Cost to society from unprevented money laundry/bribery/corruption
Being Forward-looking Information	Economic risks (e.g. market risks, supply risks), except when relevant for measurement.	Benefit from employees' talent & skills	Tax planning activities
	Planetary boundary risks SDG 2030	Benefit to society of previous employees' talent & skills	Cost to society of tax planning activities
Boundaries / Business Relationships		Outside-in: Risks & Opportunities	Inside-out: Impacts

84 The main reasons (vertical categories) for information not covered by IFRS might change over time. The categories 'Not in focus for Investors' and 'Being Forward-looking Information' may change in short or medium term, while the categories of 'Not Meeting Definition of Control' and 'Not Meeting Definition of Assets and Liabilities' might be outside the scope of FI for a fairly long term.

85 A more detailed illustration of the limits of IFRS standards on a selection of topics (sales, waste,...) is presented in the Appendix 2A and an illustration of the boundaries of financial information is presented in Appendix 5.

GAPS NFRD VS FINANCIAL REPORTING

86 This section presents the assessment of the boarders between Financial Reporting and Non-Financial Reporting: using the NFRD as reference point, where Financial Reporting stops and where Non-Financial Reporting starts and which gaps exist between FR and NFR have been analysed (see Figure 7).

87 For this purpose, the starting point was to list the NFRD requirements and consider whether these requirements are included in financial reporting (IFRS Financial statements incl. notes) and/or the (revised) IASB management commentary[4].

88 The analysis led to a list of requirements not included in FI or 'identified gaps', presented in the last column of figure 5 below. Then the analysis of whether these gaps would be closed by information in the management report (requirements according to EU Accounting Directive) was performed (see next section: *Panorama of NFI Frameworks and connectivity models*).

89 This analysis shows that the majority of NFRD requirements are not included in the financial statements. The management commentary offers slightly more overlap, although this is voluntary. The identified gaps offer opportunities for creating connectivity.

Figure 7

NFRD REQUIREMENTS	FINANCIAL STATEMENTS INCL NOTES (IFRS)	(REVISED) MANAGEMENT COMMENTARY (NFI)	WHAT IS LEFT OUT / IDENTIFIED GAPS
Information to the extent necessary for an understanding of the undertaking's development, performance, position and impact of its activity, *(Double materiality)*	The outside-in perspective offers theoretical anchor points	*Grey area:* Pre-financial info in the planning horizon Inside-out with rebound impacts on the company ('rebound effect') in the planning horizon	Inside-out perspective Outside-in outside the boundaries of FI
relating to, as a minimum, environmental, social and employee matters, respect for human rights, anti-corruption and bribery matters, including:	Possible overlap on: • employee matters with IAS 19 but only partial • IAS 37 contingent liabilities, legal claims • IAS 1 risks affecting going concern or risks and uncertainties affecting the estimates • for entities operating in high risk sectors for one of the topics, depending on judgemental materiality assessment, partial information may be found.		Substantial part of the requirement
(a) brief description of the undertaking's business model;	None	Included in management commentary in relation with the value creation for the entity and its shareholders	Aspects other than the value creation for the entity and its shareholders

4 Based on the information publicly available about the tentative decisions of the IASB up to October 2020 as part of the ongoing project on Management Commentary Practice Statements.

NFRD REQUIREMENTS	FINANCIAL STATEMENTS INCL NOTES (IFRS)	(REVISED) MANAGEMENT COMMENTARY (NFI)	WHAT IS LEFT OUT / IDENTIFIED GAPS
(b) a description of the policies pursued by the undertaking in relation to those matters, including due diligence processes implemented;	None	None	Entire requirement
(c) the outcome of those policies;	None	None	Entire requirement
(d) the principal risks related to those matters linked to the undertaking's operations including, where relevant and proportionate, its business relationships, products or services which are likely to cause adverse impacts in those areas, and how the undertaking manages those risks;	Possible overlap with IAS 37 disclosure in highly exposed segments.	Possible overlap with management commentary information	Substantial part of the requirement
(e) non-financial key performance indicators relevant to the particular business.	None	In progress: identification of management measures and indicators (MMI) that need to be addressed in management commentary	Entire requirement

PANORAMA OF NFI FRAMEWORKS AND CONNECTIVITY MODELS

90 The issue of interconnectivity between financial and non-financial reporting has been addressed by various financial reporting standard setters, non-financial reporting initiatives and standard setters, professional organisations, and regulators.

91 A detailed assessment of the existing major NFI frameworks on which connectivity approaches are considered has been performed and is presented in Appendix 3.

92 A key takeaway drawn from that analysis is that the existing non-financial reporting landscape regarding connectivity issues is rather diverse in terms of which reporting connectivity approach is applied.

93 First, a distinction is possible between quantitative and qualitative methods or models as an approach to connectivity:

a) When considering quantitative models, scenario analysis, impact valuation, disclosure of indicators with ESG attributes, risk quantification, qualitatively linking changes in ESG indicators to financial performance, disclosure of ESG indicators in the mainstream report, disclosure of financial indicators in the ESG report, disclosure of additional capitals and disclosure of targets were identified as possible connectivity approaches.

b) When considering qualitative models, qualitative disclosures regarding value creation and strategy, risks & opportunities, governance, performance and assets & liabilities, as well as qualitative impact analysis and the disclosure of measures were identified as possible connectivity approaches.

94 The location and scope of NFI reporting according to the existing frameworks have also been analysed:

a) Some frameworks (e.g. IIRC, World Economic Forum – International Business Council (WEF-IBC)) suggest that connectivity information should be disclosed in the management report;

b) Others, such as the GRI, encourage organisations to include connectivity information in a separate report outside the mainstream report, i.e. in a separate non-financial or sustainability report;

c) No framework suggests including connectivity information directly in the financial statements, although the Task Force on Climate-related Financial Disclosures (TCFD) suggests reporting the climate-related disclosures in the annual report, which is called the 'mainstream report'.

95 Regarding the reporting boundary, most frameworks do not apply the control concept inherent to IFRS, but consider a value chain concept, including also upstream and downstream effects.

96 Our analysis led to a detailed map of applied interconnectivity approaches by the various initiatives (see Figure 8). The detailed analysis is presented in Appendix 3.

Figure 8: Type of connectivity

QUANTITATIVE ANALYSIS	
a) Scenario Analysis	TCFD, WEF-IBC, PTF on climate risk
b) Impact valuation	Value Balancing Alliance, IMP, WEF-IBC, capitals coalition, multi capitals accounting
c) Indicators with ESG attributes	EU Taxonomy, selected SASB indicators, TCFD, non-binding guidelines
d) Risk quantification	Applied by some companies as part of the materiality analysis (GRI, NFRD), TCFD, non-binding guidelines
e) Qualitatively linking changes in ESG indicators to financial performance	SAP
f) ESG indicators in mainstream report	Accounting Directive, SASB, WEB-IBC, NFRD (option), TCFD, non-binding guidelines
g) Financial indicators in ESG report	GRI
h) Additional capitals	IIRC
i) Targets	GRI, TCFD, non-binding guidelines, NFRD (part of concepts)

QUALITATIVE ANALYSIS	
a) Value creation / strategy	IIRC, EU Taxonomy, TCFD, non-binding guidelines, NFRD
b) Risks & Opportunities	IIRC, EU Taxonomy, TCFD, non-binding guidelines, NFRD
c) Governance	IIRC, TCFD, NFRD
d) Performance	IIRC, TCFD
e) Assets / liabilities	IIRC, TCFD, non-binding guidelines
f) Qualitative impact analysis	GRI, SDG reporting guides, WEF-IBC, Value Balancing Alliance (VBA), IMP, capitals coalition, multi capitals accounting
g) Measures	GRI, TCFD, non-binding guidelines, NFRD

EXPERIMENTS TO INCLUDE NON-FINANCIAL INFORMATION IN 'FINANCIAL-LIKE' MODELS

97 Many experimental models have been developed and tested in order to integrate capitals other than economic capital (this is, natural, human, and social) and a larger definition of performance into financial reporting. Those models can be classified into three categories: the full cost models, the Sustainability Assessment Models (SAM) and the integrated models. A detailed analysis can be found in Appendix 7.

ANCHOR POINTS NFRD/FI AND POSSIBLE INTERCONNECTIVITY MODELS

98 In the previous sections of this assessment report, the NFRD requirements that present an overlap with requirements of financial reporting have been analysed and the NFRD requirements that are outside of the financial statements have

been described. This allowed identifying a number of anchor points, i.e. limits of financial and non- financial reporting that need to be considered when developing interconnectivity at the level of each respective requirements.

99 Per each anchor point was assessed whether the prevailing NFR frameworks/standards/guidelines offer possible connectivity models. Figure 9 below summarises the results of this assessment, which are explained in the paragraphs below in more detail.

Figure 9

NFRD	GAP items out of FFSS	Possible directions
Double materiality perspective	Inside-out perspective	Separate assessment of materiality
(a) business model	value creation for providers of other than economic capital	Consistency with assumptions in FFSS /Cross-reference NFI narrative-MC (e.g. GRI or IIRC)
(b) policies and due diligence	entire requirement	No connectivity solution in NFR initiatives (possible limited overlap in MC for climate risk)
(c) outcome	entire requirement	Qualitative and quantitative impact valuation analysis; Disclosure of additional capitals; NF targets and likely impacts; narrative on financial performance, assets & liabilities.
(d) risks and risk management	substantial part of the requirement	1. Qualitative/quantitative solutions (e.g. GRI, TCFD, IIRC), such as scenario analysis or risk quantification. 2. Principle-based approach to a report that covers entire double materiality (IIRC) 3. Qualitative risk disclosures/qualitative TCFD disclosures
(e) NF KPIs	entire requirement (some overlap in MC per EU Accounting directive)	1. Quantitative: impact valuation/indicators with ESG attributes (e.g. EU Taxonomy, SASB, TCFD and EU NBG) 2. Narrative about how changes in ESG indicators impact financial performance 3. Present ESG indicators in the mainstream report 4. Present financial indicators in the ESG report

NFRD OVERARCHING DISCLOSURE OBJECTIVE

100 The NFRD requires to:

a) provide information to the extent necessary for an understanding of the undertaking's development, performance, position and impact of its activity (i.e. double materiality perspective);

b) relating to, as a minimum, environmental, social and employee matters, respect for human rights, anti-corruption and bribery matters.

101 When comparing this overarching disclosure objective of the NFRD to the scope of financial reporting (financial statements and notes), it can be noted that the inside-out perspective proper of the NFRD double materiality will be outside the financial reporting.

Brief description of the undertaking's business model

102 When comparing the NFRD requirement to describe the business model (double materiality perspective) with the scope of financial reporting (financial statements and notes), there is a limited overlap of information. When considering also the management commentary (in particular taking into account the directions of the ongoing IASB project), the overlap relates to the value creation for the entity and its providers of financial capital. The NFRD requirements that cannot be expected to be found in the scope of financial statements, notes and management commentary relate to aspects other than the value creation for the entity and its providers of financial capital, especially the value creation and impacts with regards to other stakeholders.

103 When developing possible approaches to connectivity, future standards should consider that a substantial part of this requirement (value creation for the entity and its providers of financial capital) is already expected to be in the revised management commentary. Thus, there is a risk that information will be provided twice if no interconnectivity between management commentary and NFI is created.

104 The following possible connectivity model may be explored: narrative disclosure/ description of the business model (for strategy and value creation), including how ESG topics affect value creation. Guidance is available from various frameworks (e.g. GRI).

Description of the policies pursued by the undertaking in relation to those matters

105 The NFRD requires disclosure of a description of the policies pursued by the undertaking in relation to those matters, including due diligence processes implemented (i.e. identification and assessment of adverse impacts, management approach, targets, measures, …). When comparing this NFRD requirement with the scope of financial reporting (financial statements and notes, but also management commentary), the entire requirement is out of the scope of financial reporting. However, no requirements about reporting on policies on climate risks in the management report or management commentary have been found, so potentially there is a limited overlap.

106 No suitable connectivity models have been identified. This may not be an issue per-se, as there may only be a limited or no need to create connectivity for policies. It may also be worth noting that various non-financial reporting frameworks (e.g. GRI) offer good guidance the description and structure of policies.

The outcome of those policies

107 The NFRD requires disclosure of a description of the outcome of the policies, including the impact of the policies on its business. The entire requirement is not included in the financial reporting (financial statements and notes). The following NFRD required contents are not included:

a) Information needed to get an understanding of the undertaking's development, performance, position affected by ESG topics (the result of the outcome of the ESG policies on the financial performance (qualitative or quantitative information), i.e. outside-in perspective. This type of information is typically not included in FR unless it meets the recognition criteria.

b) Analysis of the social and environmental impact of business activities (qualitative or quantitative information) and its 'rebound effect' on the company in the future (big social or environmental impact may have currently little or no financial relevance for a company but this may change over time).

108 Future standards should consider that, except for climate risks or other material ESG risks in the management commentary, there is no overlap between financial reporting and NFI reporting on the outcome of ESG policies. This also means that there is no risk of providing the same information twice.

109 However, it should also be considered that there are two potential missing elements that may be relevant to stakeholders:

a) An analysis of the outcome of an ESG policy on the company's development, performance and position. The likely result of the outcome of ESG policies on the financial performance – qualitatively or quantitatively – is not required by the financial statements nor the NFRD (companies are only encouraged to consider the relationship between financial and non-financial outcomes);

b) An analysis of the outcome of an ESG policy on the social and environmental impacts of business activities (quantitative or qualitative information) with their 'rebound effect' on the company in the future (i.e. on the company's development, performance and position). The NFRD only requires an analysis of the social and environmental impact as part of the materiality analysis in determining if a non-financial matter is necessary for an understanding of the undertaking's impact of its activity, but not an analysis of how this may influence the financial performance of a company in the future (big social impacts may have little or no current financial relevance for a company in a current period but this may change over time and may even affect 'the license to operate' for a company).

110 The following potential interconnectivity methods may be considered:

a) *Disclosure of non-financial targets, including explanations of the likely financial impact on both, the company's performance and the social and environmental impacts:* This approach has the advantage of providing quantitative information on non-financial targets, with explanations of financial impacts, which should be useful for stakeholders. However, under this approach, the outcome of policies should not only include disclosure of targets, but also if targets are met. For this to be feasible, it is questionable how one can explain the financial impact of the targets without using other quantitative methods, like impact valuation (for environmental or social impacts) or other quantification methods (for impact on companies' performance).

b) *Qualitative and quantitative impact valuation analysis:* Explanation of how the outcome of policies affect social external impacts (environmental, social, economic) of business activities and explanation about how this in turn affects the entity's business model now and in the future. The analysis can be done qualitatively and quantitatively. This approach has the advantage of providing qualitative or quantitative information on connectivity issues relating to the outcome of policies on social impacts, including the rebound effects on a company's financials and business model. This offers the opportunity of achieving a holistic analysis with regard to the different connectivity issues. However, qualitative analysis only may not be sufficient. Detailed guidance would need to be available (standardisation of impact valuation) in order to ensure comparable analyses and application. More detailed guidance on impact valuation is currently being developed by various organisations. In addition, most impact valuation frameworks look at social impacts and currently there is little guidance on the rebound effects of social impacts on a company's financial statements. More research and guidance may need to be developed.

c) *Qualitative Analysis of financial performance, assets and liabilities:* Qualitative explanation of how outcome of policies and ESG management affect financial performance, assets and liabilities of a company, also over time (forward -looking information); see e.g. disclosure for interconnections based on GRI 102, 103, 201; see also Non-binding guidelines for NFRD, 2017: 'Companies may consider explaining how financial and non-financial outcomes relate, and how this relation is measured and managed over time'. This approach has the advantage of providing qualitative information on connectivity issues with regard to financial performance or the impact on assets or liabilities relating to the outcome of policies. However, this approach stand-alone maybe not sufficient and would have to be accompanied by additional disclosures (qualitatively and/or quantitatively). In addition, qualitative description may be quite subjective and biased and may be difficult to audit, if no detailed guidance is developed.

d) *Disclosure of additional capitals:* Disclosure of additional capitals based on IIRC Framework (Financial Capital, Manufactured Capital, Intellectual Capital, Human, Capital, Social and relationship Capital, Natural Capital). Outcomes are the internal and external consequences (positive and negative) for the capitals as a result of an organisation's business activities and outputs (IIRC, p. 33). Specifically, disclosing a company's dependencies on different capitals may be a facilitator for interconnection of FI and NFI. This approach has the advantage of being clear in principle. However, it is questionable whether the outcome of policies can be fully described by the disclosure of different capitals. There might be a need for additional qualitative and/or quantitative disclosures, as the IIRC is a framework that doesn't offer detailed application guidance.

111 It should be noted that the methods discussed above under a) – c) can be fairly easily embedded into the current reporting structures. Disclosure of additional capitals would require fundamental changes to the current reporting structures.

THE PRINCIPAL RISKS RELATED TO THOSE MATTERS LINKED TO THE UNDERTAKING

112 The NFRD requires the entity to report the principal risks related to the ESG matters linked to the undertaking's operations including, where relevant and proportionate, its business relationships, products or services which are likely to cause adverse impacts in those areas, and how the undertaking manages those risks.

113 Looking at the financial statements and notes, possible overlaps can be identified, limited to the segments financially highly exposed to specific ESG factors, with reference to the requirement of recognising a provision or disclosing a contingent liability according to IAS 37 disclosure. Looking at the management commentary (IASB ongoing project of

revision of the management commentary) there are possible overlaps, at least for entities significantly exposed to ESG factors.

114 However, a substantial part of the requirement is outside financial reporting (and management commentary).

115 The following potential interconnectivity models may be considered:

a) Taking inspiration of the IIRC Framework, a principle-based approach to the preparation of a management report that covers both the perspectives of the double materiality (despite the IIRC Framework being prepared to serve primarily providers of financial capital). This approach offers in principle the opportunity of integrating the key financial information typically provided in the management report into an NFI report or the other way around. However, in practice the management report will have to continue to serve its primary purpose of informing the providers of financial capital and the integrated approach would put at risk its ability to continue to focus on financial materiality and may create possible disclosure overload.

b) With specific reference to the risks, the perspective covered by the IIRC Framework is broader than the contents normally covered in the management report, as it relates to the risks that the entity causes adverse impact on the various dimensions of value creation (including ESG dimensions of value). A possible linkage would be where the management report refers to or uses information prepared for the Integrated Report, as for financial capital it may be expected that the Integrated Report covers also information about risks that are typically reported in the management report.

c) Quantification of ESG risks with likely impact on business performance by using various risk models. Risk quantification covers business model with entire value chain effects. An example is offered by the TCDF key metrics of climate risk.

d) Qualitative Analysis of ESG risks with likely impact on business performance, using for example the GRI guidance. The anchor point is, as said above, the overlap with IAS 37 and management report, and exists for sectors particularly exposed to ESG risks, where GRI standards require qualitative disclosure about risks and opportunities, including financial implication of climate risks. However, this approach has a limit insofar as the perspective of GRI is much broader than that of FI and there is in the GRI framework no specific approach to interconnectivity/integration of FI information. Similarly, limited to sectors particularly exposed to climate risks, narrative TCFD disclosure offer anchor point to the management report (i.e. information provided pursuant to TCFD is also expected to be relevant for the management report).

e) Scenario Analysis: Calculation of the potential financial impact (revenues, expenditures, assets & liabilities, capital & financing) of various climate scenarios and explanation of why the business will be risk resilient with the different measures taken. The scenario analysis, developed by the TCFD for climate risk, could potentially be expanded to topics other than climate change. The scenario analysis covers business models with entire value chain effects. Scenario analysis appears to be a possible approach to be explored as a tool that provides quantitative financial metrics to quantify climate changes risks and opportunities.

NON-FINANCIAL KEY PERFORMANCE INDICATORS RELEVANT TO THE PARTICULAR BUSINESS

116 The NFRD requires disclosure of non-financial key performance indicators relevant to the particular business. There is no similar or overlapping requirement in the financial reporting. The ongoing IASB project on management commentary is exploring the identification of management measures and indicators (MMI). The Accounting Directive requires (Article 19.1) presentation in the management report information to the extent necessary for an understanding of the undertaking's development, performance or position. The analysis shall include both financial and, where appropriate, non- financial key performance indicators relevant to the particular business, including information relating to environmental and employee matters. The entire requirement is however outside of the scope of financial statements and notes.

117 Future standards should consider that currently there is a requirement in the Accounting Directive to report non-financial indicators that are relevant for the understanding of the company's development, performance or position ('original' requirement in Article 19). In addition, the future management commentary may also require the disclosures of

certain non-financial key performance indicators. Thus, when looking at the management commentary, there is a risk of providing the same information twice – in the NFI and in the FI. In order to mitigate this risk guidance on the location of these indicators and cross-references should be considered.

118 The key question is how non-financial indicators may impact current or future financial statements, and how will they affect the understanding of the company's development, performance or position if this is not adequately addressed by appropriate guidance. Some possible pathways are presented below:

a) *Impact valuation:* Calculation of social monetary value of external impacts (environmental, social, economic) of business activities and explanations about how this affects the business model now and in the future and how a company will reduce negative externalities and improve positive externalities (see also IIRC Fundamental concepts). This approach has the advantage of creating linkage to business model impacts, with the entire value chain and value creation and connects NFI impacts to potential FI impacts (through the rebound effects). However, the approach presents measurement complexities and no common disclosure metrics exist. In conclusion it is important to consider and link social impacts back to business performance and value creation.

b) *Disclosure of financial indicators with ESG attributes* (e.g. based on EU Taxonomy, selected SASB indicators, TCFD and EU non-binding guidelines on reporting climate-related information). Examples:

(i) Taxonomy 'green' revenue, 'green' OPEX, 'green' CAPEX, % of 'green' investments);

(ii) SASB: Asset values, CAPEX, Product Design and Life-cycle management (green revenues) and Physical impacts of climate change (asset values, losses, capex).

This approach has the advantage of achieving alignment with EU taxonomy and EU Sustainable finance KPIs. In addition, KPIs provide 'linkage' to financial information. However, the KPIs and the definitions are still under development/not yet fully established. In conclusion, the EU taxonomy based KPIs or TCFD requirements can be considered; current NFI frameworks provide some interconnectivity, but there is not little guidance for disclosure of financial indicators with ESG attributes.

c) *Qualitatively linking changes in ESG indicators to financial performance:* calculation of the financial impact of changes in ESG indicators (e.g. 1% change in employee engagement has 50m EUR impact on operating income). This includes also intensity indicators, such as energy intensity, carbon intensity (GRI 302-3, GRI 305-4). Another approach which also may be considered is the one of TCFD, which links climate-related risks and opportunities/metrics & targets to financial impacts. However, correlations/financial impacts of changes in ESG indicators might be difficult to measure and more detailed guidance would be required. In conclusion, no developed current NFI solution exists, but to focus on risk/opportunity consideration when linking NFI KPIs to FI might be useful.

d) *Presentation of ESG indicators in what some frameworks call the 'mainstream report':* e.g. disclosure of ESG indicators (CO_2 Emissions, Diversity...) in the mainstream report / management report. The accounting directive (chapter 5, article 19 Content of Management Report) requires disclosing of non-financial KPIs relevant to a particular business, including information related to environmental and employee matters. The TCFD recommendation on climate disclosures in financial filings, NFRD, Diversity disclosures offer another solution as well. The advantage of this approach is that presenting non-financial KPIs next to financial KPIs provides more context than reporting them separately. Qualitative explanations may describe how management has assessed financial materiality, in this way the more direct responsibility of the Board is incentivised. However, there are no clear definitions of the KPIs. In conclusion, this approach is not offering interconnectivity strictly speaking, but for some sectors financial material impacts could be qualitatively assessed by this presentation and the provided explanations.

e) *Presentation of financial indicators in the ESG report:* Example in frameworks like GRI: disclosure of financial indicators in ESG / Sustainability report (e.g., net revenues, debt, equity, net income...). The advantage would be to pursue a combined presentation in NFI. However, the KPIs in the current NFI frameworks are used more as an organisational profile, to provide contextual information, rather than measuring financial impact of non-financial matters. In conclusion, to date there is no clear interconnectivity approach offered by this possible solution.

TOWARD THE CONCEPTS OF DIRECT AND INDIRECT CONNECTIVITY

119 Starting from the identified possible connectivity models offered at the level of a single anchor point by the prevailing NFR Frameworks/Standards/Guidelines, as described above, a possible categorisation of the connectivity models, as a first step toward the development of a more structured approach to connectivity is proposed.

120 Two possible categories of connectivity are considered: a direct connectivity and an indirect connectivity.

121 Direct connectivity is characterised by the possible reconciliation of the NFI to data included in the financial statements or in the general ledger. In addition, direct connectivity exists if the assumptions for preparing the FR are consistent with the assumptions used in NFR (or vice versa). This relates for example to impairment assumptions or useful lives of assets in FR that are consistent with the information given in NFR on the topic. Also, FR may require certain disclosures on risks where interconnection exists through consistent disclosures in NFR.

122 Possible examples of direct connectivity models are: the direct reconciliation to financial statements, such as the reporting (as part of the NFI) of 'training costs' that can be reconciled to a financial statements account or the reporting (as part of the NFI) of the proportion of 'green' revenues, where revenues can be reconciled to IFRS revenues.

123 The indirect connectivity concept aims at identifying links to financial reporting information, for disclosure objectives of the NFRD that cannot be directly reconciled to the financial statements or the general ledger in the current period or to accounting estimates used in the current period for preparing FR.

NFI may relate to future events that could affect financial performance in the future or to current activities that cannot be directly measured in financial terms in the current year. In trying to differentiate indirect connectivity with the consistency of assumptions under direct connectivity, indirect connectivity relates to potential future impact on FR that are not reflected in the accounting assumptions or disclosed in the current FR.

124 Possible examples of indirect connectivity models are:

a) Value creation / analysis on financial performance, assets and liabilities: Qualitative explanation of how the management of ESG topics affects value creation of a company or financial performance or assets or liabilities, also over time (forward -looking information; other methods described under indirect connectivity in this section can be used to support the disclosure.

b) Scenario analysis to quantify climate changes risks and opportunities. This would include the calculation of the potential financial impact (on revenues, expenditures, assets, liabilities, capital, financing) under various climate scenarios, together with an illustration of why the business will be risk resilient, thanks to the different measures taken. The concept can potentially be expanded to topics other than climate change, if there is sufficient scientific guidance on how potential scenarios would look like.

c) Qualitative or quantitative impact valuation analysis: Calculation of the social monetary value of external impacts (environmental, social, economic) of business activities and explanation about how this affects the business model now and in the future ('rebound effect') and how a company will reduce negative externalities and improve positive externalities. Further guidance will have to be developed on the rebound effect – besides standardising impact valuation analysis. Alternative to quantitative disclosures the impacts could also be described as qualitative disclosures.

d) Disclosures of additional capitals: disclosure, based on the IIRC Framework, internal and external consequences (positive and negative) for the capitals as a result of an organisation's business activities and outputs.

e) Risk quantification: Quantification of ESG risks with likely impact on business performance by using various risk models; this could also be done as a qualitative analysis.

f) Non-financial targets: disclose non-financial targets with explanation of the likely financial impact on both, the company's performance and the social impacts; this could be done quantitatively or qualitatively by using other methods described in this section.

g) Quantitatively linking the changes in ESG indicators to financial performance: Calculation of the financial impact of changes in ESG indicators (e.g. 1% change in employee engagement has xx mEUR impact on operating income).

125 The development of a structured navigation approach across different reports, i.e. include in an integrated (FI+NFI) management executive summary cross references to information presented in the financial statements, in the management report or to the full NFRD report may also be explored as an option to create connectivity.

126 In the indirect connectivity concept, it is anticipated that no obvious connectivity approach can be developed for the information required by the NFRD that (i) belongs to the outside-in materiality space, but (ii) doesn't belong to the financial reporting space, such as potential future environmental risks that may negatively impact the financial performance in the future but are at present not yet likely.

127 In both cases (direct and indirect connectivity), the differences in reporting boundaries between the two dimensions (FR and NFR) would have to be considered. Interconnectivity is in general possible only limited to the financial reporting boundary. For example, when in a direct connectivity approach training costs are presented in the NFI report with sufficient detail to allow for a reconciliation with the corresponding data point presented in the notes to the financial statements, the reconciliation will be limited to the accounting consolidation perimeter. No connectivity will be possible for example for the training costs of a key supplier.

128 Table 2 below presents a recap of the differences between the two concepts:

Table 2

DIRECT CONNECTIVITY	DIRECT CONNECTIVITY
• Direct connectivity is characterised by the possible reconciliation of the NFI to data included in the financial statements or in the general ledger. • E.g.: direct reconciliation to financial statements possible: e.g. 'training costs' disclosed in NFI can be reconciled to F/S accounts; % 'green' revenues where revenues can be reconciled to IFRS revenues. • In addition direct connectivity exists if the assumptions for preparing the FR are consistent with the assumptions used in NFR (or vice versa). This relates for example for impairment assumptions or useful lives of assets in FR that are consistent with the information given in NFR on the topic.	• The indirect connectivity concept aims at identifying links to financial reporting information, for disclosure objectives of the NFRD that cannot be directly reconciled to the financial statements or the general ledger in the current period or to accounting estimates used in the current period for preparing FR. • E.g. identify metrics of likely future impact of non-financial matters on FI, including 'rebound effect' on FI

SALIENT POINTS

A SUBSTANTIAL EVOLUTION OF FINANCIAL REPORTING STANDARDS IN A NEAR FUTURE IS UNLIKELY[5]

129 The current mission[6] of the IFRS Foundation is to deliver robust, reliable and transparent information as input for the decisions of the primary users of general-purpose financial statements. IFRS Standards are based on the concept of financial materiality, which implies focusing on information which – if omitted – could influence the decisions of investors or other users of the financial statements who are interested in the performance and long-term health of the reporting entity: Information is material if omitting, misstating or obscuring it could reasonably be expected to influence decisions that the primary users of general-purpose financial statements make on the basis of those financial statements which provide financial information about a specific reporting entity, as stated in IAS 1 Presentation of Financial Statements.

130 IFRS standards are the result of a long development process and have reached a stage of substantial maturity and stability.

a) The past two decades have been significant: international accounting standards became a reality and enjoyed widespread international recognition;

b) During the 2010s the IASB further worked to enhance the IFRS quality, introducing major upgrades to the reporting for subsidiaries, joint ventures and non-consolidated entities, accounting for financial instruments, revenue recognition, leasing and insurance contracts (the latter completed only in recently, in June 2020, will be effective starting from 2023);

c) In the past 10 years, IFRS preparers have been constantly following the development of this new generation of standards, which are more judgemental in nature and address areas of particular complexity in accounting. Implementation investments have been and continue to be material, common interpretation and higher-quality implementation practices that typically follow the first application of a new standard take a few years to emerge and this process is still partially ongoing. The financial reporting community has called for a period of stability, in order to have the time to properly complete this process.

131 At the same time, to respond to the need of investors to receive information that goes beyond the limits of traditional financial reporting, the IASB has chosen to undertake a revision of the Management Commentary Practice Statement (a document is expected in the first term of 2021), making more visible for investors those factors that may affect a company's future cash flows but may not yet be reflected in the financial statements—such as climate change and the risks and opportunities associated with the company's intangible assets.

132 Considering the above, the scenario of an evolution of financial reporting standards to consider the inclusion of more information on currently unrecognised intangibles, or to accommodate the need of the broader stakeholders that are users of nonfinancial information, or even to reflect financial performance measures adjusted for externalities, it is unlikely.

133 IFRSs will continue to play their role and their Conceptual Framework and intrinsic characteristics described in this section of the report will likely stay unchanged, while being accompanied by a broader set of non-financial information that are relevant to assess the impact of ESG factors on the financial prospects of the entity, such as thanks to a modernised management commentary.

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5 The Request of Information for the 2020 Agenda Consultation covering the next 5 years has been postponed till the first term of 2021.

6 The IFRS Foundation issued in September 2020 a Consultation Paper on Sustainability Reporting (SR), open for comments until December 31, 2020. This Paper was not included in the present analysis as this project is too early to inform on the final IFRS Foundation' decision on the establishment of a new Board to deal with SR, and its position about relevant issues (in particular, users and materiality concept), and how this could affect connectivity between FR and NFR.

134 It is thanks to the conceptual foundation and clear limits described earlier in the report that financial accounting may be reliable and may continue to serve its fundamental role of informing existing and potential investors, lenders and other creditors about (i) the economic resources of the entity, claims against the entity and changes in those resources and claims, and about (ii) how efficiently and effectively the entity's management and governing board have discharged their responsibilities to use the entity's economic resources. However, this also means that NFI that investors deem relevant, will not be found in the financial statements.

135 This assumption was confirmed through a call organised with Mr. Nick Anderson, member of the IASB. The list of questions discussed with him can be found in Appendix 5, as well as the commentaries of the IASB staff on the status of the Management Commentary Statement Practice project.

136 The key takeaways of this exchange of views are the following:

a) NFRD requirements are not specifically addressed in the Management Commentary revision project as the IASB has a mission to serve in a neutral and balanced way all the jurisdictions around the globe;

b) Our statements on the hard boundaries of the financial statements being stable in the foreseeable future is confirmed;

c) Our statement that the Management Commentary serves only the outside-in plus rebound effect is confirmed. Nothing from inside-out will be found before the externalities materialise in the planning horizon (e.g. dilemmas excluded, when taxation or litigation/reputation will hit, they will impact the financial statements);

d) The Management Commentary is the IASB's key path to serve the integration and the growing attention to the ESG factors. The limit to what they the Management Commentary can achieve is in the need to stay focused and avoid the so called 'disclosure overload', i.e. too much information that is not material for the providers of financial capital and obscures material financial information;

e) The Management Practice Commentary Statement is non-mandatory guidance from the IASB. While it does not form part of IFRS Standards, individual jurisdictions may choose to mandate the requirements in the Practice Statement.

f) The Management Practice Commentary Statement does not refer to any ESG framework in particular. It is a sort of 'skeleton' of possible ESG topics organised by the management at their discretion according to a principles-based approach. While the principles are similar to those of the IIRC, the approach does not include the IIRC's six capitals. A predefined list of indicators will not be prescribed. In addition to indicators, for the financially material topics there will be a description of the strategy and achievements, not only quantitative KPIs. Practice Statement is expected to permit reporting of additional information that would not be material in management commentary if required by local laws or regulations. The management commentary may include this information provided it does not obscure material information;

g) When looking at how to connect FI and NFI, reconciliation to the financial statements is important, but more important is the consistency of the story telling across documents;

h) As for the structure of the reporting, the IASB is not working on it per se (how to connect FI with an NFI reporting having the characteristics of the NFRD). They understand that users appreciate separate reports to serve separate needs. They would not consider integrating the NFRD report into the Management Commentary as a way forward, due to the risk to obscure material information.

BENEFITS OF INTERCONNECTION[7] BETWEEN FINANCIAL REPORTING AND NON-FINANCIAL REPORTING

137 Connectivity between financial and non-financial information is a key challenge to obtain a holistic and coherent view on corporate reporting.

7 words interconnection, interconnectivity, connectivity,... are used with the same meaning.

138 The principle of interconnecting financial and non-financial information is widely shared but remains technically and operationally challenging in order to create a seamless relationship between financial information with clear limits and non-financial information in current development.

139 Connectivity practice between financial and non-financial reporting is still emerging but presenting and developing non-financial information in close connection with financial information is vital to provide a comprehensive picture. It is relevant to assess the need for connectivity between the two types of information.

140 Financial reporting has clear limits:

a) It is designed to serve primarily the information needs of providers of financial capital, with a scope based on 'financial materiality';

b) the boundaries of the entity are defined on the basis of a relatively clear concept of control (scope of consolidation);

c) financial information is primarily monetary and retrospective with a strong emphasis on neutrality and availability of data which can be reliably determined;

d) liabilities are reported if there are probable cash outflows resulting from past events; low levels of probability do not generate financial liabilities;

e) to be recognised, assets have to be under the control of the reporting entity allowing it to benefit from the resulting future cash inflows, that should be linked to the asset, the cost should be also reliably measured and it should be identifiable; in this context, the recognition of internally generated intangibles is limited;

f) applying the 'double entry' accounting approach, every entry to an account (e.g. a component in the profit or loss) requires a corresponding and opposite entry to a counterpart account (e.g. a component of the statement of financial position) and this contributes to the arithmetical robustness of financial statements.

141 As a consequence, those clear limits entail some limitations:

a) Inside-out materiality and 'rebound effects' hitting the financial statements in subsequent periods, are not reflected in FR;

b) ESG topics can become financially material over time – especially adverse ESG impacts very often not reflected in FR as recognition or disclosure criteria are not met;

c) Forward looking information is typically not reflected in FR.

142 Reporting boundaries are in general different between FR and NFR and different reporting boundaries likely lead to connectivity needs for stakeholders. In addition, application of various NFI frameworks lead to different reporting boundaries and a lack of comparability.

143 The analysis of the requirements of the NFRD has shown gaps between FR and NFR (which can be explained by the reasons above) with the opportunity to close the link between FR an NFR for various information needs.

144 However, despite the highlighted need for connectivity information, an operational approach to the concept of connectivity doesn't exist. Several possible methods have been identified by in this Assessment Report (see above) from various NFI standard setting initiatives, to be further explored and tested as a possible way forward. An additional standard setting challenge will be that the implementation in these reporting practice lacks clear and precise guidelines, able to foster comparability and enforceability.

145 There are several benefits that improved connectivity can provide. Non-financial information should be consistent with information in financial reporting. Non-financial information complements and supplements financial information in order to place related content in context. Connectivity of information also reinforces coherence. Non-financial information can be more useful, relevant and coherent, when connected to financial information, and vice-versa. Connectivity is also important to avoid overlaps and repeating same information in different reports.

146 Interconnectivity is highlighted in several NFI frameworks – they promote disclosures on how ESG topics are likely to impact an organisation's future financial position. For example, the principle of connectivity of information has been specifically addressed by IIRC and TCFD.

a) The principle of connectivity (in its declination as 'integrated information') is a guiding principle in IIRC Framework. This framework highlights the need for giving a holistic picture and provides linkages between factors, clarifying the relationship between past, present and forward-looking information, and explaining interdependencies and trade-offs between the capitals. An integrated report should show a holistic picture of the combination, interrelatedness and dependencies between the factors that affect the organisation's ability to create value over time.

b) TCFD discusses the interconnection of FI and NFI explicitly in its recommendations for climate-related financial disclosures. The connectivity focuses on disclosure of metrics, about the financial impact that climate-related risks and opportunities have or could have on an organisation.

THE MEANING OF MATERIALITY

147 Materiality is a key concept in the context of the identification of the scope of financial information and to map the complementarity of the two dimensions (FR, and NFR) of corporate reporting.

148 A first observation is that materiality seems to have different meanings in the two dimensions (FR and NFR).

a) In financial reporting standards, materiality is a judgement call for the management to select information that may have an impact on decision making of the primary users of the reporting. In the prevailing practice, financial materiality has to be assessed considering both the qualitative and the quantitative dimension;

b) In the NFRD, a similar concept is developed, as the entity has to present information 'to the extent necessary for an understanding of the undertaking's development, performance, position and impact of its activity'. Furthermore, on the guidelines, it is added that 'companies are expected to consider the information needs of all relevant stakeholders'. Nevertheless, close to the concept of assisting the management in selecting the information to be presented, the so called 'double materiality' approach provides as well an approach to define the two perspectives of outside-in (how ESG factors impact the entity's development, performance, position – often identified as 'financial materiality') and inside-out (how the entity's activity impacts on ESG factors – often identified as 'environmental and social materiality').

149 A closer look at the two perspectives outside-in and inside-out shows that:

a) there is a third perspective, i.e. some impacts of the entity's activity on ESG factors may result in the future in further impacts on the entity's development, performance and position. This third perspective is conventionally called 'rebound effect' and is considered as conceptually pertaining to the outside-in perspective, in a broader sense;

b) there is a macro trend ongoing. With the growth of socially responsible investments, investors are more and more interested in environmental and social materiality. This may impact the theoretical bright line between investors' needs (to understand performance) and other stakeholders' needs (to understand responsibility), as well as the conceptual limit FI/NFI based on the double materiality as described above. In the mid- to long-term, investors' needs may actually be quite aligned with other stakeholders' needs.

POTENTIAL CONNECTIVITY APPROACHES (DIRECT CONNECTIVITY AND INDIRECT CONNECTIVITY)

150 As a first step towards the development of a more structured approach to connectivity, connectivity models have been categorised as follows: direct and indirect connectivity.

151 Direct connectivity is characterised by the possible reconciliation of the NFI to data included in the financial statements or in the general ledger. In addition direct connectivity exists if the assumptions for preparing the FR are consistent with the assumptions used in NFR (or vice versa). This relates for example for impairment assumptions or useful lives of assets in FR that are consistent with the information given in NFR on the topic.

152 Possible examples of direct connectivity models are: the direct reconciliation to financial statements, such as the reporting (as part of the NFI) of 'training costs' that can be reconciled to a financial statements account or the reporting (as part of the NFI) of the proportion of 'green' revenues, where revenues can be reconciled to IFRS revenues.

153 The indirect connectivity concept aims at identifying links to financial reporting information, for disclosure objectives of the NFRD that cannot be directly reconciled to the financial statements or the general ledger in the current period or to accounting estimates used in the current period for preparing FR.

154 Possible examples of indirect connectivity models are:

a) Value creation / analysis on financial performance, assets and liabilities: Qualitative explanation of how the management of ESG topics affects value creation of a company or financial performance or assets or liabilities, also over time (forward -looking information; other methods described under indirect connectivity in this section can be used to support the disclosure;

b) Scenario analysis to quantify climate changes risks and opportunities. This would include the calculation of the potential financial impact (on revenues, expenditures, assets, liabilities, capital, financing) under various climate scenarios, together with an illustration of why the business will be risk resilient, thanks to the different measures taken. The concept can potentially be expanded to topics other than climate change, if there is sufficient scientific guidance on how potential scenarios would look like;

c) Qualitative or quantitative impact valuation analysis: Calculation of the social monetary value of external impacts (environmental, social, economic) of business activities and explanation about how this affects the business model now and in the future ('rebound effect') and how a company will reduce negative externalities and improve positive externalities. Further guidance will have to be developed on the rebound effect – besides standardising impact valuation analysis. Alternative to quantitative disclosures the impacts could also be described as qualitative disclosures;

d) Disclosures of additional capitals: disclose, based on the IIRC Framework, internal and external consequences (positive and negative) for the capitals as a result of an organisation's business activities and outputs

e) Risk quantification: Quantification of ESG risks with likely impact on business performance by using various risk models; this could also be done as a qualitative analysis;

f) Non-financial targets: disclose non-financial targets with explanation of the likely financial impact on both, the company's performance and the social impacts; this could be done quantitatively or qualitatively by using other methods described in this section;

g) Quantitatively linking the changes in ESG indicators to financial performance: Calculation of the financial impact of changes in ESG indicators (e.g. 1% change in employee engagement has xx mEUR impact on operating income);

155 The development of a structured navigation approach across different reports, i.e. include in an integrated (FI+NFI) management executive summary cross references to information presented in the financial statements, in the management report or to the full NFRD report may also be explored as an option to create connectivity.

LOCATION OF NON-FINANCIAL INFORMATION

156 The location of non-financial information can also be seen as a possible tool to reinforce connectivity. The objective of this section is to assess the advantages and drawbacks of the permitted approaches under the EU directives regarding the location of non-financial information subject to the NFRD, namely inclusion in the management report and publication of a separate report, either published together with the management report or on an entity's website no longer than six months after the balance sheet date.

157 While there are a variety of different stakeholders' information demands, especially in relation to ESG matters, there is broad agreement that, generally, financial and non-financial information are both required to understand an entity's full 'story'.

158 In light of this and the fact that location is a central lever of integrating financial and non-financial information, the location of non-financial information is of key relevance and, thus, the currently authorised approaches in this context need to be assessed.

159 All of the currently authorised approaches come along with drawbacks, so that none of them in isolation can be identified as the clearly preferred option.

160 While including non-financial information in the management report has various advantages as it enhances and more strongly accounts for the integration and interconnectivity of financial and non-financial information (see Appendix 4) and is generally appropriate, this only applies to the extent that both a reasonable concept of materiality and assumption about primary users are defined and applied. Otherwise, there is a significant risk of unbalanced reporting, which would reduce the usefulness of the management report for capital market participants and result in an information overload.

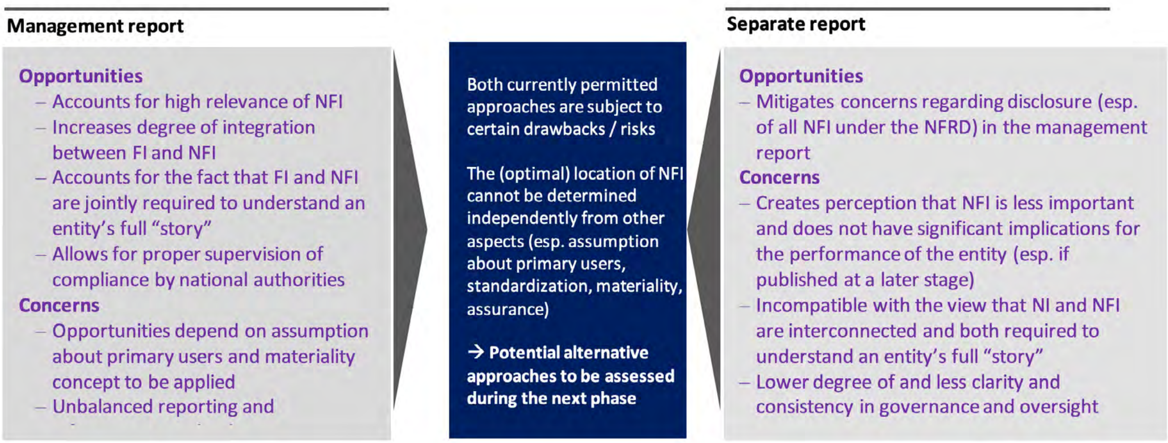
161 Publishing non-financial information in a separate report, which may potentially gain less attention, depending on the entity-specific context (e.g. distribution channel, publication date), might create the perception that non-financial information is of secondary importance and not required to understand an entity's full 'story'. These drawbacks are exacerbated if the separate report is published at a later stage. Further concerns arise regarding the clarity and rigor of the applicable governance and oversight requirements and process.

162 Defining an approach for locating non-financial information that mitigates the abovementioned concerns and drawbacks as much as possible is of central importance to increasing the overall usefulness of corporate reporting.

163 However, the (optimal) location of non-financial information subject to the NFRD cannot be determined independently from other issues, especially related to the assumption about primary users, materiality, assurance and standardisation.

164 Below is a recap of A4 assessment (Figure 9).

Figure 9



APPENDIX 1A: LIABILITIES, PROVISIONS AND CONTINGENT LIABILITIES

INTRODUCTION

1 This appendix provides further details on the assessment as to what degree liabilities, provisions and contingent liabilities as accounted for under IFRS currently capture ESG-related matters.

2 To this end, the applicable definition and recognition criteria as outlined in the IFRS Conceptual Framework and IAS 37 are analysed. As the criteria applying to these three concepts overlap to a meaningful degree yet become less strict as one moves from a liability to a contingent liability, liabilities have been analysed in a first step, and the analysis of provisions and contingent liabilities have built on the findings of this first step.

ASSESSMENT

Liabilities – General

3 According to CF.4.26, a liability is 'a present obligation of the entity to transfer an economic resource as a result of past events'. The criteria 'present obligation', 'transfer of an economic resource', and 'as a result of past events' are analysed separately.

Liabilities – Present obligation

4 IAS 37.10 defines an obligating event as 'an event that creates a legal or constructive obligation that results in an entity having no realistic alternative to settling that obligation'. According to IAS 37.17, this is only the case '(a) where the settlement of the obligation can be enforced by law; or (b) in the case of a constructive obligation, where the event (which may be an action of the entity) creates valid expectations in other parties that the entity will discharge the obligation'. In CF4.32, it is specified that in some cases 'an entity's duty or responsibility to transfer an economic resource is conditional on a particular future action that the entity itself may take. (…) In such situations, the entity has an obligation if it has no practical ability to avoid taking that action'.

5 Based on this guidance, the following limitations to capture ESG-related matters result:

- Legal obligations related to ESG-related matters are often (still) unlikely to exist while constructive obligations are more likely to exist. However, this also depends on the entities' practices and commitments.
- Entities may often have the practical ability to avoid actions with adverse ESG-related implications (which may give rise to an obligation), by e.g. changing operations, but deem them as (economically) favourable (especially as long as negative externalities are not priced).
- In a similar vein, payments may be avoidable from the perspective of the reporting entity, but (economically) preferable (e.g. to counteract reputational damages).
- Even for constructive obligations, it may (still) often not be the case that 'valid expectations' have been raised.
- According to CF4.35, 'it might be uncertain whether the act occurred, whether the entity committed it or how the law applies'. In transitory phases, how the law applies may in fact not always be fully clear at a particular reporting date.

6 Consequently, the definition of a 'present obligation' is likely often not (yet) met.

Liabilities – Transfer of an economic resource

7 According to CF4.37, an obligation 'must have the potential to require the entity to transfer an economic resource to another party'.

8 Based on this guidance, the following limitations to capture ESG-related matters result:

- The reference to 'economic':

  a) requires the existence of a monetary/financial link. While such a link is likely to often exist (even if it may be difficult to measure or expected to surface in a more distant future), this may not always be the case for ESG-related matters (e.g. for negative externalities for which no market price exists or will exist for as long as an entity would be affected by it); and

  b) implies an outside-in perspective. This suggests that the inside-out perspective could generally not be (fully) captured, but only – potentially – to the extent to which adverse effects on the outside also have a monetary/financial impact on the inside ('rebound' effect).

- The reference to 'other party' implies that there needs to be a third party to claim the economic resource. Thus, for instance, an outflow of an economic resource due to lower sales as a consequence of reputational damages would not qualify. Generally, however, 'third party' is rather broadly defined (see CF4.29) and could also be the society as a whole.

Liabilities – As a result of past events

9 According to CF4.43, a present obligation 'exists as a result of past events only if: (a) the entity has already obtained economic benefits or taken an action; and (b) as a consequence, the entity will or may have to transfer an economic resource that it would not otherwise have had to transfer'. However, according to CF4.46, a present obligation 'can exist even if a transfer of economic resources cannot be enforced until some point in the future'. IAS 37.21 provides an example in this regard: 'For example, when environmental damage is caused there may be no obligation to remedy the consequences. However, the causing of the damage will become an obligating event when a new law requires the existing damage to be rectified or when the entity publicly accepts responsibility for rectification in a way that creates a constructive obligation'. Still, in accordance with IAS 37.19, only 'those obligations arising from past events existing independently of an entity's future actions' would qualify.

10 Based on this guidance, the following limitation to capture ESG-related matters results in future operations and actions (rather than only past events) which may only give rise to obligations in the future are also of interest for non-financial stakeholders.

Liabilities – Conclusion

11 Liabilities as accounted for under IFRS are currently unlikely to cover ESG-related matters to a great extent, especially as a 'present obligation' does often not (yet) exist and/or because there an outflow of an 'economic' resource does not (yet) occur.

12 In addition to these limits of financial reporting which relate to the definition criteria of a liability, the applicable recognition criteria are also often unlikely to be met (both the probability and the reliable estimate criterion, see below).

13 However, the degree to which ESG-related matters are captured by liabilities as accounted for under IFRS would increase if more legal/regulatory measures were taken (e.g. pricing of negative externalities similar to the EU ETS, adoption of mHRDD laws, prohibition of activities with above-threshold GHG emissions, etc.) and if entities were to commit more to compensation voluntarily as, thereby, legal obligations and constructive obligations associated with an outflow of an economic resource would be created, respectively, both of which is likely to increasingly be the case in the future.

Liabilities – Conclusion

14 According to IAS 37.10, a provision is 'a liability of uncertain timing or amount'. In accordance with IAS 37.14, a provision 'shall be recognised when: (a) an entity has a present obligation (legal or constructive) as a result of a past event; (b) it is probable that an outflow of resources embodying economic benefits will be required to settle the obligation; and (c) a reliable estimate can be made of the amount of the obligation'.

15 Accordingly, in addition to the definition criteria of a liability which also apply for provisions and have been discussed above, the outflow of an economic resource needs to be probable and reliably measurable.

16 As to the probability criterion, given that a present obligation resulting from a past event exists that would lead to an outflow of an economic resource, in the context of ESG-related matters, this outflow may likely often not be deemed as probable, e.g. in transitory phases during which entities are uncertain about the regulatory environment.

17 As to the reliable estimate criterion, IAS 37.25 includes the following presumption: 'Except in extremely rare cases, an entity will be able to determine a range of possible outcomes and can therefore make an estimate of the obligation that is sufficiently reliable to use in recognising a provision'. However, this assumption does not seem to hold, at least not to the same extent, for ESG-related matters (e.g. due to uncertainties about the regulatory environment or technological developments, long time horizons).

18 Based on this guidance, the following limitations to capture ESG-related matters result:

a) An obligation as a result of past events does likely often not (yet) exist (see above).

b) ESG-related matters do likely often not (yet) give rise to an outflow of an economic resource (see above), and even if this is the case, this outflow is likely often not a) deemed as probable and/or b) reliably measurable.

Provisions – Conclusion

19 Provisions as accounted for under IFRS are currently unlikely to cover ESG-related matters to a great extent, even if a present obligation exists which would lead to an outflow of an economic resource as the probability and reliable estimate criteria are likely often not (yet) met.

20 However, in a similar vein to the above rationale, the degree to which ESG-related matters are captured by provisions as accounted for under IFRS is likely to increase.

Contingent liabilities – General

21 According to IAS 37.10, a contingent liability is '(a) a possible obligation that arises from past events and whose existence will be confirmed only by the occurrence or non-occurrence of one or more uncertain future events not wholly within the control of the entity; or (b) a present obligation that arises from past events but is not recognised because: (i) it is not probable that an outflow of resources embodying economic benefits will be required to settle the obligation; or (ii) the amount of the obligation cannot be measured with sufficient reliability'. In accordance with IAS 37.27, an entity 'shall not recognise a contingent liability'. Rather, in accordance with IAS 37.28, a contingent liability 'is disclosed (…), unless the possibility of an outflow of resources embodying economic benefits is remote'.

22 Liabilities and provisions can be transferred to contingent liabilities analogously. The guidance above together with these liabilities and provisions results in a limited capturing of ESG-related matters. In fact the possibility of an outflow of an economic resource may (still) often be remote because many negative externalities do not lead today to an outflow of economic resources for the company, but rather for society as a whole. One might also say that many negative externalities might not be expected to lead to such an outflow.

Contingent liabilities – Conclusion

23 Contingent liabilities are currently most likely to cover ESG-related matters as the definition and recognition criteria are less strict. Nonetheless, given the above considerations, it is likely that this may still often not be the case.

Other relevant terms

24 In addition, the degree to which 'economic compulsion' and 'legal commitment' as a source of an obligation can be transferred to ESG-related matters has been analysed and whether this would have implications for the conclusion drawn above.

25 ‘Economic compulsion’ is addressed in in IFRIC 21 in the context of levies. The following issue is discussed in this context: ‘Does economic compulsion to continue to operate in a future period create a constructive obligation to pay a levy that will be triggered by operating in that future period?’. In accordance with IFRIC 21.9, ‘an entity does not have a constructive obligation to pay a levy that will be triggered by operating in a future period as a result of the entity being economically compelled to continue to operate in that future period’. Also, IFRIC 21.10 clarifies that ‘the preparation of financial statements under the going concern assumption does not imply that an entity has a present obligation to pay a levy that will be triggered by operating in a future period’.

26 As to ‘legal commitment’, as outlined above and in accordance with IAS 37.20, ‘(…) an obligation always involves a commitment to another party’. However, a commitment must not necessarily be of legal nature. Rather, in accordance with IAS 37:20, an obligation might also relate to ‘a constructive obligation (…) {if} communicated (…) to those affected by it in a sufficiently specific manner to raise a valid expectation’ such as in the case of restructurings (except for envisaged sales of operations).

27 Both terms and the respective guidance can be transferred to ESG-related matters analogously. Yet, this does not have any implications for the above drawn conclusions.

APPENDIX 1B: REPORTING BOUNDARIES IN DIFFERENT INITIATIVES

GRI

1 Instead of referring to reporting boundaries, it refers to 'where the impact for a material topic occurs', and it states 'When describing 'where the impacts occur', the organisation can identify the entities where impacts occur, which can be entities in the organisation(*) and/or entities with which it has a business relationship, such as entities in its value chain' (GRI, 2016, p.6).

(*) The so-called entities in the organisation are the ones that are included in the organisation's consolidated financial statements.

GHG

2 The **organisational boundaries** serve to determine reporting, in the case of controlled entities/facilities, emissions are reported in total; in the other cases (jointly controlled and significant influence), the equity share method is used, which accounts for the percentage of economic interest in/benefit derived from an operation.

3 **Operational boundaries** are applied to identify emissions, both direct (Scope 1) and indirect (Scopes 2 and 3). Scope 1 emissions are direct emissions from owned or controlled sources. Scope 2 emissions derive from the generation of purchased energy and happen in the premises of the producers of energy. Scope 3 emissions occur in the value chain of the reporting company, including both upstream and downstream emissions. Scope 1 and 2 are mandatory to report, whereas scope 3 is voluntary and the hardest to monitor. (GHG Protocol, 2004)

SASB

4 The Framework (2017) does not explicitly state how the reporting boundaries should be set, however the Application Guidance (2018) states that 'The reporting boundaries for disclosures that conform with the SASB standards shall include all parent and subordinate entities that are consolidated for financial reporting purposes. ... However, the entity should disclose information about unconsolidated entities to the extent that the entity considers such information necessary to understand the effect of one or more SASB disclosure topics on the entity's financial condition or operating performance' (p. 2). Nevertheless, for certain sectors SASB requires reporting on supply chain management or raw material sourcing.

IIRC

5 In the IR Framework (2013) the reporting boundary results from the combination of two aspects; 1) the 'financial reporting entity', 2) and the 'risks, opportunities and outcomes' that can be attributed or associated with the entities and stakeholders that lie **beyond it** and have a **significant/material influence** on the organisation's ability to create value.

CDSB

6 As stated in the Framework (2019): 'Environmental information shall be prepared for the entities within the boundary of the organisation or group for which the mainstream report is prepared and, where appropriate, shall distinguish information reported for entities and activities outside that boundary' (Req 7).

7 'Where sources of environmental impact originate outside the organisation's reporting boundary as a result of contractual or other relationships between the reporting organisation and third parties (e.g.: indirect or scope 3 GHG emissions in the supply chain), the provision of quantitative information is encouraged where material to the reporting organisation, but is not required by the CDSB Framework. However, qualitative information about the material risks and opportunities

associated with sources of environmental impact originating from third parties on whom the reporting organisation depends, should be provided in response to REQ-03'.

NFRD

8 The NFRD refers to large undertakings, but in the related EU Guidelines (2017), when referring to Examples and KPIs on page 6, it is stated: 'A company may consider that impacts through its upstream supply chain are relevant and material issues and report on them accordingly. Impacts may be direct or indirect…'. The climate-related EU Guidelines (2018, p.8, and 2019, p.5) 'When assessing the materiality of climate-related information, companies should consider their whole value chain, both upstream in the supply-chain and downstream.'

APPENDIX 2A: DETAILED ANALYSIS OF LIMITS AND LIMITS OF IFRS STANDARDS

EXAMPLES OF ESG TOPICS INCLUDED AND NOT INCLUDED IN IFRS STANDARDS

1 The assessment presented in this appendix has been performed by identifying the relevant IFRS Standards, selecting the main definitions in those Standards and picking financial information covered by the recognition principles or disclosure requirements that are relevant to each topic selected for review. It is linked to Appendix 6 which presents the limits of the IFRS Standards, incl the Conceptual Framework, in a more illustrative way.

2 The following topics have been analysed:

- sales
- waste
- emissions to air
- procurement
- investments
- human resources
- management / related parties
- Equity Investments, associates and joint arrangements
- Public Authorities, Banks and Other Loan Providers, and Non-controlling Interests

Sales

IFRS Standards	IFRS 15 – Revenue from Contracts with Customers IFRS 9 – Financial Instruments (e.g. interest income, receivables, impairment for credit losses) IFRS 7 – Financial Instruments: Disclosures (e.g. financial risks) IAS 32 – Financial Instruments: Presentation (e.g. definition of F.I. & financial assets) IAS 37 – Provisions, Contingent Liabilities and Contingent Assets (ad 1)		
Primary definitions	Performance obligations	A promise in a contract with a customer to transfer goods or services. Transfer occurs when the customer obtains control of the goods or services.	Appendix A (IFRS 15) IFRS 15.31
	Control	Refers to the ability to direct the use of and obtain substantially all of the remaining benefits from the asset, i.e. goods or services (service = momentary asset when received and used).	IFRS 15.33
	Receivable	A contractual right to receive cash or another financial asset.	IAS 32.11
	Expected credit loss	Weighted average of credit losses with the respective risks of default occurring as weights	Appendix A (IFRS 7 & 9)
	Contract liabilities	Obligation to transfer goods or services for consideration received	Appendix A (IFRS 15)
	Provision	See 2.2 Waste	IAS 37.10
Limits	IFRS includes	• *Revenue from sale of goods and services*, incl. revenue from construction contracts. • *Trade receivables and contract liabilities*, i.e. monetary items • *Provision for credit losses*, which may be impacted by increased credit risk due to new regulation, e.g. carbon tax or emission restrictions, but also from the impact of a pandemic. • *Provisions for warranties, refund liabilities, legal claims, etc.* • *Cash flows from collection of End of Use Tax* is recognised as a receivable/payable, and most likely netted against revenue. • *Tax on profit*, indirectly covering the company's use of public infrastructure (e.g. roads) for distribution, health care for damages caused by the company's products, etc. • *Disclosure of credit risk and currency risk*	
	IFRS does not include	**Not in focus for investors (single materiality), e.g.:** • *Disclosure of the company's purpose.* • *Disclosure of the positive impact on society from the company's products or services.* **Not meeting definition of control, e.g.:** • *Revenue from sale of goods and services when the company acts as an agent.* Agent, when not controlling the goods before transfer or when legal title of goods is obtained only momentarily before transferred to the customer. **Not meeting definition of assets and liabilities, e.g.:** • *Provisions* for potential health problems caused by the company's products, such as alcohol, tobacco, medicine, hormonal damages, etc., except to the extent of legal claims. • *Provisions* for potential nature/environment impacts caused by the company's products, such as micro plastic in groundwater, seawater and loss of biodiversity as a result of using the products etc., except to the extent of legal claims. **Not including forward looking information, e.g.:** • Disclosure of economic risks, such as market risks, except to some extent for assumptions on measurement and estimation uncertainty.	

Waste

IFRS Standards	IAS 2 – Inventories IAS 16 – Property, Plant and Equipment IAS 37 – Provisions, Contingent Liabilities and Contingent Assets (ad 1)		
Primary definitions	Cost of inventories	Comprise all costs of purchase and conversion.	IAS 2.10
	Cost of conversion	Direct and indirect costs incurred in converting materials into finished goods. Includes among other abnormal amounts of wasted materials.	IAS 2.12 IAS 2.16
	Decommissioning costs/ provision	Costs of obligations for dismantling, removing and restoring the site on which an item is located.	IAS 16.18 IAS 37.14
	Provision	A liability of uncertain timing or amount. Only recognised when 1) the company has a present obligation as a result of a past event; 2) an outflow of resources is probable; and 3) a reliable estimate can be made. Involves a commitment to another party, whose identity need not be known and may be to the public at large. The commitment can be legal or constructive.	IAS 37.10 IAS 37.14 IAS 37.20
	Legal obligation	Derives from contracts and legislation	IAS 37.10
	Constructive obligation	Derives from an entity's actions, where past practice, published policies or statements has indicated that the entity will accept certain responsibilities, and such has created a valid expectation on other parties that the entity will discharge those responsibilities.	IAS 37.10
	Contingent liability	Being either: 1. A possible obligation arising from past events whose existence will be confirmed only by the occurrence or non-occurrence of one or more uncertain future events not wholly within the control of the entity. 2. A present obligation that arises from past events but is not recognised because: (i) it is not probable that an outflow of resources embodying economic benefits will be required to settle the obligation; or (ii) the amount of the obligation cannot be measured with sufficient reliability.	IAS 37.10
	Contingent asset	A possible asset that arises from past events and whose existence will be confirmed only by the occurrence or non-occurrence of one or more uncertain future events not wholly within the control of the entity.	IAS 37.10
Limits	IFRS includes	• *Costs:* o Costs of damaged or expired materials (e.g. food) o Recycling costs (e.g. cleaning of returnable bottles) o Costs of disposals (e.g. transportation), less income from sale of used materials/ biproducts o Waste taxes o Decommissioning costs • *Provision* for legal or constructive decommissioning obligations • *Contingent liabilities (disclosure)* for legal claims for damages caused by waste. • *Contingent assets*, due to legal claims that will be resolved by others outside the control of the entity or for other actions.	
	IFRS does not include	**Not meeting definition of assets and liabilities, e.g.:** • *Environmental impact* of spill water, pollution, shipbreaking *or other breaking up, etc.*, when there is no legal or constructive obligation to pay for removal/clean-up. • *Value* of potential reuse of materials. • *Provisions* for potential health problems caused by the company's waste, such as from combustion.	

Emissions to air

IFRS Standards	IAS 37 – Provisions, Contingent Liabilities and Contingent Assets (ad 1) Optional: IFRIC 3 – Emission Rights (issued in 2004, withdrawn in 2005)		
	Sources: EY Int. GAAP 2016, chapter 27, 6.5. Giner, B., 2014. Accounting for emission trading schemes: a still open debate. *Social Environmental Accounting Journal*, Vol 34 (1), pp. 45-51. Allini, A., Giner, B., and Calderelli, A. (2018), Opening the black box of accounting for greenhouse gas emissions: The different views of institutional bodies and firms, *Journal of Cleaner Production*, Vol. 172: 2195-2205		
Primary definitions	Provision/ contingent liability	See 2.2 Waste	
	Emission asset/ right	An identifiable non-monetary asset without physical substance (intangible asset). An asset is identifiable if it 1) is separable, i.e. capable of being separated or divided from the entity and sold, licensed etc.; or 2) arise from contractual or legal rights.	IAS 38.8 IAS 38.12
Limits	IFRS includes	• When a company applies IFRIC 3 to emission trading schemes: o Asset for allowances held (rights according to IFRIC 3) o Liability for obligations to deliver allowances equal to emissions that have been made • *Provision* for legal claims, e.g. from health problems caused by emissions from the company. • *Contingent liabilities (disclosure)* for legal claims not recognised as a provision due to cash outflow is not probable.	
	IFRS does not include	**Not in focus for investors (single materiality), e.g.:** • *Cost* of damaged on environment or climate changes caused by emissions, such as CO_2 or methane gas. **Not meeting definition of assets and liabilities, e.g.:** • *Provisions* for potential health problems caused by the company's emissions, such as NOx and SOx from plants and vehicles.	

Procurement

IFRS Standards	IAS 2 – Inventories IFRS 9/IFRS 7/IAS 32 – Financial Instruments/F.I. Disclosures/F.I. Presentation IAS 37 – Provisions, Contingent Liabilities and Contingent Assets (ad 1)		
Primary definitions	Cost of inventories/ conversion	See 2.2 Waste	
	Provision/ contingent liability	See 2.2 Waste	
	Payable	A contractual obligation to deliver cash or another financial asset to another entity.	IAS 32.11
Limits	IFRS includes	• *Cost of goods sold and other OPEX* • *Trade & other payables,* i.e. monetary items • *Provision or contingent liabilities,* e.g. for chain liabilities • *Disclosure of currency risk & liquidity risk* • *Cost of loss of scarce minerals, fish, oil/gas or other limited resources,* by price increases in the long term. • *Tax on profit*, indirectly covering the company's use of public infrastructure (e.g. roads) for transportation, etc.	
	IFRS does not include	**Not in focus for investors (single materiality), e.g.:** • *Cost of using the nature*, e.g. from loss of biodiversity, adverse impacts on people and planet from unsustainable forestry, mining, or fishing, etc. • *Disclosure of emissions and waste in the supply chain* • *Disclosure of risks of negative ethical behaviour in the supply chain*, e.g. forced labour, child labour, poor working conditions or welfare benefits for people, sexual harassment, poor animal welfare, corruption/bribery, etc. **Not meeting definition of control, e.g.:** • *Cost of goods and services sold when the company acts as an agent.* **Not including forward looking information, e.g.:** • *Disclosure of economic risks*, such as price & supply risks, etc. except to some extent for assumptions on measurement and estimation uncertainty.	

IFRS Standards	IAS 16 – Property, Plant and Equipment IAS 38 – Intangible assets (ad 3) IAS 41 – Agriculture IFRS 16 – Leases IAS 37 – Provisions, Contingent Liabilities and Contingent Assets (ad 1)		
Primary definitions	Property, Plant and Equipment	Tangible assets that are held for use in the production or supply of goods or services, rental, etc. and are expected to be used during more than one period	IAS 16.6
	Intangible assets	An identifiable non-monetary asset without physical substance. An asset is identifiable if it 1) is separable, i.e. capable of being separated or divided from the entity and sold, licensed etc.; or 2) arise from contractual or legal rights.	IAS 38.8 IAS 38.12
	Research	Original and planned investigation undertaken with the prospect of gaining new scientific or technical knowledge and understanding.	IAS 38.8
	Development	The application of research findings or other knowledge to a plan or design for the production of new or substantially improved materials, devices, products, processes, systems or services before the start of commercial production or use.	IAS 38.8
	Exploration and evaluation assets ('E&E')	Arising from exploration and evaluation of mineral resources, when the costs qualify for recognition, which is the case, when an entity applies the exemption granted by IFRS 6, i.e. when applying the full-cost method or the successful efforts method. Generally, this is only applicable, if the entity applied one of the methods prior to its first-time adoption of IFRS.	IFRS 6
	Internally generated intangible asset	An asset arising from the company's own development activities, when certain criteria are met.	IAS 38.52 IAS 38.57
	Biological asset	Living animal or plant	IAS 41.5
	Bearer plant	Living plant that is used in the production or supply of agricultural produce and is expected to bear produce for more than one period.	IAS 41.5
	Right-of-use asset ('RoU')	An asset that represents a lessee's right to use an underlying asset for an agreed term.	Appendix A (IFRS 16)
	Control	An entity controls an asset, if the entity has the power to obtain future economic benefits flowing from the underlying resource and to restrict the access of others to those benefits. Technical knowledge is controlled only if the knowledge is protected by legal rights. Same applies to skills and technical talent of employees or management.	IAS 38.13 IAS 38.14 IAS 38.15
	Cost of an asset	The acquisition cost, construction costs or development costs. By and large, the cost of a RoU asset is the present value of the future lease payments. The cost of PPE and RoU include provision for dismantling costs.	IAS 16.6 IAS 16.18 IAS 38.27 IAS 38.65 IFRS 16.24
	Construction/ development costs	The direct costs necessary to create, produce and prepare the asset capable of operating	IAS 16.16 IAS 16.22 IAS 38.66
	Decommissioning costs/ provision	See 2.2 Waste	

Limits	IFRS includes	• *The depreciated (or impaired) cost of the assets, inclusive decommissioning costs.* • *Depreciation and amortization over the useful life.* • *Impairment losses*, e.g. from climate related impacts or change in demand of products/services from deterioration of name/brand value due to negative behaviour by the company or its relations. • *Impact from technical obsolescence on useful lives, etc.,* e.g. due to climate changes. • *Provision* for legal or constructive decommissioning obligations • *Royalty, license and lease income (revenue) from granted use or access to the company's assets, some of which may not be recognised as assets,* e.g. royalty for use of brand name or labels, license for use or access to software, lease income from use of property, etc. • *Disclosure of committed investments*
	IFRS does not include	*Overall, the same as for Procurement – see 2.4. In addition:* **Not in focus for investors (single materiality), e.g.:** • Stranded and retired assets (see 2.2 Waste). • Disclosure of risks of negative behaviour by parties to which the company has granted right to use its intangible assets, e.g. brand name, labels, software, etc., or its property subject to leaseholds. **Not meeting definition of control, e.g.:** • The value of unrecognised technical knowledge, skills and talent. **Not meeting definition of assets and liabilities, e.g.:** • The potential future value from research and development activities not recognised as an intangible asset. • The potential future value from unextracted mineral reserves. • The total cost of E&E, not recognised as an asset due to the company's choice of accounting policy, of which future benefits are probable.

IFRS Standards	IAS 19 – Employee benefits		
Primary definitions	Employee benefits	All forms of consideration given by an entity in exchange for service rendered by employees or for the termination of employment.	IAS 19.8
	Short- and long-term benefits	Wages, salaries, social contributions, paid leave (for holiday, sickness, etc.), bonuses, and non-monetary benefits, such as medical care, housing, cars and free or subsidized goods or services for current employees.	IAS 19.5
	Termination benefits	Benefits provided in exchange for the termination of an employee's employment, such as severance pay.	IAS 19.8
	Post-employment benefits	Employee benefits that are payable after the completion of employment. Includes retirement benefits, such as pensions, life insurance and post-employment medical care or non-monetary benefits.	IAS 19.5 IAS 19.8
Limits	IFRS includes	• *Cost of employee benefits* • *Provision for post-employment benefits (Defined Benefit Plans)* • *Provision for constructive obligations or legal claims raised for violation of labour or human rights.* • *Provision for constructive obligations or legal claims raised due to bad behaviour by the employees* • *Disclosure of contingent liabilities for legal claims not meeting the recognition criteria.* • *Various disclosures about post-employment benefits* • *Tax on profit*, indirectly covering welfare benefits offered by the public community, such as education, schooling, maternity pay, medical care, medicine, etc.	
	IFRS does not include	**Not in focus for investors (single materiality), e.g.:** • *The cost of educating and training of employees prior to employment* • *The cost of employees for human reproduction, not covered by the company or public benefits,* such as loss of life income. • *The value given to the society related to the knowhow, skills and talent of former employees* • *Disclosure of the risk of violation of the employees' labour or human rights somewhere in the company's geography and/or supply chain.* • *Disclosure of the risk of negative behaviour by employees* • *Disclosure of the level of security for employees and safety precautions.* • *Disclosure of precautions to prevent violation of the employees' labour rights, such as forced labour, child labour, poor working conditions, low or inequal pay, etc.* • *Disclosure of precautions to prevent violation of human rights, such as discrimination, sexual harassment, freedom of expression, etc.* • *Disclosure of precautions to prevent negative ethical behaviour by employees.* • *Disclosure of (no means exhaustive):* o The number of people employed o The number (or share) of freelancers o Gender distribution or other diversity information, such as age o Equality in compensation/benefits o Employee satisfaction o Employee turnover o Number of accidents o Number of days caused by sickness or accidents o Number of days granted for leave in excess of legal requirements. **Not meeting definition of assets and liabilities, e.g.:** • The value to the company (current and potential) of the knowhow, skills and talent of its employees • Provision for degeneration of bodies or physical or mental disability caused by the employment.	

Management / related parties

IFRS Standards	IAS 19 – Related Party Disclosures		
Primary definitions	Key management personnel	Those persons having authority and responsibility for planning, directing and controlling activities of the entity, directly or indirectly, including any director (whether executive or otherwise) of the entity.	IAS 24.9
Limits	IFRS includes	• *Compensation costs, inclusive share-based payment* • *Provision for long-term and post-employment benefits* • *Disclosure of compensation by category* • *Related party transactions (other than compensation)*	
	IFRS does not include	*Overall, the same as for Human Resources – see 2.6. In addition:* **Not in focus for investors (single materiality), e.g.:** *Disclosure of (no means exhaustive):* • The number of executives and board members • Other governance information about the stewardship efficiency of top management	

Equity Investments, associates and joint arrangements

IFRS Standards	IAS 28 – Investments in Associates and Joint Ventures IFRS 11 – Joint Arrangements IFRS 9/IFRS 7/IAS 32 – Financial Instruments/F.I. Disclosures/F.I. Presentation IFRS 12 – Disclosure of Interests in Other Entities		
Primary definitions	Associated	An entity over which the investor has significant influence	IAS 28.3
	Joint Venture	A joint arrangement whereby the parties sharing control have rights to the net assets of the arrangement	IAS 28.3
	Joint Operation	A joint arrangement whereby the parties sharing control have rights to the asset, and obligations for the liabilities, relating to the arrangement	IFRS 11, Appendix A
	Equity instrument	Any contract that evidence a residual interest in the assets of an entity after deducting all its liabilities, such as shares	IAS 32.11
Limits	IFRS includes	• *Dividend income* • *The company's share of equity in associates/joint ventures, or fair value, if investment qualifies for fair value measurement.* • *The company's share of assets and liabilities in joint operations* • *Loans to/from associates/joint ventures or collaborators* • *Fair value of other equity interests.* • *Provision for the risk of loss in relation to provided guarantees or other legal or constructive obligations in relation to those interests.* • *Commitments and contingent liabilities (or contingent assets) in relation to those interests.* • *Disclosures of information that enables users to evaluate:* o *The nature, extent and financial effects of the company's interests in joint arrangements and associates, including the nature and effects of its contractual relationship with the other investors.* o *The nature of, and changes in, the risks associated with its interests in joint ventures and associates.* • *Disclosure of the name, principal place of business and proportion of ownership (of material interests).* • *Disclosure of summarised financial information about the associate or joint venture.* • *Disclosure of fair value of joint ventures or associates when there is a quoted market price for the investment.* • *Disclosure of financial risks in relation to other equity interests.* • *Various disclosures about fair value measurement.*	
	IFRS does not include	**Not in focus for investors (single materiality), e.g.:** • *Disclosure of the risk of negative behaviour by the associates, joint ventures, collaborators, or other investors.* • *The impacts (negative/risks or positive/value creation) on environment and society in joint ventures, associates, and other equity interests in relation to sale, waste, procurement, human resources, etc., to which the company is indirectly exposed by its equity interest.* • *Disclosure about the company's stewardship or policies for active ownership of its equity investments.*	

IFRS Standards	IAS 12 – Income Taxes IAS 20 – Government Grants IFRS 9/IFRS 7/IAS 32 – Financial Instruments/F.I. Disclosures/F.I. Presentation IFRS 10/IFRS 12 – Consolidated Financial Statements/Disclosure of Interests in Other Entities IFRIC 12 – Service Concession Arrangements		
Primary definitions	Government	Refers to government, government agencies and similar bodies whether local, national or international.	IAS 20.3
	Non-controlling Interests ('NCI')	Equity in a subsidiary not attributable, directly or indirectly, to the parent company.	IFRS 10, Appendix A
	Public-to-private service concession arrangements	Contractual service arrangements where the private sector participates in the development, financing, operation and maintenance of public infrastructure, such as roads, bridges, tunnels, prisons, hospitals, airports, water distribution facilities, energy supply and telecommunication networks.	IFRIC 12.1 IFRIC 12.2
Limits	IFRS includes	• *Interest expenses/income, etc.* • *Income and costs of Service Concession Arrangements* • *Government grants* • *Taxes* • *Assets from construction or upgrade of public infrastructure in a Service Concession Arrangement (Intangible or Financial asset)* • *Cash & Cash Equivalents and Cash Flow Statement* • *Borrowings from banks and other loan providers* • *Capital contributions from and dividends paid to NCI's* • *Disclosure of financial risks (interest rate risk, currency risk, credit risk, liquidity risk, etc.)* • *Disclosure of the nature and extent of government grants recognised in the financial statements and an indication of other forms of government assistance from which the company has directly benefited.* • *Disclosure of unfulfilled conditions and other contingencies attached to government assistance.*	
	IFRS does not include	**Not in focus for investors (single materiality), e.g.:** • *Disclosure of the risk of negative behaviour by the company's banks, loan providers or NCI's* • *Disclosure about tax planning activities.* • *Disclosure about earnings and taxes by country* • *Disclosure of precautions to prevent money laundering,* e.g. by securing information about the origin of funds provided by loan providers and NCI's. • *Disclosures to handle pressure from people in Public Authorities for corruption or bribery, wherever this may be applicable.* **Not meeting definition of assets and liabilities, e.g.:** • *Costs and decommissioning provision for Service Concession Arrangements,* e.g. if the company is not contractually obliged to do it.	

APPENDIX 2B: DETAILED ANALYSIS OF LIMITS OF IFRS STANDARDS

Considering the financial materiality assessment under IFRS and other specific IFRS requirements, to what extent we can reasonably expect to find disclosure of ESG matters provided in IFRS reports?

IFRS SCOPE REGARDING ESG MATTERS WITH FINANCIAL IMPLICATIONS

1 In order to assess whether and to what extent the concepts in financial reporting standards may accommodate the environmental and social materiality, it is helpful to refer to a recent article issued in November 2019 by Nick Anderson, IASB member, 'IFRS standards and climate-related disclosures'. In this article, the IASB notes that:

1) while climate-change risks and other emerging risks are not covered explicitly by IFRS Standards, the Standards do address issues that relate to them. The potential financial implications arising from climate-related and other emerging risks may include requirements set out in: IAS 1 *Presentation of Financial Statements;* IAS 36 *Impairment of Assets*; IAS 16 *Property, Plant and Equipment;* IAS 38 *Intangible Assets;* IFRS 13 *Fair Value Measurement;* IFRS 9 *Financial Instruments;* IFRS 7 *Financial Instruments: Disclosures;* and IAS 37 *Provisions, Contingent Liabilities and Contingent Assets;*

2) the need for materiality judgements is pervasive in the preparation of financial statements. As set out in IAS 1, information is material if omitting, misstating or obscuring it could reasonably be expected to influence decisions that the primary users of financial statements make on the basis of those financial statements, which provide financial information about a specific reporting entity. Materiality depends on the nature or magnitude of information, or both. Building on this concept, the IASB Practice Statement 2, *Making Materiality Judgements*, emphasises that an item of information could influence primary users' decisions regardless of its size, and a quantitative threshold could even reduce to zero, such as when information about a transaction, other event or condition is closely scrutinised by the primary users.

3) disclosures in other documents (including presentations, management commentary and sustainability reports) will not compensate for the omission of disclosures that are required to be made in the financial statements and are therefore subject to audit in most jurisdictions.

2 The IASB in conclusion acknowledges that financial statements do not and cannot satisfy the needs of each primary user and all interested parties. Financial statements focus on common investor needs and are not intended to report to all users on all matters that may be of interest to them. The IASB notes that management commentary or management discussion and analysis complement the financial statements. Finally, the IASB would expect management to report on environmental and social issues to the extent necessary for primary users of financial statements to form their own assessment of the company's longer-term prospects and management's stewardship of the business.

IFRS REQUIREMENTS THAT MAY RESULT IN ESG MATTERS (E.G. CLIMATE CHANGE) TO BE DISCLOSED

3 IFRS Standards may require an update to the financial information for climate-related risks or other emerging risks. The following is a brief summary for standards that may be relevant.

Table 3: Potentially relevant IFRS Standards[8]

IAS 1	IAS 1 requires disclosure in the notes of information that is not presented elsewhere in the financial statements but is relevant to an understanding of them. Information will be relevant if it could reasonably be expected to influence decisions made by investors. For example, a company may need to explain whether and how it has considered climate-related risks in its impairment calculations even though IAS 36 makes no requirement for such a disclosure. Where other companies in a similar industry have recognised significant write-downs and investors have publicly demanded such information, a company may need to disclose whether climate-related risks have affected the carrying amount of the assets recognised in the financial statements.
IAS 36	The carrying amount of assets such as property, plant and equipment, assets recognised in relation to mineral resources, intangible assets and goodwill could be overstated if the impairment calculations do not account for the effect of climate-related risks. A company's exposure to climate-related risks could be an indicator that an asset or a group of assets is impaired; that exposure could also affect future estimated cash inflows and outflows used for recoverable amount calculations. IAS 36 requires disclosure of the key assumptions on which cash flow projections have been based and management's approach to determining the value assigned to these key assumptions, in particular, in relation to goodwill or indefinite-life intangible assets. Where climate-related risks could significantly affect the recoverable amount of a company's assets, information about how the effect has been factored into recoverable amount calculations would be relevant for the users of the financial statements. Such information about long-lived assets and assets recognised in relation to mineral resources would be particularly relevant to users. In the extractive industries, investors may look for explanations as to whether a company has considered the effect of climate-related risks in determining whether exploration, or the evaluation of certain areas of interest, should continue.
IAS 16	Other than impairment, climate-related risks may also affect: • whether some expenses relate to items that satisfy the definition of an asset and can be recognised (for example, as property, plant and equipment or an intangible asset); and • the estimated useful lives of assets, and therefore the amount of depreciation or amortisation recognised each year.
IAS 37	The impact of climate change may affect: • the recognition and disclosure of a contingent liability for potential litigation and fines or penalties due to regulations; and • the best estimate of a provision (including onerous contract or for decommissioning or rehabilitating environmental damage).
IFRS 7[9] and 9[10]	For the calculation of IFRS 9 impairments, forward-looking information is necessary to calculated expected credit losses. Therefore, for credit providers, the determination of the impact of climate-risk factors on credit risk may be important, e.g., when providing credit to fossil-fuel-intensive projects. IFRS 7 requires disclosures about price risk for investments, e.g. in industries that may be affected by climate change. Disclosures include the exposures, the risk management objectives related to the exposure and changes from the previous period.
IFRS 13[11]	Key-assumption disclosures may incorporate a number of scenarios including climate change or other emerging risk. Disclosure of the relevant assumptions may be important even if quantification of impact is not possible.

8 Source of this table: In brief – IFRS Standards and climate-related disclosures, November 2019

9 Financial Instruments: Disclosures

10 Financial Instruments

11 Fair Value Measurement

FOCUS ON IAS 36: ASSESSING THE VALUE OF STRANDED ASSETS

4 The table above reports the key requirements in IAS 36. The core principle in IAS 36 is that an asset must not be carried in the financial statements at more than the highest amount to be recovered through its use or sale. If the carrying amount exceeds the recoverable amount, the asset is described as impaired. The entity must reduce the carrying amount of the asset to its recoverable amount and recognise an impairment loss. The recoverable amount of the following assets in the scope of IAS 36 must be assessed each year: intangible assets with indefinite useful lives; intangible assets not yet available for use; and goodwill acquired in a business combination. The recoverable amount of other assets is assessed only when there is an indication that the asset may be impaired. Recoverable amount is the higher of (a) fair value less costs to sell and (b) value in use. Fair value less costs to sell is the arm's length sale price between knowledgeable willing parties less costs of disposal.

5 When applying IAS 36, operating businesses in sectors exposed to climate changes and in particular transition risks may reasonably consider that property, plant and equipment on balance sheet may be hit by an indicator of potential impairment. As such, they have to estimate the recoverable amount of their assets, i.e. the higher of fair value less cost to sell and value-in-use and if this is higher than the current carrying amount, recognise an impairment loss. In absence of prices formed in an active market to be used as a basis for the fair value, both fair-value less cost to sell and value-in-use will be estimated using discounted-cash-flows techniques and incorporating management expected cash flows. Before the full incorporation of the projected financial impacts of the transition risks in the corporate strategy (including in business plan and budgets), it is unlikely that such impacts will be considered in the calculation of the recoverable amount. As a result, the negative implications of transition risk on the financial position of the entity will be not directly visible as part of the reported performance, until they have materialised.

6 This is another illustration of the absence of a forward-looking perspective in IFRS reported performance. Investors increasingly need information that allows them to anticipate the negative impacts of the transition risks, in order to be able to make informed investment decisions.

7 To remediate to this risk, the Carbon Tracker Initiative (CTI) introduced in 2017 the concept of *stranded assets* to start stakeholders to consider the implications of not adjusting investment in line with the required emissions trajectories to limit global warming. Stranded assets are assets that at some time prior to the end of their economic life, are no longer able to earn an economic return (i.e. meet the company's internal rate of return), as a result of changes associated with the transition to a low-carbon economy (lower than anticipated demand / prices). Examples are coal mines, coal and gas power plants, and other hydrocarbon reserves which have become stranded by the transition to a low-carbon economy.

8 The disclosures of both contingencies and management's assessment and evaluation of long-lived assets for potential impairment are critically important in assisting stakeholders in understanding an organisation's ability to meet future reported earnings and cash flow goals.

9 Finally, careful consideration should be given to the linkage between scenario analyses performed to assess the resilience of an organisation's strategy to climate-related risks and opportunities (as suggested in the Task Force's recommendations) and assumptions underlying cash flow analyses used to assess asset (e.g. goodwill, intangibles, and fixed assets) impairments.

APPENDIX 2C: DETAILED ANALYSIS OF LIMITS OF IFRS STANDARDS

HOW THE ISSUE OF UNRECOGNISED INTANGIBLES IMPACTS THE RELEVANCE OF FINANCIAL REPORTING

1 One of the key open financial reporting issues that dominate the current standard setting debate is the relevance of the financial information for intangibles, as resulting from the current financial reporting requirements. Some observers argue that the relevance of financial statements is eroding, citing an increasing difference between the book value and market value of equity or assets[12]. In addition, the growing attention to responsible investments has resulted in increasing demand by primary users of financial statements (providers of financial capital) for better information about how an entity creates and maintain economic value. In this context 'intangibles' refers not only to assets, but also in general to economic resources and opportunities and, more broadly to understanding which are the risks to which the economic value of an entity is currently exposed to or to which an entity may be exposed in the future.

2 With the current economy focussing on services rather than manufacturing, tangible assets have become less important and have been surpassed by innovation, and other intellectual property as the most important value drivers: value creation is now driven by automation, superior technology as well as customer loyalty and human capital. Further evidence is that the ten largest companies by market capitalisation[13] includes one oil company, a reinsurance conglomerate and a healthcare and consumer product conglomerate with the remaining seven representing technology, internet platforms or internet-related offerings.

3 The Coalition for Inclusive Capitalism notes the following in its report, Embankment Project for Inclusive Capitalism (EPIC): *In this 21st century business environment, intangible assets like human capital, organisational culture, customer loyalty and trust are more important than ever. They have become such important determinants of a business's success that, globally, intangible assets now represent on average over 50% of a company's market value – and up to 80% in some industries, such as advertising and technology. The problem is that standard accounting practices show the costs associated with these intangible assets, such as the cost of training employees or investing in innovation. But they still do not reflect the vast majority of their value.*

4 This issue originates by the limits of current financial reporting approach. In fact, as a result of the IFRS requirements, the current balance sheet of an entity does not reflect the value of many economic resources to which the entity has access, either because they fail to meet the accounting definition of an asset of the Conceptual Framework of IFRSs, or because, despite meeting this definition, they don't qualify for recognition under IAS 38 or IFRS 3. In this report this issue is referred to as to the 'unrecognised intangibles'. This issue is further illustrated below.

5 Examples of intangibles include (but not limited) computer software, patents, copyrights, motion picture films, customer lists, mortgage servicing rights, fishing licences, import quotas, franchises, customer or supplier relationships, customer loyalty, market share, marketing rights, business processes, dynamic capabilities (such as the ability to adapt to new working methods), capability, presence in geographic markets or locations, strong labour relations, ongoing training or recruiting programs, knowledge capital, ecological attitudes, outstanding credit ratings and access to capital markets and favourable government relations.

6 However, not all these items meet the definition:

1) of asset under the IFRS Conceptual Framework, i.e. resource controlled by the entity as a result of past events and from which future economic benefits are expected;

12 Paragraph 2.13 of the EFRAG report, 'What do we really know about goodwill and impairment? A quantitative study', September 2016

13 https://www.statista.com/statistics/263264/top-companies-in-the-world-by-market-capitalization/

2) of intangible asset under IAS 38, i.e. identifiability, control over a resource and existence of future economic benefits. For example, customer loyalty is important for many businesses but (unlike a customer list) cannot be sold or otherwise made available to others (except on the sale of a business as a whole). Also, as identified in IAS 38, an entity does not have sufficient control over its skilled workforce (and the training that has created those skills) to meet the definition of an asset.

7 In addition, IAS 38 (paragraph 51) specifies that it is difficult to assess whether an internally generated intangible asset qualifies for recognition (whether and when there is an identifiable asset that will generate expected future economic benefits and determining the cost of the asset reliably). IAS 38 indicates that internally generated goodwill, brands, mastheads, publishing titles, customer lists, start-up costs, training costs, advertising costs, relocation costs and items similar in substance shall not be recognised as intangible assets.

8 Furthermore, regarding research and development costs, all research costs are charged to expense when incurred. Development costs are capitalised only after technical and commercial feasibility of the resulting product or service have been established.

IFRS requirements for internally developed and acquired Intangibles (IAS 38)

9 The following illustration focusses on recognition requirements contained in IAS 38 and on the definition of asset of the Conceptual Framework.

10 The recognition of an item as an intangible asset requires an entity to demonstrate that the item both meets:

a) the definition of an intangible asset (identifiability, control, and future economic benefit); and

b) the additional recognition criteria.

11 Intangible assets are defined as an 'identifiable non-monetary asset without physical substance'.

12 Under the IFRS Conceptual Framework, an asset is a resource controlled by the entity as a result of past events and from which future economic benefits are expected to flow to the entity.

13 Therefore, when assessing whether to recognise an intangible an entity has to cumulatively assess whether

a) it meets the definition of an asset; and

b) it is identifiable.

14 An asset is identifiable if it either:

a) is separable, i.e. is capable of being separated or divided from the entity and sold, transferred, licensed, rented or exchanged, either individually or together with a related contract, identifiable asset or liability, regardless of whether the entity intends to do so; or

b) arises from contractual or other legal rights, regardless of whether those rights are transferable or separable from the entity or from other rights and obligations.

15 An entity controls an asset if the entity has the power to obtain the future economic benefits flowing from the underlying resource and to restrict the access of others to those benefits.

16 Market and technical knowledge may give rise to future economic benefits. An entity controls those benefits if, for example, the knowledge is protected by legal rights such as copyrights, a restraint of trade agreement (where permitted) or by a legal duty on employees to maintain confidentiality.

17 The future economic benefits flowing from an intangible asset may include revenue from the sale of products or services, cost savings, or other benefits resulting from the use of the asset by the entity. For example, the use of intellectual property in a production process may reduce future production costs rather than increase future revenues.

18 Intangible assets are recognised if it is probable that the future economic benefits that are attributable to the asset will flow to the entity and the cost of the asset can be measured reliably.

19 An entity shall assess the probability of expected future economic benefits using reasonable and supportable assumptions that represent management's best estimate of the set of economic conditions that will exist over the useful life of the asset.

20 The probability recognition criterion is always considered to be satisfied for intangible assets that are acquired separately.

21 All research costs are charged to expense when incurred. An intangible asset arising from development (or from the development phase of an internal project) shall be recognised only after all the conditions described below can be demonstrated:

a) the technical feasibility of completing the intangible asset so that it will be available for use or sale;

b) its intention to complete the intangible asset and use or sell it;

c) its ability to use or sell the intangible asset;

d) how the intangible asset will generate probable future economic benefits;

e) the availability of adequate technical, financial and other resources to complete the development and to use or sell the intangible asset; and

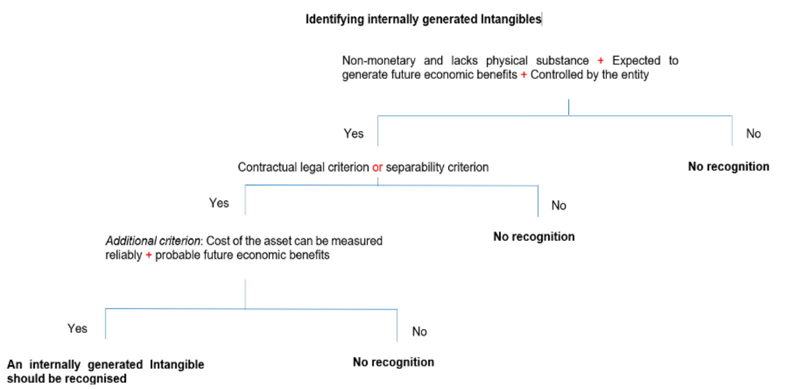
f) its ability to measure reliably the expenditure attributable to the intangible asset during its development.

22 It is sometimes difficult to assess whether an internally generated intangible asset qualifies for recognition (whether and when there is an identifiable asset that will generate expected future economic benefits and determining the cost of the asset reliably).

23 Internally generated goodwill, brands, mastheads, publishing titles, customer lists, start-up costs, training costs, advertising costs, relocation costs and items similar in substance shall not be recognised as intangible assets.

24 For example, if an entity recognises a prepayment asset for advertising or promotional expenditure, it is only able to do so up to the point at which it has the right to access the goods purchased or up to the point of receipt of services. Mail order catalogues are specifically identified as a form of advertising and promotional activities and are expensed when they are received.

25 In summary the following decision tree should be considered when identifying whether internally generated intangibles can be recognised:



Intangibles acquired in Business Combination (IFRS 3)

26 The following illustration focusses on recognition requirements contained in IFRS 3.

27 Similar to IAS 38 Intangible Assets, IFRS 3 Business Combination defines intangibles asset as 'identifiable non-monetary asset without physical substance'.

28 Therefore, intangibles acquired in a business combination must meet the three conditions (identifiability, control, and future economic benefit) attached to definition of an intangible asset.

29 However, the additional recognition criteria (measurability and probability of future economic benefits) are assumed to be always met in the context of a business combination.

30 Intangible assets, including in-process research and development, acquired in a business combination are recognised separately from goodwill if they arise as a result of contractual or legal rights, or if they are separable from the business.

31 Therefore, the acquirer's application of these recognition principle and conditions may result in recognising some assets and liabilities that the acquiree had not previously recognised as assets and liabilities in its financial statements. For example, the acquirer may recognise the brand name, a patent or a customer relationship, that the acquiree had not recognised as assets in its financial statements because it developed them internally and charged the related costs to expense.

32 The identifiability criteria determine whether an intangible asset is recognised separately from goodwill. The acquirer shall recognise, separately from goodwill, the identifiable intangible assets acquired in a business combination. An intangible asset is identifiable if it meets either the separability criterion or the contractual-legal criterion.

33 An intangible asset that meets the contractual-legal criterion is identifiable even if the asset is not transferable or separable from the acquiree or from other rights and obligations. For example, if an entity owns a technology patent with the exclusive use receiving a specified percentage of future revenue. If this entity is acquired, this patent would meet the contractual-legal criterion.

34 The separability criterion means that an acquired intangible asset is capable of being separated or divided from the acquiree and sold, transferred, licensed, rented or exchanged, either individually or together with a related contract, identifiable asset or liability.

35 An intangible asset that the acquirer would be able to sell, license or otherwise exchange for something else of value meets the separability criterion even if the acquirer does not intend to sell, license or otherwise exchange it. An acquired intangible asset meets the separability criterion if there is evidence of exchange transactions for that type of asset or an asset of a similar type, even if those transactions are infrequent and regardless of whether the acquirer is involved in them. For example, customer and subscriber lists are frequently licensed and thus may meet the separability criterion. However, a customer list acquired in a business combination would not meet the separability criterion if the terms of confidentiality or other agreements prohibit an entity from selling, leasing or otherwise exchanging information about its customers.

36 An intangible asset that is not individually separable from the acquiree or combined entity meets the separability criterion if it is separable in combination with a related contract, identifiable asset or liability. For example, an acquiree owns a registered trademark and documented but unpatented technical expertise used to manufacture the trademarked product. To transfer ownership of a trademark, the owner is also required to transfer everything else necessary for the new owner to produce a product or service indistinguishable from that produced by the former owner. Because the unpatented technical expertise must be separated from the acquiree or combined entity and sold if the related trademark is sold, it meets the separability criterion.

37 IFRS 3 includes examples of the following identifiable intangible assets:

a) marketing-related intangible assets, such as trademarks, trade names, internet domain names, non-competition agreements etc.

b) customer-related intangible assets, such as customer lists, customer contracts, customer relationships etc.

c) artistic-related intangible assets, such as books, pictures, musical works, audio-visual material etc.

d) contract-based intangible assets, such as licensing agreements, servicing contracts, employment contracts, use rights etc.

e) technology-based intangible assets, such as patented technology, computer software, databases, etc.

38 Economic benefits that usually do not constitute identifiable intangible assets.

39 Other resources are commonly found in business combinations but do not meet the definition of an identifiable intangible asset. As such, they may affect the value of other assets, liabilities and contingent liabilities or they are simply included in goodwill. Normally, they would however not be recognised as identifiable intangible assets:

40 Previously recognised goodwill: Previously recognised goodwill does not arise from contractual or other legal rights. It is also not capable of otherwise being separated or divided from the entity in a hypothetical transaction.

41 Assembled workforce: The assembled workforce is not considered identifiable. There is usually insufficient control over the economic benefits that may result from the assembled workforce.

42 Synergies: Synergies are usually not identifiable as they do not depend on contractual or other legal rights and they are usually not capable of being separated from the acquired entity.

43 Market share, market potential, monopoly situations or similar 'strategic values': A robust position in the market may enhance the actual value of identifiable marketing-related or technology-driven intangible assets. However, the acquiree's market share or market condition is itself not an identifiable intangible asset as this economic condition does not describe a controllable potential future economic benefit.

44 High credit or going concern: Value is sometimes attributed to a high credit rating or other indicators of the sustained ability of the acquiree to operate as a going concern and these factors may affect the cost of the combination. However, these values do not normally meet the criteria for identifiability and are not controllable future economic benefits.

Boundaries of IFRS definition

45 The IASB doesn't have any ongoing standard setting project to address a revision of IAS 38. However, the topic may originate a new research project in the IASB Agenda, following the IASB Agenda consultation planned for 2021.

46 As also recognised in the IASB Staff paper[14] of December 2019, IAS 38 does not provide information about unrecognised internally generated intangible assets, such as:

a) Human capital (e.g., workforce culture and employee competencies) that drive towards higher productivity and innovation;

b) Organisational capital (e.g., innovation, business processes, data, systems and software) that contribute to maintaining competitive advantage; and

c) Relationship capital (e.g., brand and reputation) with key external stakeholders such as customers and suppliers to ensure future business sustainability.

Asymmetric treatment of internally generated and acquired intangibles

47 As described above, IFRS 3 allows for the recognition on balance, under certain conditions, of the intangibles acquired in a business combination. This results in a different treatment between entities that undertake organic growth (who cannot recognise on balance sheet their internally generated assets) and entities that engage in M&A transactions to foster their growth (who will recognise on balance sheet the acquired intangible that meet the conditions of IFRS 3 and

14 https://cdn.ifrs.org/-/media/feature/meetings/2019/december/asaf/ap1-agenda-consultation.pdf

IAS 38 described above). Some observe that this asymmetric treatment contributes to the reduced relevance of financial reporting, as important ratios used in the valuation process that use total book value of assets as denominator are not comparable across entities and may result in a distorted depiction of value.

48 The IASB has recently considered this issue in its Discussion Paper on Business Combinations: Disclosure Goodwill and Impairment (March 2020). In this paper the IASB has excluded the issue of addressing the recognition of internally generated intangible assets from the scope of their current research project. Accordingly, to date there is no active IASB project aimed at addressing this issue.

Measurement uncertainty

49 An obstacle to the possible development of standard setting solutions that would allow recognition of more intangibles on balance sheet is the measurement uncertainty attached to them. Most of the intangibles do not have an active market and then a reliable price/value. Hence, they are a challenge for traditional accounting.

50 Intangibles in the IASB project on Management Commentary Practice Statement (MCPS).

51 The IASB decided in November 2017 to add to its agenda a project to update the Management Commentary Practice Statement and expects to publish an Exposure Draft on the revised MCPS in the first quarter of 2021.

52 During its discussions, the IASB considered a number of content elements of the revised MCPS, including:

a) Business model, resources and relationships, strategy and opportunities;

b) Risks and externalities and trends; and

c) Performance, position and progress; including forward-looking information.

53 As part of the 'Resources and relationships' it is expected that the revised MCPS would set as a principle, that when management identifies 'resources and relationships that the entity depends on for its long-term success', it would need to provide qualitative and quantitative information necessary for primary users' understanding of the nature and importance of those resources and relationships (and their continued availability) to the future operation of the business.

54 The IASB staff does not propose to have a separate section on intangible resources and relationships, but the guidance on resources and relationships will specifically refer to and include examples of intangible resources and relationships. The proposed guidance would apply to both tangible and intangible resources.

55 The proposed guidance will refer to 'intangible resources and relationships' (rather than intangible 'assets) to make it clear that key resources and relationships discussed in management commentary are not only those recognised or disclosed in the financial statements. In other words, in identifying its key resources and relationships, an entity should consider both its tangible and intangible assets and also identify those resources and relationships that have not been reflected in the financial statements because they do not meet the accounting definition of assets or the criteria for recognition as assets.

56 The IASB also confirmed that the current status of the Practice Statement should prevail and therefore, that the MCPS is non-binding.

Other NSS initiatives

57 National standard setters have also recently attempted to address some of the perceived shortcomings of IFRS on the topic of intangible assets. Among the others, two initiatives have recently resulted in proposals that, similarly to the IASB's approach, do not have the ambition to modify the recognition criteria, but propose quantitative or tabular information to be provided as a requirement in the notes to the financial statements. These two proposals are described below:

Financial Reporting Council

58 In February 2019, the FRC launched a consultation about possible improvements to the reporting of how a business generates value. The consultation considered the case for radical change to the accounting for intangible assets and the likelihood of such change being made in the near future.

59 It suggested that:

a) relevant and useful information could be provided without the need to recognise more intangible assets in companies' balance sheets;

b) such information could cover a range of factors, broader than the definition of intangible assets in accounting standards, that are relevant to the generation of value;

c) improvements could be made on a voluntary basis within current reporting frameworks (such as the strategic report); and

d) participants in the reporting supply chain could collaborate to bring about improvements.

60 A majority of respondents acknowledged the limitations of the current reporting framework in capturing and presenting clearly the nature and value of intangibles and were supportive of efforts to address this issue, including strong support from investor respondents.

61 The main reservation expressed about the proposals in the Discussion Paper was that disclosures may be highly subjective and involve significant management judgement due to the inherent measurement uncertainty of intangible assets, and the difficulty in identifying future-oriented expenditure. This was accompanied by concerns around the commercial sensitivity of the information and the costs of compliance. However, comparability was not necessarily seen as a barrier to providing useful information to users and some frameworks such as the WICI Intangibles Reporting Framework is flexible enough to facilitate general comparison, industry specific comparison as well as entity specific measures.

62 Many respondents considered that the measurement uncertainty of intangibles is significant, although some with qualifications as some considered that progress can be made on recognition and measurement. Others suggested further research to evidence whether the measurement uncertainties for internally generated intangibles really are greater than those for internally generated tangible assets or externally purchased intangibles. However, one respondent argued that the measurement uncertainty is not insurmountable and suggested that ideally, separable intangibles should be valued at value in use, to reflect the fact that the value of the same intangible to two different businesses would be different. It also stated that fair value measurement could be considered for intangibles that are separable, legally identifiable, and already employed in company operations.

63 A majority of respondents supported revisiting the current requirements, however respondents were split on the question whether accounting standards should be revised with the aim of improving the accounting for intangibles. Several respondents argued that the current requirements of IAS 38 should not be revisited unless there is a compelling need, as they are well understood and appropriate. Many of these respondents favoured focusing on improvements to narrative reporting.

64 Several respondents specifically noted the importance of focusing on those intangibles that are critical to the business model and value generation and disclosure of metrics standardised by industry with some support for the WICI industry-based metrics and 'inverted pyramid' approach to support comparison across companies supplemented by some entity-specific measures.

Korean Accounting Standards Board (KASB)

65 The KASB has an active research project that advocates for 'The Third Way' around core intangible assets, where the purpose is to report unrecognised intangible assets at the same level of importance as other recognised assets and provide information for decision-making purposes.

66 The idea is that there would be a definition of 'core intangibles' which is regarded as the main driver of the company's value; this is valued at fair value and present and disclose these in a separate statement to be provided in the notes to the financial statements, the Statement of Core Intangibles (SCI)'. The SCI would provide monetary valuation of core intangibles in a separate report, including basis of preparation; main assumptions; key valuation inputs and assumptions.

67 Core intangibles were tentatively defined as intangible factors that are important to an entity in its creation of value, whether or not they are secured by legal means and whether or not they meet the current accounting definition of 'assets'. These are important intangibles that could affect the market as it continues to generate excess profits in relation to the reporting company's (value creation) primary operating activities, and if the information is (important) omitted or misrepresented, it effects information user's decision making (e.g. description on gap between market value and book value).

Practical approaches to enhance effective communications that prevail in intangible-intensive segments

68 To overcome the limits of current IFRS requirements, IFRS preparers in the more intangible-intensive segments (e.g. Biotech, pharmaceuticals and health care equipment & supplies; Interactive media and software; Household products, personal products, textiles and apparel & luxury goods[15]) have developed practical ways to integrate the information required by users, but this is mainly in presentations to investors and press releases, not captured by financial reports, not audited and, despite some market discipline that result in a degree of comparability within the same segment, the information provided is comparable across entities and across segments.

Evidence from academic literature (financial reporting and broader corporate reporting)

69 Given the limitations to recognising intangibles as described above, the solution for those internally generated intangibles that cannot be recognised in the balance sheet is disclosure (Lev, 2001; Lev and Gu, 2016). These unaccounted assets are the focus of attention of a recent literature review commissioned by EFRAG (Zambon et al., 2020).

70 After that review, Zambon et al. (2020, p. 19) conclude 'there are some promising attempts to develop intangibles reporting outside financial reporting, i.e. in integrated reports. The WICI Framework is compatible with the <IR> Framework just in order to facilitate this approach. Yet, we face serious issues of consistency in measurement and disclosure, and hence of comparability'. In other words, the solution is disclosure outside the traditional financial statements.

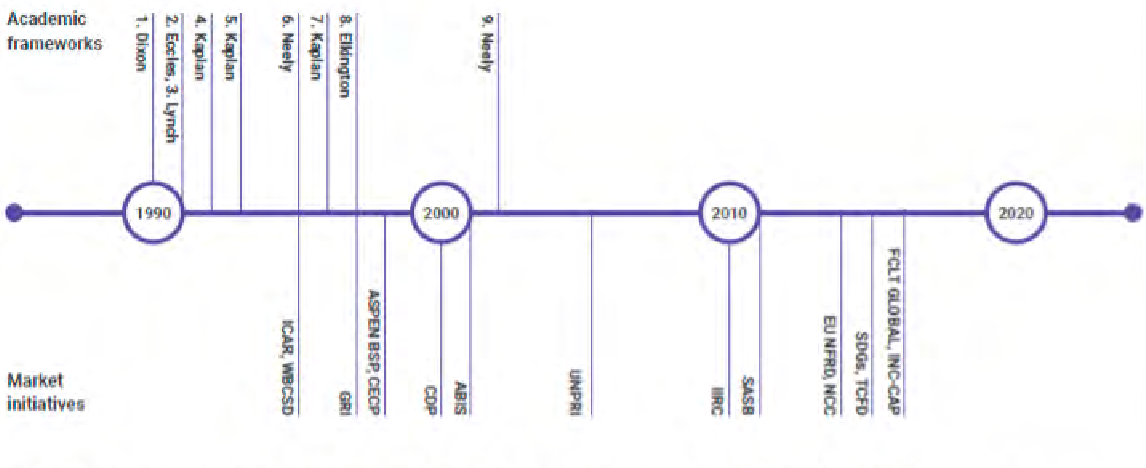
71 Caddy (2000) differentiates between 'hard' intangibles, which are capitalised, and 'soft', also called intellectual capital that gathers human capital, relational capital, and structural capital (human capital could be separated from intellectual capital, also called organisation capital), which are not recognised in the balance sheet. This author remarks that if there are intellectual assets, there are also intellectual liabilities.

72 The interest on the topic of intellectual capital has grown considerably, since it is argued that its management and disclosure should allow organisations to create value and achieve greater profitability. This 'grand theory' seems to support the idea that the more intellectual capital, the better (Dumay, 2012; Guthrie et al., 2012; Lev, 2001; Mouritsen et al., 2001). But as Lev and Gu (2016) mention, the non-recognition of intangible assets is not only due to the standard-setters, but also to the managers and auditors' incentives, who do not like to introduce volatility in the financial statements. In other words, it is not just the assets, but the related risks that convey impairments and potential liabilities what matters.

15 EFRAG ongoing research *Better Information on Intangibles* benefits from the input of a group of expert from these sectors composing an Advisory Panel, in a joint dialogue between users and preparers.

73 On the broader topic of non-financial reporting, a whole host of initiatives has been launched and is summarised as follows in the EPIC report:

Evolution of measurement and reporting



1. Dixon, J., Nanni, A., and Vollmann, T., The New Performance Challenge. **2.** Eccles, R.G., The performance measurement manifesto. **3.** Lynch R.L. and Cross, K.F., Measure Up! **4.** Kaplan, R.S. and Norton, D.P., The balanced scorecard: measures that drive performance. **5.** Kaplan, R.S. and Norton, D.P., Putting the balanced scorecard to work. **6.** Neely, A.D., Gregory, M. and Platts, K., Performance measurement system design. **7.** Kaplan, R.S. and Norton, D.P., The Balanced Scorecard: Translating Strategy into Action. **8.** Elkington, J. (1998). Cannibals with forks: the triple bottom line of 21st century business. **9.** Neely, A., Adams, C. and Kennerley, M. (2002) 'The Performance Prism: The Scorecard for Measuring and Managing Stakeholder Relationships

Information needs of users of NFI outside the financial information perimeter

74 Moving the perspective from the reporting needs of primary users of financial statements (providers of capital), to the reporting needs of a broader group of stakeholders, including investors with a focus on responsible investment and sustainability, but also other stakeholders such as employees, environment and community/society (broader corporate reporting, the current financial reporting requirements show even more prominently their limits, due to their intrinsic characteristics. Financial information is designed to provide mainly retrospective information of monetary quantities, while users of broader corporate reporting need appropriate information to identify and analyse the key risks and opportunities that will influence the company's future development and performance, including information that is relevant for both the financial materiality (outside-in perspective) and the non financial materiality (inside-out perspective). This information is mainly forward-looking in nature, non-monetary in nature and in many cases not relevant from a financial materiality perspective. In other terms, the inherent limitations of financial accounting arising out of the concepts and conventions that have been adopted, explain why, by construction, financial accounting reflects only part of the complex reality of the company:

75 Many analysts note how they are constantly searching for information on the companies they analyse that is much broader than that provided by financial information as codified in accounting standards.

76 Attempts for developing structured best practice guidance approaches to serve the broader corporate reporting have been promoted by private sectors' initiatives, including on reporting for intangibles. Among the others, two relevant initiatives are the WICI Framework and the <IIRC Framerowk>.

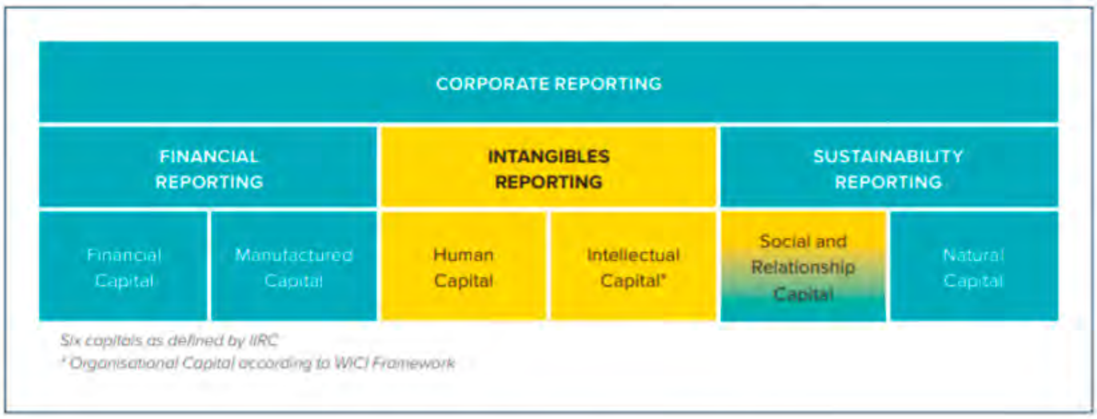
WICI Framework

77 Published in September 2016 by the World Intellectual Capital/Assets Initiative (WICI), the 'WICI Intangibles Reporting Framework' (WIRF) establish principles, the contents and the structure for the reporting of intangible resources that are material for an organisation's value creation process and its communication to stakeholders. Intangibles are defined as 'non-physical resources which, either alone or in conjunction with other tangible or intangible resources, can generate a positive or a negative effect on the value of the organisation in the short, medium and long term'. In the Framework, intangibles are considered as substantially equivalent to the notion of Intellectual Capital. WICI recognises that intangibles may impact two distinct but inter-connected forms of value:

78 Strategic value, related to the enhancement of the competitive, market, product, reputation, and/or risk profile of the organisation;

79 Financial value is linked to the generation of net cash flows over time.

80 The WICI framework position the resulting intangible reporting as intermediate content between traditional financial reporting and sustainability (NFI) reporting and considers as overlapping contents with NFI reporting the information about social and relationship capital, leaving out the information on natural capital, as shown in the following graph.



Source: WICI Intangibles Reporting Framework, 2016, p. 9

<IIRC Framework>

81 Launched through a Conceptual Framework, the International Framework, in December 2013, it aims to help companies communicate to the providers of financial capital and the other stakeholders how they are planning to continue creating value in the short, medium and long-term. The concept of integrated reporting is based on multi-capital thinking: it recognises that organisations rely on a variety of capitals to create value, namely manufactured, natural, intellectual/organisational, social and relationship, financial, and human.

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WICI Framework

<IIRC> Framewowk

APPENDIX 3: CONNECTIVITY MODELS FROM NFI FRAMEWORKS

1 This appendix table shows the connectivity models or methods identified in existing NFI frameworks.

TYPE OF CONNECTIVITY	EXPLANATION	Source
Quantitative Analysis		
a) Scenario Analysis	Calculation of the potential financial impact (revenues, expenditures, assets & liabilities, capital & financing) of various climate change scenarios and explanation why the business will be risk resilient. Concept can be expanded to topics other than climate change.	TCFD, WEF-IBC, PTF on climate risk
b) Impact valuation	Calculation of the social monetary value of external impacts (environmental, social, economic) of business activities and explanation how this affects the business model now and in the future and how a company will reduce negative externalities and improve positive externalities.	Value Balancing Alliance, IMP, WEF-IBC, capitals coalition, multi capitals accounting
c) Indicators with ESG attributes	Disclosure of financial indicators with ESG attributes (e.g. 'green' revenue, 'green' OPEX, 'green' CAPEX, % of 'green' investments)	EU Taxonomy, selected SASB indicators, TCFD, non-binding guidelines
d) Risk quantification	Quantification of ESG risks with likely impact on business performance by using various risk models	Applied by some companies as part of the materiality analysis (GRI, NFRD), TCFD, non-binding guidelines
e) Qualitatively linking changes in ESG indicators to financial performance	Calculation of the financial impact of changes in ESG indicators (e.g. 1% change in employee engagement has 50m EUR impact on operating income)	SAP
f) ESG indicators in mainstream report	Disclosure of ESG indicators (CO_2 Emissions, Diversity,...) in mainstream report / management report	Accounting Directive, SASB, WEB-IBC, NFRD (option), TCFD, non-binding guidelines
g) Financial indicators in ESG report	Disclosure if financial indicators in ESG / Sustainability report (e.g., net revenues, debt, equity, net income,...)	GRI
h) Additional capitals	Disclosure of additional capitals (Financial Capital, Manufactured Capital, Intellectual Capital, Human, Capital, Social and relationship Capital, Natural Capital)	IIRC
i) Targets	Disclosure of non-financial targets	GRI, TCFD, non-binding guidelines, NFRD (part of concepts)
Qualitative Analysis		
a) Value creation / strategy	Qualitative explanation of how ESG topics affect value creation / strategy of a company	IIRC, EU Taxonomy, TCFD, non-binding guidelines, NFRD
b) Risks & Opportunities	Qualitative explanation of how ESG topics affect risks and opportunities, also over time (forward looking information)	IIRC, EU Taxonomy, TCFD, non-binding guidelines, NFRD
c) Governance	Qualitative explanation of how ESG topics are managed by a company	IIRC, TCFD, NFRD

TYPE OF CONNECTIVITY	EXPLANATION	Source
d) Performance	Qualitative explanation of how ESG topics affect financial performance of a company, also over time (forward looking information)	IIRC, TCFD
e) Assets / liabilities	Qualitative explanation of how ESG topics might affect assets / liabilities of a company, also over time (forward looking information)	IIRC, TCFD, non-binding guidelines
f) Qualitative impact analysis	Explanation of the qualitative social external impacts (environmental, social, economical) of business activities and explanation how this affects the business model now and in the future and how a company will reduce negative externalities and improve positive externalities.	GRI, SDG reporting guides, WEF-IBC, Value Balancing Alliance, IMP, capitalscoalition, multi capitals accounting
g) Measures	Description of measure taken to manage ESG topics	GRI, TCFD, non-binding guidelines, NFRD
Place of reporting		
a) management reporting	Connectivity information should be given in the management report	IIRC, Accounting Directive, NFRD (Option); EU Taxonomy (follows NFRD), SDG reporting guides, WEF-IBC
b) financial statements	Connectivity information should be given in the financial statements	
c) annual report	Connectivity information should be given in the annual report outside the management report	
d) separate report	Connectivity information should be given in a separate report outside of mainstream report (e.g. non-financial report, sustainability report)	NFRD (option), EU Taxonomy (follows NFRD), GRI
e) additional reports	Connectivity information should be given in the mainstream report and supplementary ESG information can be given through other communication means / reports	IIRC (one core report and more if needed)
Scope of reporting		
a) control concept	see IFRS requirements for consolidation	IFRS
b) value chain concept	Report information on value chain ('upstream'), own operations and products and services in use ('downstream')[16]	many non-financial reporting frameworks (GRI, GHG Protocol,...)
Materiality		
a) dynamic materiality	material for financial statements, material for enterprise value, impact on society	Collaboration Statement, WEF-IBC
b) Double materiality	material for development, performance and position of companies AND external impact of activities are material	NFRD

16 For a detailed analysis see: Girella, L. (2017), The boundaries in financial and non-financial reporting, Routledge, New York

APPENDIX 4:
LOCATION OF NON-FINANCIAL INFORMATION

INTRODUCTION

1 This appendix provides further details on the assessment of the currently permitted approaches regarding the location of non-financial information subject to the NFRD.

2 To this end, the advantages and drawbacks of the three currently permitted approaches, namely inclusion in the management report and publication of a separate report, either published together with the management report or on an entity's website no longer than six months after the balance sheet date, are analysed in further detail.

ASSESSMENT

Current regulatory environment regarding the location of non-financial information subject to the NFRD

3 Entities may choose from the following approaches to disclose non-financial information subject to the NFRD:

- In principle, the inclusion in the management report is foreseen (Directive 2013/34/EU Art. 19a (1) and Art. 29a paragraph 1).
- Member States are granted an option with regard to the alternative presentation in a separate report (Directive 2013/34/EU Art. 19a para. 4 or Art. 29a para. 4) provided that such report:

a) is published together with the management report in accordance with Art. 30; or

b) is made publicly available within a reasonable period of time, not exceeding six months after the balance sheet date, on the undertaking's website, and is referred to in the management report.

4 Most Member States took up the abovementioned option when transposing the Directive (see EU consultation on the NFRD revision).

5 Irrespective of whether the non-financial statement is contained in the management report or in a separate report, it is explicitly excluded from the scope of Art. 34 of the Accounting Directive, i.e. there is currently no assurance is required.

Resulting possibilities for the disclosure of non-financial information

6 Accordingly, non-financial information can be found in the following locations:

- Non-financial statement (i.e. mandatory non-financial information subject to the NFRD):

a) Inclusion in the management report:

(i) Separate section in the management report; or

(ii) Full integration into the management report.

b) Separate publication – together with the management report:

(i) Separate report in periodic report outside the management report.

c) Separate publication – on an entity's website:

(i) Separate report;

(ii) Part of another report (separate section); or

(iii) Part of another report (fully integrated).

- (Certain) corporate governance-related information, incl. about diversity (i.e. mandatory non-financial information, subject to Accounting Directive and/or NFRD):

a) Corporate governance statement as a separate section in management report; or

b) Corporate governance statement as a separate report (Member State option).

- Other non-financial information (i.e. voluntary): Full flexibility (e.g. annual report PDF/web, CSR report PDF/web, website without specific report, different reports for particular topics such as only for HR-related or climate-related information, etc.).

Focus areas regarding the location of the non-financial statement in the EU consultation on the NFRD revision

7 Based on the EU consultation on the NFRD revision, the following two key questions regarding the location of non-financial information need to be assessed in further detail:

- Should all non-financial information subject to the NFRD be disclosed in the management report and a respective requirement be imposed?

- Otherwise, if the option of disclosing non-financial information in a separate report were maintained, should the regulatory disclosure requirements and publication dates regarding the management report and the separate report be harmonised?

8 As a basis for concrete proposals to be developed at a later stage, the advantages and drawbacks of the inclusion in the management report and publication of a separate report are analysed in further detail.

Management report

9 It is currently understood that the management report cannot solely be understood as a primary communication outlet for capital market participants that is primarily targeted towards their respective information needs. Consequently, the below assessment is based on this presumption.

10 Taking the objective of the management report into account based on the Accounting Directive and as amended by the NFRD, (certain) non-financial information is clearly relevant for the primary users of management reports (and financial statements).

11 For instance, information about the business model, risk management strategies and due diligence processes related to ESG-related matters are also relevant from an outside-in perspective due to a potential 'rebound' effect. In addition, these aspects are determined by management and are of strategic nature.

12 Further, including non-financial information in the management report in addition to financial information:

- fosters and more strongly accounts for the integration and interconnectivity of financial and non-financial information;

- fosters and more strongly accounts for the fact that both types of information are (equally) relevant and (jointly) required to understand an entity's full 'story'; and

- enables proper supervision of compliance by national authorities.

13 However, these advantages/arguments only apply to the extent that:

- a reasonable concept of materiality is defined and applied (irrespective of the standard or framework used/imposed to comply with the NFRD); and
- a reasonable assumption about the primary users is defined and applied, which does not encompass all stakeholders and parties that are potentially interested in non-financial information.

14 If one or both of these preconditions are not met, this would lead to unbalanced reporting, which would reduce the usefulness of the management report for capital market participants and result in an information overload, especially for capital market participants, but likely also for other stakeholders, who might e.g. only be interested in particular ESG-related matters.

15 This scenario could, for example, emerge if entities were required to disclose all non-financial information subject to the NFRD in the management report and, to this end, a standard were developed or imposed which requires a broad set of KPIs, irrespective of the entity- or industry-specific context and irrespective of their materiality and their link to the outside-in perspective.

16 Consequently, while including non-financial information in the management report has various advantages and is generally appropriate, this does not apply unconditionally for any non-financial information subject to the NFRD.

Separate report

17 The publication of non-financial information in a separate report which likely gains less attention creates the perception that the information reported in the separate report is of secondary importance and does not have meaningful implications for the development, position and performance of the entity.

18 The full separation of financial and non-financial information is incompatible with the view that non-financial information and financial information are interconnected and are both required (jointly) to understand an entity's full story.

19 Even if the separate report were published at the same time, cross-referencing alone is unlikely to mitigate these issues to a reasonable/sufficient extent. In addition, these drawbacks are exacerbated if the separate report is further published at a later stage.

20 Separate reports such as for non-financial information are out of the legal mandate of the national competent authorities, whose mandate over periodic reports is limited to the annual and semi-annual financial reports (which include the management report) (see EU consultation on the NFRD revision).

21 Separate reports such as for non-financial information are not required to be filed in the Officially Appointed Mechanisms (OAMs) designated by Member States pursuant to Art. 21(2) of the Transparency Directive (see EU consultation on the NFRD revision).

22 More generally, issues/concerns arise regarding the clarity, rigor and consistency of the respective (national) applicable governance and oversight requirements and process. This also calls into question whether and to what degree users of non-financial information disclosed in separate reports can rely on their respective quality.

APPENDIX 5: MEETING WITH IASB – REVISION OF THE MANAGEMENT COMMENTARY PRACTICE STATEMENT AND OTHER CONSIDERATION ON NON FINANCIAL INFORMATION

1 List of questions prepared for the meeting with Nick Anderson, IASB Member on 23 October 2020 (10-11:30 am)

BACKGROUND

2 Workstream A4 of EFRAG's Project Task Force on Non-Financial reporting Standards (PTF) focuses on the interconnection between financial and non-financial information and is responsible for identifying financial information limits and mapping the complementarity of the two dimensions of corporate reporting.

3 The approach of workstream A4 is technical and does not address organisation and governance issues related to interconnection. The keys topics analysed under A4 are related to (i) the boundaries of financial information (where does it 'stop'?) on the basis of the underlying concepts (conceptual framework), (ii) the possible evolution of those boundaries and (iii) the guidelines for a seamless transition from Non-financial to Financial under the umbrella of a global approach to corporate reporting.

4 Hans Hoogervorst in his speech dated Sept 28 2020 mentioned that 'the Management Commentary is a logical place for sustainability reporting' and 'upcoming revisions to this Practice Statement will help fill this gap by improving the guidance to prompt companies to identify issues such as climate risk that may be material to their investors'.

5 It is key to understand the thoughts of the IASB about complementarity, overlapping or interactions between FI and NFI today and in the future. We are primarily interested by the current developments of the IASB Management Report Project but not limited to this report. The recent Consultation paper on Sustainability Reporting is also interesting, as it can shed light on the current thinking of the Trustees on the technical connectivity between FI and NFI.

QUESTIONS / SUBJECTS TO COVER

Management Commentary Practice Statement Project – Understanding of the current status

6 The table in Sub-appendix A below has been completed on the basis of the minutes of IASB Board meetings from November 2017 until September 2020.

7 Comments from the IASB staff related to this appendix including discussions held at the October 2020 IASB meeting are presented in the last column of the table in Sub-appendix A.

Specific questions

8 **Table NFRD requirements:** table in Sub-appendix B[17] is linking the requirements of the EU Non-Financial Reporting Disclosure (NFRD) with the Financial reporting (Financial statements and management commentary) and underlining the potential gaps (information required by the NFRD not found in the financial reporting). We would be interested to have your comment on this table.

9 **Likelihood of change in definition:** thanks to the conceptual foundation and clear boarders described in this session of the report, the financial accounting is technically reliable and may continue to serve its fundamental role of informing existing and potential investors, lenders and other creditors about (i) the economic resources of the entity, claims

17 See Figure 7 – NFRD table

against the entity and changes in those resources and claims and about (ii) how efficiently and effectively the entity's management and governing board have discharged their responsibilities to use the entity's economic resources. What is the likelihood that the following IFRS definitions may change in the near future:

- Contingent Liabilities
- Constructive obligations
- Intangibles recognised in the balance sheet
- Contingent assets
- Control

10 **Likelihood that financial reporting standards evolve in a near future:** A key statement in our analysis is that an evolution of IFRS standards to accommodate the need of the broader stakeholders that are users of nonfinancial information, or even to reflect financial performance measures adjusted for externalities, is unlikely. **Do you agree with this statement? Or not? If not, what changes can be anticipated?**

11 **Boundaries of the financial reporting:** The management commentary is seen as the territory for more ESG and intangibles/related information, however limited to financial materiality and financial planning horizon (see our table in Sub-appendix A). Additional information may be found in different standards within the boundaries of the financial reporting (as clearly articulated by the article of Nick Anderson for Climate related matters). How do you envisage an effective coordination in a single annual report between FI reporting (Financial statements + Management commentary) and NFI broader Corporate reporting?

12 **Management commentary as a bridge:** Is in your view the management commentary a sort of 'bridge' between other sets of requirements (Financial Statements /Broader Corporate Non-financial Reporting)? Is the IASB or the Foundation elaborating a structured approach for it?

13 **Socially Responsible Investors:** Information needs of investors are evolving rapidly with the macrotrend of responsible and ESG investment. As more information of 'inside-out' nature is of interest of responsible investors than what is of interest for 'mainstream' investors, how is this need from SRI investors taken into consideration in the management commentary?

14 **Indicators:** Will the management commentary prescribe non-financial indicators? If so, how should they be selected?

15 **Forward Looking information:** As the Practice Statement foresees the Management Commentary to include forward-looking information:

- What is your view on the appropriate / possible time horizon for (forecasts of) non-financial information?
- Should entities also disclose action plans and related descriptions on how they plan to achieve these targets?
- Would it be required or recommended to include description of the progress – milestones' results and what are obtained as to concrete targets and goals – for instant CO_2 emission 2030?

16 **Dilemmas & Controversies:** Would it be required or recommended to include descriptions of dilemmas and challenges as to for instant human rights – or other sustainability issues?

17 **Table NFRD requirements:** table in Sub-appendix B linking the requirements of the EU Non-Financial Reporting Disclosure (NFRD) with the Financial reporting (Financial statements and management commentary) and underlining the potential gaps (information required by the NFRD not found in the financial reporting). We would be interested to have your comment on this table.

18 **Reference of Climate related Frameworks in the MCPS:** During the discussion on Risks at the May 2020 Board meeting, a comment was made on the fact that 'the Practice Statement would be more effective if it is consistent with other frameworks (i.e. TCFD).'

a) Our understanding is that the TCFD is going to be referred to as a good practice for Risk management disclosures related to Climate in the Management commentary. Could you confirm?

b) Is TCFD going to be referred to for other topics than risks, namely governance, strategy or kpis?

c) Is the SBTi (Science Based Target initiative) going to be mentioned as a reference for climate related disclosures?

19 **Reference of other NFI Frameworks in the MCPS:** Are other frameworks going to be referred to? IIRC? GRI? SASB? Other? If so for which specific topic? If a company applies one or several NFI frameworks, will the management commentary require to have this information mentioned?

20 **Integrated reporting:** The Management Commentary seems inspired by some initiatives on integrated reporting, can you tell more?

21 **Connectivity between Financial Statements and Management commentary:** If the management commentary includes monetary indicators, will it be required to reconcile them with the Financial statements?

22 **Business Model:** Will the information required to present the Business Model refer to the disclosures in IFRS15 – Revenue Recognition (for the part of the business model related to customers and cash inflows)?

23 **Climate-related and other emerging risks in the financial statements:** If a company includes in its financial statements Climate-related and other emerging risks as per Nick Anderson's report (for instance in the disclosures (IAS1), through impairment (IAS36), impacts on Property Plant & equipment other than impairment (IAS16 & IAS38), impact on fair value measurement (IFRS13), impact on financial instruments (IFRS9 and IFRS7), provisions, contingent liabilities or contingent assets (IAS37)), will these impacts be disclosed in the management commentary? How do you see the link between Financial Statements and Management commentary in this case?

24 Will **guidance** be included in the revision of the management commentary on **forward looking** information, in particular in the case were targets are likely not being achieved?

25 Would it be required or recommended to include **ESG Quantitative Highlights** in the Management Statement (most important indicators)

26 **Organisational or reporting boundary:** Some but not all the new initiatives consider a broader boundary for the non-financial reporting that the one based on control that characterises the financial reporting. (In particular GRI considers indirect emission due that happen in the premises of the producers of energy and those that occur in the value chain of the reporting company, including both upstream and downstream emissions. Along the same lines, the Guidelines of the NFRD states that company may consider those impacts through the upstream supply chain that are relevant and material issues and report on them accordingly. Which is the view of the IASB on those aspects?)

SUB-APPENDIX A: STATUS OF THE MANAGEMENT COMMENTARY PROJECT

TOPIC	WS4 ASSESSMENT ON THE BASIS OF IFRS BOARD MEETINGS UP TO SEPTEMBER 2020	Comments from the IASB staff including the Oct 2020 IFRS Board meeting
Status	On going project	
ED publication	February 2021	At the October 2020 Board meeting the publication date of the Exposure Draft has been deferred to April 2021.
First implementation date	?	At the October 2020 Board meeting, the Board tentatively decided that: a. entities stating compliance with the Practice Statement will be required to apply the revised Practice Statement for annual reporting periods beginning on or after the date of its publication; and b. earlier application of the revised Practice Statement will be permitted. (Agenda Paper 15C *Due process and permission for balloting*)
Scope	The Management Commentary Practice statement (MCPS) provides a broad, non-binding framework for the presentation of management commentary that relates to Financial statements prepared applying IFRS standards. (Introduction to Management Commentary March 2018)	See comments on the objective of management commentary
Periodicity Timeliness	Annual ? / same as Financial statements ? The staff recommended that the revised Practice Statement states that management commentary is more useful if it is published at the same time as the financial statements or soon after them. (22 Oct 2019 board meeting)	October 2019 Agenda Paper 15A *Enhancing qualitative characteristics in management commentary* included this recommendation, but at the Board meeting the Board tentatively decided that the revised Practice Statement would not include guidance on timeliness.
Mandatory / voluntary basis	Voluntary: The Board tentatively decided that: a. the revised Practice Statement would be a non-binding framework for the preparation of management commentary; b. the revised Practice Statement would not become an IFRS Standard; and c. an entity could state that its financial statements comply with IFRS Standards without preparing a management commentary that complies with the revised Practice Statement (23 Sept 2020 board meeting)	Entities may choose to apply the Practice Statement voluntarily or may be required to do so by local legislation. In September 2020, the Board tentatively approved guidance on asserting compliance with the revised Practice Statement. The Board tentatively decided that the revised Practice Statement should: a. require an entity to include in its management commentary an unqualified statement of compliance with the revised Practice Statement if the management commentary complies with all the requirements in the revised Practice Statement; and b. permit an entity to include in its management commentary a statement of partial compliance with the revised Practice Statement, In this case, the management commentary would need to explain which requirements of the revised Practice Statement the management commentary does not comply with. In response to comments on a working draft of the Exposure Draft, in November 2020 the Board will discuss whether entities can assert compliance with the revised Practice Statement if their financial statements are not prepared in accordance with IFRS Standards.

TOPIC	WS4 ASSESSMENT ON THE BASIS OF IFRS BOARD MEETINGS UP TO SEPTEMBER 2020	Comments from the IASB staff including the Oct 2020 IFRS Board meeting
Subject matters covered	The MCPS focuses on what's relevant to the unique circumstances of the business. (Introduction to Management Commentary March 2018)	The Board has tentatively decided that the revised Practice Statement should specify requirements and provide guidance for six areas of content to be addressed in a management commentary: *business model, management's strategy, resources and relationships, risks, external environment and performance and position.* Discussion of each area of content would be required to address key matters that could fundamentally affect the entity's ability to create value and generate cash flows, including where applicable ESG matters.
Risk/opportunity or performance approach	Risk / Opportunity approach: The staff recommend that the revised Practice Statement specifies the disclosure objective for risks as follows: a) Management commentary shall provide information and analysis to help investors and creditors understand the risks that could disrupt: the entity's business model; management's strategy for developing and sustaining that model; or the entity's resources and relationships. b) That information and analysis helps investors and creditors assess the magnitude and likelihood of potential future disruption to the entity's ability to create value and generate cash flows.. The Practice Statement would be more effective if it is consistent with other frameworks (i.e. TCFD). Staff confirmed that this should be the case (20 May 2020 board meeting)	Information about opportunities being pursued by the entity's management is expected to be addressed by requirements and guidance on reporting on management's strategy (April 2020 Agenda Paper 15C *Strategy*). The TCFD recommendations were one source reviewed by the staff in developing requirements and guidance for reporting on risks. The TCFD recommendations cover other areas (strategy, and metrics and targets) on which information may also be required to be included in a management commentary. The Exposure Draft is expected to explain interaction with other narrative reporting frameworks, standards and guidance, rather than endorse any specific ones. Specifically, the Exposure Draft is expected to allow preparers to use other organisations' frameworks, standards and guidance to help them identify key matters and material information about those key matters that need to be discussed in management commentary. (See October 2020 Agenda paper 15A *Overview of guidance on matters affecting long-term prospects, on intangible resources and relationships and on ESG matters*)
Generic or sector specific	The MCPS does not prescribe detailed industry or issues-specific disclosures. (Introduction to Management Commentary March 2018)	See also the discussion of the Board's principle-based approach in paragraphs 13-17 of October 2020 AP 15B *Overview of the likely effects or the proposals*)
Existence of:		

<table>
<tr><th>TOPIC</th><th>WS4 ASSESSMENT ON THE BASIS OF IFRS BOARD MEETINGS UP TO SEPTEMBER 2020</th><th>Comments from the IASB staff including the Oct 2020 IFRS Board meeting</th></tr>
<tr><td>• Objectives</td><td>Yes – The Board agreed that the objective of management commentary should be to give context for the financial statements by providing primary users with the historical financial and operational information and analysis that is useful in assessing the prospects for the entity's future net cash inflows and in assessing management's stewardship of the entity's economic resources.

(22 July2019 board meeting)</td><td>The Board tentatively confirmed the refined objective of management commentary at its March 2020 meeting (see Agenda Paper 15A The objective of management commentary) as supporting primary users (investors and creditors) in assessing an entity's prospects for future cash flows and management's stewardship of the entity's economic resources by providing useful information and analysis that:
a. enhance the primary users' understanding of the entity's performance and position as depicted in the related financial statements; and
b. give insight into factors that could affect the entity's prospects.</td></tr>
<tr><td>• Principles</td><td>Yes – The staff assert that information in the management commentary must possess the qualitative characteristics identified in the Conceptual Framework

(23 Sept 2020 board meeting)</td><td>In July 2019, the Board discussed approach to guidance on qualitative characteristics. In July, September and October 2019, the Board discussed guidance to be included in the revised Practice Statement in relation to qualitative characteristics.</td></tr>
<tr><td>• Boundaries</td><td>Same as Financial statements

Supply chain and products' impacts are not taken into account except in the following circumstance: 'An entity's ability to generate cash flows can be affected by value created or destroyed by the entity for other parties if an entity depends on relationships with those parties for its future success.'

(20 Nov 2019 board meeting)</td><td>The Practice Statement is not expected to permit the exclusion of material information on the grounds that it relates to a matter that is external to the entity.

Depending on the entity's circumstances, information on supply chain and product impacts may need to be included in a management commentary as a result of the requirements and guidance on reporting on, for example, the entity's resources and relationships.</td></tr>
<tr><td>• Indicators (KPIs)</td><td>(list of set ESG indicators ?)

Management measures and Indicators (MMIs) were discussed during the 23 July 2020 Board meeting, where financial resources, progress in managing key matters and disclosure objective for performance and position were also discussed. No decisions were taken on Management measures and indicators at that meeting but the following topics were discussed:
• Relationship between management measures and indicators (MMIs), adjusted MMIs and management performance measures (MPMs)
• Are indicators required by regulators and taken over into the management commentary MMIs?
• One Board member asked whether entities would be allowed to cross-reference to MPMs in the financial statements, which the staff confirmed would be appropriate</td><td>In July 2020, the Board tentatively decided that information about progress in managing key matters should be included in the required types of information for business model, strategy, resources and relationships, risks and external environment.

Information required by regulators may be material in the context of management commentary. Where this is not the case, it is expected that this information would nevertheless be permitted to be included in a management commentary if it is provided in a way that it does not obscure material information (see general comments on Sub-appendix B).</td></tr>
</table>

TOPIC	WS4 ASSESSMENT ON THE BASIS OF IFRS BOARD MEETINGS UP TO SEPTEMBER 2020	Comments from the IASB staff including the Oct 2020 IFRS Board meeting
• type of indicators (Quantitative/ Qualitative – Forward-looking/ retrospective)	• **Quantitative information:** No guidance so far on how quantitative monetary information included in the management commentary should be reconciled with IFRS figures in the Financial statements (or whether it should be reconciled) • **Qualitative information:** concept of *'coherent narrative'* is o developed by the IASB staff for information within the management commentary (22 July 2019 board meeting) o not yet developped for interconnection between Management Commentary and Financial Statement • **Forward looking:** Not much guidance is given on which forward looking information should be included in the management commentary although mentioned twice in the meetings minutes o *'the management commentary should include forward looking information'* (15 May 2019 board meeting) and o *'materiality in the context of management commentary provides different information to financial statements – it is more qualitative and forward-looking'* (20 May 2020 board meeting) o Examples of Forward looking information not included in the Financial Statements are mentioned in the Conceptual Framework: *'explanatory material about management's expectations and strategies for the reporting entity'* (CF3.6)	The notion of coherence applies both within the management commentary and between information in the management commentary and the financial statements. Specifically addressing the latter: • in October 2019, the Board tentatively decided that the guidance on verifiability would require management to consider whether information presented in management commentary is consistent with information reported in the entity's financial statements, and with other publicly available reports. • In addition: o supporting guidance on business model discussed by the Board in April 2020 indicates that the description of the entity's operating structure in management commentary should be reconcilable to operating segments disclosure in the entity's financial statements; and o supporting guidance on performance and position discussed by the Board in July 2020 notes that information about the entity's performance and position should be reconcilable with information provided in the entity's financial statements on its operating segments. In relation to forward-looking information: • the Board discussed guidance on forward-looking information in March 2020 (Agenda Paper 15A *The objective of management commentary*). • the Board discussed guidance on forecasts and targets in July 200 (Agenda Paper 15C *Performance and position*) • the Board also discussed guidance on other forward-looking information, such as information about management's strategy, information about factors and trends that could affect the entity in the future, and information about risks.
• precise definitions (y/n) and/ or use of a specific framework	The qualitative characteristics of the management commentary are the fundamental qualitative characteristics listed in the Conceptual Framework Relevance (including materiality) and Faithful representation and the enhancing qualitative characteristics (comparability, verifiability, timeliness, understandability)	

TOPIC	WS4 ASSESSMENT ON THE BASIS OF IFRS BOARD MEETINGS UP TO SEPTEMBER 2020	Comments from the IASB staff including the Oct 2020 IFRS Board meeting
• location (in which report) / digital submission?		In September 2020, the Board acknowledged that management commentary might accompany an entity's financial statements as a distinguishable part of a larger report, or it might be a standalone report. The Board tentatively decided that the revised Practice Statement should require an entity to: a. either make the financial statements to which management commentary relates available with the management commentary, or identify them in the management commentary; and b. clearly identify what information constitutes its management commentary and distinguish it from other information in the same report and from information in other reports. In October 2020, the Board discussed how its proposals could improve the quality of electronic reporting. The IFRS Taxonomy could include more specific elements for management commentary. For example, IFRS Taxonomy elements could reflect types of information required by the proposed disclosure objectives for each area of content. More specific tagging could make it easier for investors and creditors to access the information they need in electronic format and analyse that information. (see October 2020 Agenda Paper 15B)
• .external control (yes/no)	No – On Verifiability, the staff recommended that the revised Practice Statement retains the statement that it does not mandate the level of assurance to which management commentary should be subjected. (22 Oct 2019 board meeting)	The revised Practice Statement will not mandate the level of assurance on management commentary. However, more structured guidance, and in particular clear disclosure objectives for each area of content are designed to provide a better basis for: a. enforcement of the Practice Statement and b. providing external assurance on management commentary.
• if yes level of the control	N/A	
• Double materiality concept (yes/no)	No: 'Outside-In' materiality is the primary focus On Materiality, the staff recommend that the guidance on identifying material information in the revised Practice Statement would … make an explicit link between identification of material information and the objective of management commentary—i.e. providing information that is useful in assessing the prospects for **future net cash inflows** to the entity and in assessing management's stewardship of the entity's economic resources (22 July 2019 board meeting)	The Board has not discussed possible interpretations of 'double materiality' or 'inside-out' materiality. In July 2019, the Board considered observations from the Management Commentary Consultative Group that preparers face challenges in making materiality judgements because they may lack understanding of users' decision-making process. The Board tentatively decided that the Practice Statement should provide guidance on considering primary users' common information needs in identifying material information (primary users are identified as existing and potential investors, lenders and other creditors and referred to as 'investors and creditors' in this project). The Board also tentatively decided that guidance on materiality should identify engagement with the entity's key stakeholders as one of the practical sources of identifying material information.

TOPIC	WS4 ASSESSMENT ON THE BASIS OF IFRS BOARD MEETINGS UP TO SEPTEMBER 2020	Comments from the IASB staff including the Oct 2020 IFRS Board meeting
• Interconnectivity / Cross-referencing	• At the 10 April 2019 meeting, the staff highlighted a few messages that emerged from the Management Commentary Consultative Group, including 'the effective use of cross-referencing both within a single filing and to other reports and sources of information' • At the 22 July 2019 meeting, the Board acknowledged that the Practice Statement should be **a stand-alone document** as the objective of management commentary is different to that of financial statements and both preparers and users of the management commentary are different to those of financial statements • At the 21 April 2020 meeting the Board members discussed Business model. o Some Board members suggested that a greater link to the financial statements in the objective would be useful – management commentary provides context of the business but it and the financial information should be linked where possible. For example, **revenue generation and value creation** o A potential overlap between these and information in the financial statements (particularly in **segment reporting**) exists; o Additional information about specific locations (including **tax-related information**) could be useful to users	**Re first bullet:** The Board discussed guidance on incorporating information in management commentary by cross-reference at its October 2019 meeting (Agenda Paper 15A *Enhancing qualitative characteristics in management commentary*). The Board tentatively decided to permit the incorporation of information in management commentary by cross-reference, subject to the overarching principle that the information incorporated by cross-reference is part of management commentary and, therefore, must possess the qualitative characteristics of useful financial information. **Re second bullet:** July 2019 Agenda Paper 15B *Making relevance and materiality judgements* noted that individuals involved in preparing management commentary can be different from those involved in preparing financial statements and cannot be assumed to have knowledge of IFRS Standards. However, the project is intended to better meet information needs of primary users who are identified as existing and potential investors, lenders and other creditors (Agenda Paper 15A). The same user group is identified as primary users of financial statements. As noted in comments on location above, the Board acknowledged that management commentary might accompany an entity's financial statements as a distinguishable part of a larger report, or it might be a standalone report. **Re third bullet:** • in July 2020 the Board discussed requirements and guidance on reporting performance and position. The Board tentatively decided to specify in the disclosure objective for performance and position that information about them should cover what affected performance and position reflected in the entity's financial statements or could affect them in the future, including over the long-term. The supporting guidance explains that these matters affecting performance and position would be key matters identified and discussed in other areas of content in management commentary, including key features of the entity's business model, key aspects of management's strategy, key resources and relationships, key risks or key factors and trends in the external environment. • supporting guidance on business model discussed by the Board in April 2020 indicates that the description of the entity's operating structure in management commentary should be reconcilable to operating segments disclosure in the entity's financial statements. • tax-related information would need to be discussed in management commentary if such information is considered to be material for investors and creditors. As all other information about the entity's performance and position, such information would need to be reconcilable with information provided in the entity's financial statements.

SUB-APPENDIX B: NFRD TABLE

27 General comments from the IASB staff related to the table below:

- In October 2020, the Board discussed an overview of guidance on matters that could affect the entity's long-term prospects, on intangible resources and relationships and on ESG matters (Agenda Paper 15A).
- That paper explained that management commentary would need to provide information about key matters that fundamentally affect or could affect the entity's ability to create value or generate cash flows. Where an ESG (or any other) matter is determined to be 'key', information on it would need to be included in a management commentary in accordance with the detailed requirements and guidance in the Practice Statement. Such information might need to include the identification of the feature of the business model and resource or relationship affected by the matter, explanations of the related risk or opportunity, descriptions of how management monitors or manages the matter, and information on progress in managing it.
- The paper also noted that the revised Practice Statement will explain the interaction between the guidance in the Practice Statement and other narrative reporting standards, frameworks or guidance (including those on sustainability reporting):
  1) Other standards, frameworks and guidance may be used by management to identify key matters or material information about them that would need to be included in management commentary – i.e. the management commentary provides a 'home' for this material information;
  2) In some cases local laws or regulations might require additional information to be reported that would not be material in management commentary. The management commentary may include this information provided it does not obscure material information.
- Many of the 'What is left out' items identified in column five appear to relate to differences between the information that would be material for investors and creditors and information that the Project Task Force expect would be material for other potential users of an NFRD report. The significance of those items would depend on the extent to which those other users' needs would need to be met by the provision of additional information.

NFRD REQUIREMENTS	FINANCIAL STATEMENTI INCL NOTES (IFRS)	(REVISED)[1] MANAGEMENT COMMENTARY (NFI)	COMMENTS FROM THE IASB STAFF	WHAT IS LEFT OUT / GAPS
Information to the extent necessary for an understanding of the undertaking's development, performance, position and impact of its activity, *(Double materiality)*	Outside in[2] perspective	*Grey area:* Inside out with rebound impacts on the company[3] ('boomerang effect')	The Board has tentatively decided to specify disclosure objectives for areas of content in management commentary that require (amongst other items) provision of information about: • progress in managing key matters; • the entity's performance and position; and • indirect wider consequences or impacts of the entity's operations. Such information would be considered material if omitting it from management commentary, or misstating or obscuring it within management commentary, could reasonably be expected to influence decisions that investors and creditors make on the basis of that management commentary and the related financial statements. The Board considered observations from the Management Commentary Consultative Group that preparers face challenges in making materiality judgements because they may lack understanding of users' decision-making process. It tentatively decided that the Practice Statement should provide guidance on considering investors' and creditors' common information needs in identifying material information. The Board has not discussed possible interpretations of 'double materiality' or 'inside-out' materiality.	Inside-out perspective Outside-in outside the boundaries of FI
relating to, as a minimum, environmental, social and employee matters, respect for human rights, anti-corruption and bribery matters, including:	Possible overlap on: • employee matters with IAS 19 but only partial • IAS 37 contingent liabilities, legal claims • IAS 1 risks affecting going concern or risks and uncertainties affecting the estimates • for entities operating in high risk sectors for one of the topics, depending on judgemental materiality assessment, partial information may be found.		A management commentary would need to provide material information about key matters that fundamentally affect or could affect the entity's ability to create value or generate cash flows. Where an environmental, social, employee, human rights, anti-corruption or bribery matter is determined to be 'key', information on it would need to be included in a management commentary in accordance with the detailed requirements and guidance in the Practice Statement. Such information might need to include the identification of the feature of the business model and resource or relationship affected by the matter, explanations of the related risk or opportunity, descriptions of how management monitors and manages the matter, and information on progress in managing it.	Substantial part of the requirement

NFRD REQUIREMENTS	FINANCIAL STATEMENTI INCL NOTES (IFRS)	(REVISED)[1] MANAGEMENT COMMENTARY (NFI)	COMMENTS FROM THE IASB STAFF	WHAT IS LEFT OUT / GAPS
(a) brief description of the undertaking's business model;		Included in management commentary[4] in relation with the value creation for the entity and its shareholders	Detailed requirements and guidance for describing an entity's business model were discussed by the Board in April 2020. This description would include information about wider consequences or impacts of the entity's operations (for example, on the natural environment, the economies of regions in which the entity operates, particular groups of people or society at large) where those consequences could fundamentally affect the entity's ability to create value and generate cash flows.	Aspects other than the value creation for the entity and its shareholders
(b) a description of the policies pursued by the undertaking in relation to those matters, including due diligence processes implemented;	None	None	Where an environmental, social, employee, human rights, anti-corruption or bribery matter is determined to be 'key', management commentary would need to include a description of how management monitors and manages the matter and information on risks arising from it, including related mitigations.	Entire requirement
(c) the outcome of those policies;	None	None	Where an environmental, social, employee, human rights, anti-corruption or bribery matter is determined to be 'key', management commentary would need to include information on management's progress managing the matter and managing the related risks.	Entire requirement
(d) the principal risks related to those matters linked to the undertaking's operations including, where relevant and proportionate, its business relationships, products or services which are likely to cause adverse impacts in those areas, and how the undertaking manages those risks;	Possible overlap with IAS 37 disclosure in highly exposed segments.	Possible overlap with management commentary information[5]	The Board has tentatively decided that the disclosure objective for 'risks' should require management commentary to provide information to help investors and creditors understand the risks that could disrupt the entity's business model, management's strategy for sustaining and developing that model or its resources and relationships. Where an environmental, social, employee, human rights, anti-corruption or bribery matter (including those arising from the impact of a business relationship, product, or service) represents a key risk, it would need to be addressed in a management commentary. The Board has discussed detailed requirements and guidance for providing information on key risks, including how management monitors each risk. The Board has also tentatively decided that information on the entity's business model should include information about wider consequences or impacts of the entity's operations if they could affect the entity's ability to create value and generate cash flows.	Substantial part of the requirement

NFRD REQUIREMENTS	FINANCIAL STATEMENTI INCL NOTES (IFRS)	(REVISED)[1] MANAGEMENT COMMENTARY (NFI)	COMMENTS FROM THE IASB STAFF	WHAT IS LEFT OUT / GAPS
(e) non-financial key performance indicators relevant to the particular business.	None	In progress: identification of management measures and indicators (MMI) [6] that need to be addressed in management commentary	In July 2020, the Board tentatively decided that information about progress in managing key matters should be included in the required types of information for business model, strategy, resources and relationships, risks and external environment. The Board also discussed guidance on the providing management measures and indicators.	Entire requirement

[1] Reference: IFRS Board discussions on the revision of the Management Commentary from Nov 2017 until Sept 2020

[2] The outside-in perspective offers theoretical anchor points which in practice may or may not work depending on the boundaries of financial information. Refer to Part 2.

[3] IASB Board Discussion Nov 2019.: The revised Practice Statement (should)explain the meaning of an entity's business model by reference to value creation for the entity itself—and that the explanation clarifies that the notion of value created for the entity is related to the entity's ability to generate cash flows and can be affected by value created or destroyed by the entity for those parties with which the entity has relationships that the entity depends on for its future success

[4] IASB Board Discussion May 2020: 'value creation' is to be considered in the narrow sense i.e. the creation of value for the entity and its shareholders.

[5] IASB Board Discussion May 2020: Management commentary shall provide information and analysis to help investors and creditors understand the risks that could disrupt: the entity's business model; management's strategy for developing and sustaining that model; or the entity's resources and relationships. – The Practice Statement would be more effective if it is consistent with other frameworks (i.e. TCFD).

[6] IASB Board Discussion July 2020: management measures and indicators (MMIs) also include any non-financial measures

APPENDIX 6: ILLUSTRATION OF FR LIMITS

1 This appendix explains the boundaries of financial reporting when preparing a complete set of financial statements in accordance with the International Financial Reporting Standards (IFRS).

2 A complete set of financial statements[18] comprises:

a) a statement of financial position at the end of the period (B/S)

b) a statement of profit or loss and other comprehensive income for the period (P/L and OCI)

c) a statement of changes in equity for the period

d) a statement of cash flow for the period (C/F)

e) notes, comprising significant accounting policies and other explanatory information

f) comparative information in respect of the preceding period (with some exceptions)

3 In addition to the set of financial statements, Annual (and Interim) Reports include a Management Report. For this purpose, the IASB has issued a Practice Statement 1 Management Commentary which is not mandatory. In the EU, national regulation determines the content of the Management Report within the frames of the Directive 2013/34/EU.

4 The analysis in this appendix does not consider required or proposed content of the Management Report. The purpose is to identify the limits of FI in context of the mandatory IFRS Standards, being the Conceptual Framework or the individual Standards.

5 The Conceptual Framework for Financial Reporting includes the general concepts and definitions. The purpose of the framework is to assist the IASB to develop IFRS Standards and to assist preparers in developing accounting policies when no Standard applies or when a Standard allows a choice of accounting policy. In case there is a discrepancy between definitions in the Framework and an individual Standard, the individual Standards will apply.

18 IAS 1 Presentation of Financial Statements, paragraph 10.

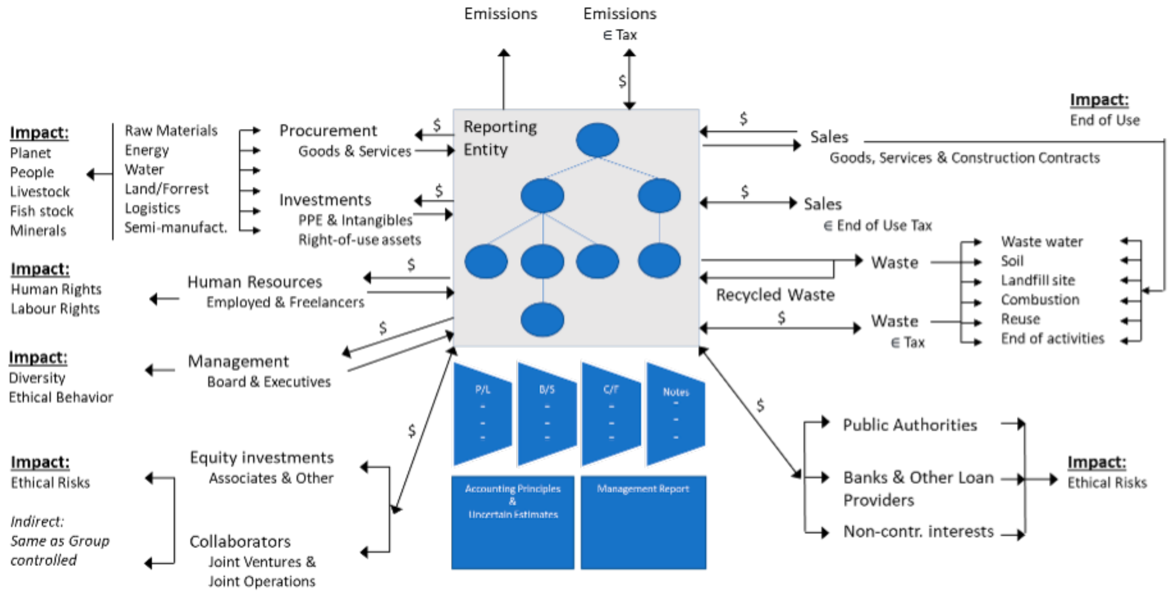
A COMPREHENSIVE VIEW OF MONETARY AND NON-MONETARY FLOWS TO AND FROM A REPORTING ENTITY

6 The sources of financial information are the transactions and events creating monetary and non-monetary flows to and from a Reporting Entity.

7 Monetary flows are cash received and paid by the Reporting Entity. Monetary flows arise either as payment and receipts for non-monetary flows, as payments and receipts for financing or investing activities, as well as for as tax payments among other economic activities.

8 Non-monetary flows are goods (delivered, produced or extracted), services received or provided as the main activity of the business, waste (disposed or recycled) and emissions, as well as property, plant and equipment (delivered ready for operation or self-constructed), intangibles (received or provided through contractual or legal rights or self-developed), among other assets, as well as services from human resources (employed, freelance) and the resources provided by management (board and executive directors).

9 Below is an illustration of monetary and non-monetary flows to and from the Reporting Entity.



10 In order to performing a systematic analysis, the flows are categorised by type with some references to business relationships.

11 Environmental or social impacts are included in the simplistic illustration by examples. The purpose is to show the scope the analysis. However, the boundaries of FI are not only analysed from the inside-out perspective, but also from the outside-in perspective. The risks and opportunities embedded in the outside-in perspective are represented in the figure by the monetary flows.

APPENDIX 7: EXPERIMENTS TO INCLUDE NON-FINANCIAL INFORMATION IN 'FINANCIAL-LIKE' MODELS

Source: What are the connections between financial and non-financial accounting? Sustainable development and intangibles, inventory of representations in financial accounting – Report Summary July 2020 published by The 'Integrated Performance Multi-Capital' Chair Audencia (Translation in English in progress, French version available here (short version) or here (long version))

1 Many experimental models have been developed and tested in order to integrate the missing capitals and a larger definition of performance into financial reporting[19].

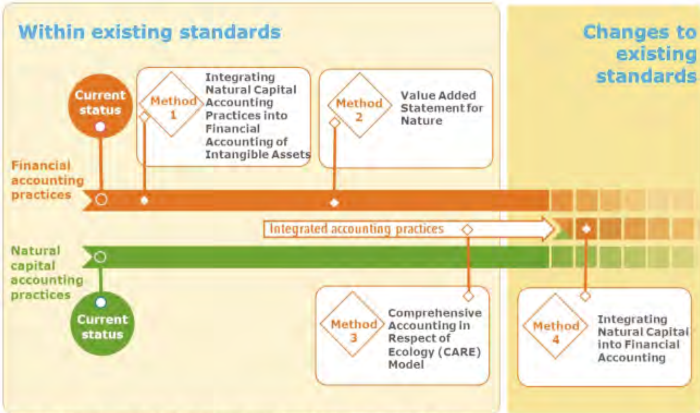
2 Those models can be classified into three categories which are at different stages of maturity: the full cost models, the Sustainability Assessment Models (SAM) and the integrated models.

3 It is therefore necessary to be cautious about the use of these three types of accounting in practice. A detailed analysis can be found in Appendix 6.

4 **The full cost models**, tested and theorised in the 1990s, are the most mature. The objective of these methods/methodologies is to show all the costs related to the company's activity, including those that do not give rise to financial activity, i.e. externalities. The mechanisms are part of costing but do not create debt. They are not a part of the day-to-day management of the company and do not impact the balance sheet or the income statement. This 'accounting' gives rise to steering tools that are complementary to financial management but not integrated. In doing so, they do not directly initiate changes in the behaviour of the functions related to the financial accounts/statements (internal and external). On the other hand, the results are highly dependent on the chosen key performance indicators. The latter can thus radically change the results, their interpretation and the resulting decision-making. Antheaume (2004) compared three different monitoring methods and observed a variation in results 'by a factor of more than 1 to 12,000 per unit produced'. 'Full cost' models are used today by only a few companies, e.g. Kering. E-P&L model

5 **Sustainability Assessment Models (SAM)**: The SAM (Sustainability Analysis Models) are the descendants of the full cost method. The aim is, as for the full cost models, to show elements not traditionally accounted for, for a project or for all the activities of an organisation. An important feature separates these models from their predecessors. Whereas the full-cost method's approach to integrating externalities into financial statements focuses on the negative impacts of human activities on the environment, the SAM methods make the creation of environmental value visible and value the creation of social value. Today, the work on the new capitals is carried out within the Capitals Coalition (which brings together the former Natural Capital Coalition and the Human and Social Capital Protocol that was originally housed at the WBCSD). The Value Balancing Alliance (VBA) created in 2019 aims at standardising the 'SAM' method with the help of the major accounting firms. According to VBA, about 300 companies use these models. The Value Balancing Alliance is also working on the European-funded 'E-GAAP' project (which aims at creating an accounting standard for natural capital for inclusion in financial statements).

19 Source of this section: What are the connections between financial and non-financial accounting? Sustainable development and intangibles, inventory of representations in financial accounting – Report Summary July 2020 published by The 'Integrated Performance Multi-Capital' Chair Audencia (Translation in English in progress, French version available here (short version) or here (long version))



Short term (Method 1) ”Intangibles”:
Four forms of additional intangibles (B/S)
Medium term (Method 2) ”Value added”:
Provision for nature (Equity) – Fund for Nature (liability)
Medium/Long term (Method 3) ”CARE”
Extension of historical costs to natural and human capitals
Long term (Method 4) ”Capitals” -> links to IIRC
Integrating capitals…

Exemple of ”method 1”related to intangibles: EPIC Value project – focus on talent, innovation, society, the environment and governance -> impact on intangibles

Value not measured

6 **The ‘integrated’ models**: Integrated models are models that wish to integrate monetised non-financial capital into financial accounting (extension of historical costs to natural and human capitals). Examples of models that can be included in this category are model CARE *(Comptabilité Adaptée au Renouvellement de l’Environnement)*, the Impact Weighted Accounts Model (Harvard Business School, the Jeremy Nicholls’ model: Integrating Financial, Social and Environmental Accounting and the Olam’s Integrated Impact Statement.

Table C1. Income Statement of the farm application under the CARE model (in thousand EUR)

Operating expenses and revenues			
Expenses on financial capital			
Amortization expenses (tractor)	50		
Expenses on natural capital			
Current expenses	50		
Amortization expenses (tree plantation)	150		
Preservation of capitals			
Preservation of soil	145	Restoration (ex post preservation)	145

7 These models are still in their infancy. Their methodologies are highly experimental and are not publicly available today. It is therefore necessary to be extra cautious about the use of this type of accounting in practice.

APPENDIX 8: EXAMPLES OF DIRECT AND INDIRECT CONNECTIVITY

1 The following approach could be applied to ensure the coherence and continuity of financial information with sustainability disclosures:

a) Step 1: Applying the NFRD requirements for a given topic, considered material for the users of the NFI, understand the links between the topic and the business model, the related policies and action plans, and the relevant KPIs that need to be measured.

b) Step 2: Identifying the anchor points: i.e., data points in FR, which are connected with the information in NFR. For these anchor points, direct connectivity concepts should be applied if relevant, then indirect connectivity concepts.

EXAMPLES

Example 1A: GHG emissions – No net zero program in place

Step 1: Application of the NFRD Requirements	
Background information (materiality, link with the business model, ...)	GHG emissions are considered material and the topic is reported as an NFI matter
Policy	The company has a GHG abatement program with the goal of a 20% reduction of GHG emissions of their production sites by 2025 (compared to a 2015 baseline) but no net zero program is in place
Expected Outcomes	• Reduction of GHG emissions in operations • Reduction in costs (avoidance of GHG taxes; increased energy efficiency, ...)
Reported indicators	The company reports GHG emissions for their production sites (scope 1 and 2)
Step 2: Definition of anchor points	
Direct connectivity with financial reporting	If material, disclose: • Costs in the current period of investments in energy efficiency measures at the production sites, ... (costs of the GHG abatement program) • Costs savings in the current period (if they can be reliably measured) • Use of accounting estimates that are in line with the plan for the future reduction measures (i.e. by adjusting useful lives of assets that will be replaced under the plan prior to their normal useful lives)
Indirect connectivity with financial reporting	• Expected estimated future costs for the GHG abatement measures and expected future costs savings • Scenario analysis to quantify the financial effects (on revenues, costs, profitability, assets) on the future performance of the company under various climate scenarios (e.g. 1.5°C and 2.7°C) in order to take into account the entire effects of climate change on the business model and not only the effects of the GHG abatement program on production sites.

Example 1B: GHG emissions – A net zero program is in place

Step 1: Application of the NFRD Requirements	
Background information (materiality, link with the business model, ...)	GHG emissions are considered material and the topic is reported as an NFI matter
Policy	The company has just announced its intent to become fully net zero by 2040 (Paris aligned)
Expected Outcomes	• Reduction of GHG emissions in supply chain, operations and products sold • Reduction in costs (avoidance of GHG taxes; increased energy efficiency, ...) • Maintaining or increasing future revenue flows by offering products that emit zero GHG emissions in the use phase
Reported indicators	The company reports GHG emissions for the supply chain, operations and use phase (scope 1, 2 and 3)
Step 2: Definition of anchor points	
Direct connectivity with financial reporting	If material, disclose: • Costs in the current period of investments in energy efficiency measures, new production technologies, ... (costs of the net zero program) • Costs savings in the current period (if they can be reliably measured) • Consistency with assumptions in the financial statements: key assumption used in the net zero program should be reflected in the assumptions for the financial statements (impairment assumptions, useful lives of non-current tangible and intangible assets, ...)
Indirect connectivity with financial reporting	• Qualitative explanation of how outcome of the net zero program will affect financial performance or assets or liabilities of a company, also over time (forward -looking information) • Expected estimated future costs and cost savings for the net zero goals by using appropriate quantification methods

Example 2: Training costs

Step 1: Application of the NFRD Requirements	
Background information (materiality, link with the business model, ...)	Training is considered material and is reported as an NFI matter
Policy	The company has a policy for training
Expected Outcomes	• Increase in quality, ultimately more client satisfaction with positive impact on revenues • Positive impact on retention and recruiting (decrease in hiring costs)
Reported indicators	• Yearly targets on training classes per employee grade and training hours • The company reports the total training hours vs targets each year in the non-financial statement
Step 2: Definition of anchor points	
Direct connectivity with financial reporting	If material, disclose: • Training costs associated with the training program
Indirect connectivity with financial reporting	• Expected effect on future or current revenues or recruiting costs. The effects can be described qualitatively or quantitatively if they are reliably measurable.

Example 3: Anti-corruption and bribery

Step 1: Application of the NFRD Requirements	
Background information (materiality, link with the business model, ...)	Anti-corruption and bribery is considered material and is reported as an NFI matter
Policy	The company has a policy for anti-corruption
Expected Outcomes	• No corruption incidents • No Fines / no exclusion from business • No reputational damage with negative impact on future business
Reported indicators	The company strives for zero incidents and reports how many employees are covered by the anti-corruption training program, the number of cases reported in the whistle-blower hotline and the number of anti-corruption incidents in the current year.
Step 2: Definition of anchor points	
Direct connectivity with financial reporting	If material, disclose: • For the costs of the program see the training example above • Fines in € that related anti-corruption cases
Indirect connectivity with financial reporting	Qualitative explanation of how outcome of the anti-corruption policy will affect financial performance or assets or liabilities of the company, also over time (forward -looking information)

Example 4: Human rights – Child labour

Step 1: Application of the NFRD Requirements	
Background information (materiality, link with the business model, …)	• Human rights is considered material and is reported as an NFI matter • Child labour is considered a material human rights issue for (eg) the agricultural sector
Policy	The company has a policy for addressing child labour (and other/related human rights topics) in the supply chain and with a focus on the commodities where it is most prevalent at smallholder / farm / plantation level
Expected Outcomes	• Greater sustainability of commodity supply chains due to sustainable livelihoods offered to adult workers • Increased access to education for children previously having to work in place of going to school. • No reputational damage to the company • No boycott of products and services by customer groups • No risk of lawsuits under legislation governing child labour in supply chains
Targets and reported indicators* ** These are offered as potential targets and indicators which would require further scrutiny against criteria governing the quality of indicators and with input from subject matter experts, and some or all may be more appropriate at the entity level than at the sector level given the validity of and need for distinct approaches to reducing child labour within distinct commodities and locations due to differences in their contexts and root causes.*	• % of commodities for which analysis has been conducted to identify key drivers of child labour, including any links to company purchasing practices • % of sourcing sites for commodity X/Y/Z where there is a substantive agreement or initiative in place aimed at reducing the occurrence of child labour. • % of sourcing sites with substantive agreements/initiatives that are showing measurable progress in reducing the occurrence of child labour. • Number of children found working who are given access to education without harm to their families' income levels
Step 2: Definition of anchor points	
Direct connectivity with financial reporting	If material, disclose: • Costs associated with the initiatives undertaken
Indirect connectivity with financial reporting	Qualitative explanation of how increased sustainability of commodity supply will affect financial performance or assets or liabilities of the company, including over time (forward-looking information)

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