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Boundaries of FR and SR, elements of 'connectivity', and update on IFRS Foundation connectivity-related discussions

Issues Paper

Objective

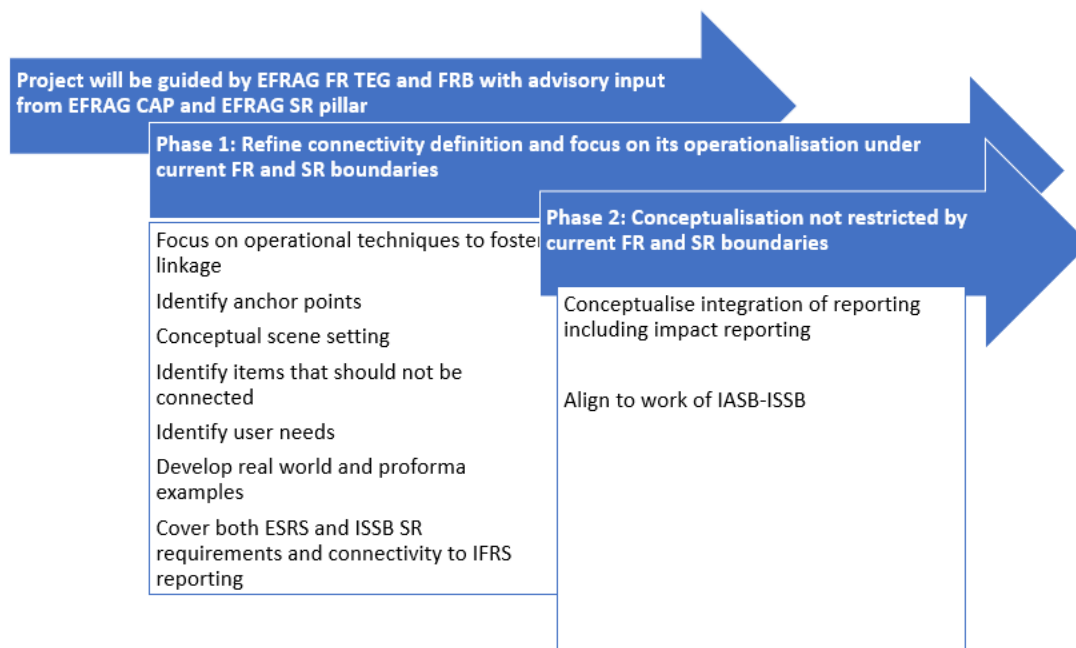
- 1 On 8 February, during the joint meeting, EFRAG FR TEG and FRB approved the scope and two-phase approach for the EFRAG research project on the connectivity between financial reporting (FR) and sustainability reporting (SR) information. During both the approval and the earlier joint discussion by EFRAG FR and SR TEGs, the importance of clarifying what connectivity means and setting the scene conceptually at the start was emphasised.
- 2 The purpose of this session is for EFRAG FR TEG to:
 - (a) agree on primary research objective and possible deliverable/s;
 - (b) agree on the possible elements of connectivity to be considered in the project;
 - (c) discuss the role of management commentary in the articulation of the boundaries between FR and SR information;
 - (d) get an update and discuss possible implications of IFRS Foundation connectivity-related activities (e.g., ISSB agenda consultation project on connectivity, and connectivity discussions during the ISSB finalisation of IFRS S1 and S2 requirements). Of note, there is a proposed distinction between the terms, 'connectivity' and 'integration in reporting', and there is a need to consider if there ought to be any implications on how EFRAG thinks about or describes its project on connectivity were this proposed distinction to be formalised after the ISSB agenda consultation;
 - (e) provide views on the use of the EFRAG advisory panel on the connectivity between financial reporting and sustainability reporting (the 'EFRAG CAP') that will likely be operational in Q2 2023.

Background

- 3 In June 2022, the EFRAG FRB approved the addition of a project on the connectivity between FR and SR information to the EFRAG proactive research agenda. The project was identified as a high priority in the feedback to the May 2021 EFRAG agenda consultation (it was the most supported new EFRAG proactive agenda project).
- 4 At the February 2023 joint meeting of EFRAG FR TEG and the EFRAG FRB, a two-phase approach to the project was approved. The first phase would focus on defining "connectivity" and operationalising it given the current FR and SR borders. The first phase would include identifying items that cannot or should not be connected. The



first phase will involve outreach to users of FR and SR information to ascertain the forms of connectivity that will address their information needs. It will also involve gathering examples of reporting practices and proforma examples on the application of the connectivity principle. After the first phase, a second phase would be discussed. This phase could consider possible connectivity developments if the conceptual boundaries of FR and SR were to be changed and would address the integration of reporting. Below is a diagrammatic depiction of some of the key elements of the two-phase approach.



Research objective

- 5 At the February meeting, it was noted that the deliverables of the research project could fulfil multiple objectives including:
 - (a) To influence the ongoing jurisdictional and international SR and FR standard setting including the expected standard setting by the IASB and ISSB, notably on Management Commentary and Integrated Reporting. The research findings could be considered when addressing conceptual issues related to SR and serve as input to the forthcoming IASB narrow-scope project on climate-related risk in financial statements.
 - (b) To contribute to research/thought leadership on the topic of connectivity, which is a nascent and high-priority area for stakeholders.
 - (c) To support practice through identified good reporting practices. Examples that will be identified during the research can enable companies to benchmark themselves and improve their reporting practices.
 - (d) To serve as an educational resource for a diverse range of stakeholders concurrent to ongoing significant developments in SR and its connection with FR.



EFRAG Secretariat analysis

- 6 The EFRAG Secretariat notes that although the research project could fulfil multiple objectives as stated in the above paragraph, it may be beneficial to decide which should be the main objective. The decision on the main objective also influences the choice of most appropriate deliverable. Thus, along with the objective/s, there is a need to discuss what deliverable/s would be appropriate for this project.

Questions for EFRAG FR TEG

- 7 Which of the objectives stated in paragraph 5 above, does EFRAG FR TEG consider should be the main objective of the project?
- 8 If the main objective of the project is either supporting practice or serving as an educational resource for stakeholders, would the publication of a Discussion Paper best suit that objective? If not, what should the 'deliverable' be?

Elements of connectivity

- 9 During the February joint meeting of EFRAG FR TEG and the EFRAG FRB, the need to consider the evolving definition of connectivity was discussed. Some members called for a definition that would go beyond ensuring consistency of financial reporting and sustainability reporting information.
- 10 To further clarify what connectivity means in the context of the project, the EFRAG Secretariat seeks the directions of EFRAG FR TEG on the aspects to be respectively considered in the first phase (i.e., in the part of the project where "connectivity" is defined and operationalised) and the second phase of the project that aims for conceptual enhancement for an integrated reporting. In this paper, the term 'integrated reporting' is not referring to the work of the International Integrated Reporting Council and its six-capital framework, which is currently voluntarily applied by many companies - but is used in a more general sense connoting a future state of an increased integration of reporting.
- 11 ESRS 1 requirements (Paragraphs 119 to 130) on connected information contain the elements of what ought to be meant by connectivity during the first phase of the EFRAG research project and these include:
- (a) **Description of relationships between different pieces of information:** The undertaking shall describe the relationships between different pieces of information. Doing so could require connecting narrative information on governance, strategy, and risk management to related metrics and targets. For example,
- (i) to allow users to assess connections in information, the undertaking might need to explain the effect or likely effect of its sustainability strategy on its financial statements or financial plans, or on metrics and targets used to measure progress against performance.
 - (ii) the undertaking might need to explain how its use of natural resources and changes within its supply chain could amplify, change or reduce its material impacts, risks and opportunities.
 - (iii) It may need to link this information to the potential or actual effect(s) on its production costs, its strategic response to mitigate such impacts or risks



and its related investment in new assets. This information may also need to be linked to information in the financial statements and to specific metrics and targets.

- (b) **Cross-referencing:** ESRS 1.120-3 require the incorporation by cross-referencing. ESRS1.125 states that when the sustainability statements include monetary amounts or other quantitative data points that are above a threshold for material information and are directly presented in financial statements, the undertaking shall include a reference to the relevant paragraph of its financial statements where the corresponding information can be found. The EFRAG project will consider where it is appropriate to use cross-referencing. And will draw on insights from constituents' feedback to the respective 2022 public consultations on ESRS and IFRS S1, S2 Exposure Drafts, and the 2021 IASB's exposure draft Management Commentary, and the redeliberations made thereafter.
- (c) **Reconciliation to financial statements information:** In some cases, sustainability statements may include monetary amounts or other quantitative data points above a threshold for material information that is either an aggregation of, or a part of, monetary amounts or quantitative data presented in the undertaking's financial statements. If this is the case, the undertaking shall explain how these relate to the most relevant amount(s) presented in the financial statements. This disclosure shall include a reference to the line item and/or to the relevant paragraph(s) of its financial statements where the corresponding information can be found. For material amounts, a reconciliation shall be provided, and it may be presented in a tabular form.
- (d) **State consistency of underpinning assumptions, data and qualitative information:** When there is no direct or indirect link, the undertaking shall state (based on a threshold for material information) the consistency of data, assumptions used, and qualitative information included in its sustainability statements with the corresponding data, assumptions and qualitative information included in the financial statements.
- 12 That said, connectivity is an evolving and multidimensional concept. And as the longer-term aspect of the EFRAG research project (phase 2) is envisioned to focus on the conceptualisation of the integration of reporting, it is useful to consider and evaluate other dimensions/elements of connectivity as understood by stakeholders and thought leaders on the subject. Such an analysis is useful, even when these other elements may not be applicable for the first phase of the EFRAG project or may not have been captured in the articulation of connected information within ESRS requirements.
- 13 Accordingly, Table 1 below lists **possible** elements of "connectivity" identified from various sources including the IASB/ISSB (IFRS S1 and S2 requirements) and presentations of the IFRS Foundations (including IASB/ISSB), EFRAG's SR publications (PTF-NFRS report and ESRS requirements), the International Integrated Reporting Council ('IIRC') framework and other publications. The elements likely to be pertinent to the first phase of the project outlined in paragraph 10 above are included in this list. And as noted, in this list, there are also,
- (a) elements of connectivity not reflected in ESRS requirements for connected information that could be applicable to the second phase of the project.



- (b) elements that would fall under what the ISSB is referring to as 'integration in reporting' (as discussed in later sections of this paper).
- (c) Elements that may be applicable for both the first and second phase of the project but are yet to be evaluated in the discussions by EFRAG FR TEG (e.g., XBRL/technology-enabled connectivity).
- (d) elements that could also be considered by some as objectives, principles, applications or methods to achieve “connectivity” rather than being “connectivity” per se.

Table 1: Elements of connectivity

Ref	Possible element	Description
Linkage and interrelationships		
Link#1 (EFRAG ¹) (Other ⁷)	Linkage	“Connectivity” is information showing how information reported in sustainability reporting and financial reporting is linked (or cannot be linked). (E.g., ‘connected information’ in Draft ESRS 1 and Draft IFRS S1).
Link#2 (EFRAG ^{1, 2})	Future reporting effects	“Connectivity” involves explaining the anticipated effects of information provided under the SR regime on the information, in the future, reporting under the FR regime. (E.g., requirements to disclose anticipated effects on sustainability-related risks and opportunities on elements in the financial statements). Future reporting effects would be an example of what is sometimes termed ‘indirect connectivity’.
Link#3 (IFRS ³)	Describing common key factors	“Connectivity” involves describing the key factors affecting both financial reporting and sustainability reporting. That is, information about the key factors that have affected or could affect the value the entity creates for itself, cash flows over time (and under a double materiality regime, impacts on people or the environment).
Link#4 (IR ⁴)	Past to future	“Connectivity” includes connecting the past (e.g., past performance) with the future (e.g., future performance).
Link#5 (IR ⁴)	Capitals of integrated reporting	“Connectivity” includes the interdependencies and trade-offs



		between the capitals, and how changes in their availability, quality and affordability affect the ability of the organisation to create value.
Link#6 (Other)	Statistically linked (i.e., established correlated and causative links)	Establishing correlated/causative statistical links between financial and non-financial performance indicators. For example, a leading EU software company has done this in its IR report.
Link#7 (Other)	Information about differences in reporting scope	“Connectivity” does not mean that it is necessary to have the same reporting scope. There could thus be differences, but “connectivity” means that the differences are explained.
Consistency		
Con#1 (EFRAG ²)	Making use of the same underlying data	<p>“Connectivity” refers to the requirements in sustainability reporting standards to provide financial reporting information. (E.g., breakdown of total revenue by significant ESRS sectors and reconciliations to segment reporting as required by IFRS 8 - Draft ESRS 2). [It could also refer to any future requirements in financial reporting to link with elements used in sustainability reporting (e.g., in relation to forward-looking estimates and risk disclosures)].</p> <p>Making use of the same information is an example of what is sometimes termed ‘direct connectivity’.</p>
Con#2 (EFRAG ²)	Same assumptions	<p>“Connectivity” means that financial reports and sustainability reports are based on the same set of assumptions (and sensitivities). (For example, the same assumptions about the development in the climate).</p> <p>Applying the same assumptions is an example of what is sometimes termed as ‘direct connectivity’.</p>
Con#3 (Other)	Information about conformity in assumptions	“Connectivity” does not mean that the same assumptions have to be applied in financial reporting and sustainability



		reporting. There could thus be differences. “Connectivity”, would mean that different assumptions and resulting differences are explained.
Con#4 (Other) (IR ⁵)	Consistent story	“Connectivity” should ensure that users of financial reports and sustainability reports get a consistent story on performance, risk and value creation. This means that all communications from the organisation need to be consistent, and that information the organisation provides is not read in isolation but combined with information from other sources when making assessments.
Con#5 (IR ⁴)	Consistency between external and internal management reporting	“Connectivity” includes quantitative indicators being consistent with the indicators used internally by management and those charged with governance.
Con#6 (Other)	Same reporting scope (reporting entity/reporting boundary)	“Connectivity” means that the reporting unit is the same under financial reporting and sustainability reporting. (Both ESRS and IFRS S1 and S2 stipulate the same reporting entity for FR and SR information).
Con#7 (Other)	Same reporting period	“Connectivity” means that the reporting period, including the reporting date, is identical for financial reporting and sustainability reporting.
Con#8 (Other)	Similar approach for events after the reporting date	“Connectivity” means that a similar approach is used in financial reporting and sustainability reporting for how to take events after the reporting date into account (including the assessment of whether the entity can report as a going concern). (Both IFRS S1 and ESRS requirements were influenced by IAS 10 <i>Events After the Reporting Period</i> requirements).
Con#9 (Other)	Similar approach for changes in estimates	“Connectivity” means that changes in estimates are treated similarly in financial reporting and sustainability reporting. This includes whether/when to change comparative figures and information. (Both IFRS S1 and ESRS



		requirements were influenced by IAS 1 <i>Presentation of Financial Statements</i> and IAS 8 <i>Accounting Policies, Changes in Accounting Estimates and Errors</i> requirements).
Con#10 (Other)	Similar approach for changes in preparation and presentation practices	“Connectivity” means that changes in preparation and presentation practices are treated similarly in financial reporting and sustainability reporting. (Both IFRS S1 and ESRS requirements were influenced by IAS 1 and IAS 8 requirements).
Con#11 (Other)	Similar approach to recognition/disclosure	If something should be disclosed under sustainability reporting it should also be disclosed or recognised in the financial reporting (and vice versa).
Con#12 (Other)	Similar requirements on ‘commercial sensitivity’	The requirements on when a specific piece of information can be left out because of its commercial sensitivity should be the same in financial reporting and sustainability reporting.
Complete information on value creation		
Com#1 (IFRS ⁶)	No information gaps	“Connectivity” should ensure that information that is significant for the primary users of financial reports and the primary users of sustainability reports is provided in the reporting package of sustainability reporting and financial reporting.
Com#2 (IR ⁵)	True economic state	<p>“Connectivity” includes minimising the gap between the true economic state of an organisation and what is reported. Gaps can result from such factors as: a biased or incomplete understanding within the organization of its true economic state; a tendency to report only positive factors; static, linear, or silo thinking; and intangibles not being included in the balance sheet.</p> <p>For instance, this aspect is evident in whenever stakeholders express views on the connectivity of FR and SR and refer to missing¹ information (e.g., in financial statements) necessary for users to get a full picture of the entity’s value creation.</p>

¹ Carbon tracker thematic reviews on reporting on climate risk highlight missing information in financial statements notwithstanding available related information in current sustainability disclosures (e.g., TCFD disclosures)



Com#3 (IR ⁴)	Encompasses both quantitative and qualitative information	“Connectivity” includes that qualitative and quantitative information is used to represent the organization’s ability to create value as each provides context for the other.
Clear communication		
Clear#1 (IFRS ⁶)	No (unintended) information overlaps	“Connectivity” should ensure that the same information is not included twice.
#11 (IR ⁴)	Clear communication	“Connectivity” includes minimising the gap between the intentions of the organisation as stated in its reports and the perceptions of report users.
Approach to management		
#13 (IR ⁵)	Integrated thinking between business functions	“Connectivity” is not only about reporting. It is also about connecting business functions. helping to break down internal barriers to working, monitoring and managing information and communicating its value-creation process
Standard setting process		
AS#1 (IFRS ³)	Connectivity in process	Ensure that the sustainability arm and financial reporting arm of a standard setter are updated and are coordinating each other’s related activities (e.g., IASB-ISSB staff and Board coordination, EFRAG SR involvement in this FR project).
Connectivity enabled through XBRL		
Tech#1	Interconnectivity between two domains	Technically achieved connectivity between two domains is achieved if: <ul style="list-style-type: none"> - The technical modelisations of the two domains are compatible, i.e., can be put in the same document without creating technical or interpretation issues. - The data from the two domains is co-usable, i.e., it is possible to exploit data from both domains using the same tools. - Actual connections between the domains have been drawn.

1: Draft ESRS 1 par. 119 and par. 124.

2: European Reporting Lab @EFRAG *Interconnection between financial and non-financial information* par. 119 – 128.

3: Agenda Paper 8 *Connectivity in financial reporting* presentation for IFRS Advisory Council meeting April 2023.

4: International <IR> Framework, January 2021, par. 3.8-3.9.

5: Connectivity, Background paper for <IR>, 2012.

6: [Connectivity - what is it and what does it deliver? www.IFRS.org](https://www.ifrs.org). 23 March 2023 (Joint statement by Andreas Barcow and Emmanuel Faber)



7: Other sources of information include articles on users’ needs ([Newton Investment Management-Jeremy Stuber](#), [CRUF article-Sue Harding](#)) and expectations and comment letters submitted in response to other initiatives.

- 14 In addition to describing elements of “connectivity,” the IIRC define “connectivity” as: *“An integrated report should show, as a comprehensive value creation story, the combination, inter-relatedness and dependencies between the components that are material to the organization’s ability to create value over time.”* “Connectivity” in the IR framework may not be in the sense of connecting SR and FR information but connectivity between different elements of value creation.

EFRAG Secretariat analysis

- 15 The EFRAG Secretariat notes the variety of elements associated with connectivity and considers that in the first phase of the project, it could be beneficial to focus on elements of “connectivity” that are also identified in ESRS requirements (ESRS 1.119-130) as detailed in paragraph 11.
- 16 Further to that, in the context of considering connectivity from the perspective of how financial reporting can link with sustainability reporting (i.e., how connectivity to SR can be considered for FR information) and vice versa (i.e., how connectivity to FR can be considered for SR information), the EFRAG Secretariat suggests only some of the elements outlined in Table 1 with a focus on the following elements:
- (a) Showing how information in FR is linked to SR and vice versa (Link#1).
 - (b) Showing future financial reporting effects of SR (Link#2).
 - (c) Considering where it would be relevant to apply the same assumptions in financial reporting as in sustainability reporting (Con#2).
 - (d) Making use of the same underlying data (Con#1).
 - (e) Ensuring the basis of preparation of SR is consistent with FR (Con#7-Con#10).
 - (f) Considering how effects of different reporting scopes can be provided (Link#7).
- 17 As noted, though not discussed so far in the context of the project, XBRL/technology-enabled connectivity may also be applicable during the first phase. But it may be premature to incorporate this aspect and it may be better considered during the second phase, if at all. To determine whether this aspect should be considered in the EFRAG project, will need monitoring of the work of the EFRAG Digital Reporting Consultative Forum-DRCF.



Questions for EFRAG FR TEG

- 18 Does EFRAG FR TEG consider that "connectivity" includes any additional elements than those included in Table 1 above? If so, please state these.
- 19 Does EFRAG FR TEG agree with the suggestion of the EFRAG Secretariat to consider the elements listed in paragraph 16 as well as ESRS requirements (ESRS 1.119-130) 16 in the first phase of the project?
- 20 Does EFRAG FR TEG consider that because the term "connectivity" is interpreted differently by different persons, it may therefore be beneficial to use another term for the project? If so, what alternative term could be appropriate? Or should a subtitle that distinguishes the project be applied, and if so, what could it be?

Boundaries of FR and SR information - the role of management report/commentary

- 21 During the February joint meeting of EFRAG FR TEG and the EFRAG FRB, it was suggested that the definition of FR and SR ought to be a precursor to the definition or description of connectivity for the purposes of the EFRAG project. In this regard, an updated detailed analysis of the boundaries of FR and SR (i.e., nature, similarities, and differences of FR and SR) will be part of setting the scene conceptually and will be presented at a future meeting.
- 22 However, during the February meeting, mixed views were expressed on whether connectivity with management commentary (or management report) information should be within the scope of the EFRAG project. Some members suggested the exclusion of management commentary as it is under the purview of local regulation. In contrast, other members expressed the view that, for connectivity purposes, the nature of information should prevail over any location considerations and therefore the relevant information could be included in the management commentary. As a result of the mixed views, at this meeting, EFRAG FR TEG's agreement on the role of management commentary, which is related to consideration of the boundaries of FR and SR information, is sought. Accordingly, below is an analysis of the FR-related and SR-related information in management commentary.
- 23 FR-related information in management commentary: The EFRAG Secretariat notes that:
 - (a) The preamble to the EU Accounting Directive (states: "The management report and the consolidated management report are important elements of financial reporting" (par. (26)).
 - (b) The 'Preface to IFRS Standards' states that the IFRS Standards "are designed to apply to the general purpose financial statements and other financial reporting of profit-oriented entities" (par. 5). "Other financial reporting comprises information provided outside financial statements that assists in the interpretation of a complete set of financial statements or improvise users' ability to make efficient economic decisions".
 - (c) The IASB's *Conceptual Framework for Financial Reporting* states that "The qualitative characteristics of useful financial information apply to financial information provided in financial statements, as well as to financial information provided in other ways (par. 2.3).
 - (d) The IASB's existing Practice Statement 1 *Management Commentary - A framework for presentation* (2010) states that "[t]he Practice Statement is



prepared on the basis that management commentary lies within the boundaries of financial reporting because it meets the definition of other financial reporting in paragraph 7 of the Preface to International Financial Reporting Standards. Therefore management commentary is within the scope of the Conceptual Framework for Financial Reporting.” (par. IN 4)

The existing Practice Statement describes the objective of management commentary as follows (the Practice Statement is under review at the moment and will allow alignment with the ISSB and potentially other developments):

- (i) Provide users of financial statements with integrated information that provides a context for the related financial statements. Such information explains management’s view not only about what has happened, including both positive and negative circumstances, but also why it has happened and what the implications are for the entity’s future.
- (ii) Complements and supplements the financial statements by communicating integrated information about the entity’s resources and the claims against the entity and its resources, and the transactions and other events that change them.
- (iii) Explain the main trends and factors that are likely to affect the entity’s future performance, position and progress. Consequently, management commentary looks not only at the present, but also at the past and the future.

- 24 SR-related information in management commentary: The EFRAG Secretariat is cognisant that, going forward, under the EU reporting legislative framework (CSRD and ESRS requirements), the placement of sustainability reporting information will be within the sustainability statements, which is a separate section of the management report. Thus, there will be a corresponding need for connectivity between sustainability statements and the rest of the management report and this is reflected in the ESRS requirements.
- 25 According to the Basis for Conclusions for Draft ESRS 1: “connected information establishes clear links between the management report, sustainability statements and financial statements and provides a holistic view between all the factors that affect value creation. This allows information to be more useful, relevant, and cohesive and the management report to be viewed as a single, balanced and coherent set of information properly linked with financial reporting [...]. This concept is also aligned with the corresponding content of IFRS S1.” (BC 42).

EFRAG Secretariat recommendations

- 26 Based on the above analysis, the EFRAG Secretariat recommends that management commentary/management report should be in the scope of the EFRAG research project, and FR should be considered to include the financial information included in the management commentary.
- 27 As noted above, the management report will include both FR and SR information. Accordingly, connected information can establish links between different sections of the management report. This recommendation takes into account that, as outlined further below (paragraphs 31 to 62) in the analysis of the IFRS Foundation connectivity-related discussions and, as discussed at the April 2023 IFRS Advisory Council meeting (see [IFRS Foundation slides- Connectivity in Financial Reporting](#)), the nature of information in management report/commentary makes it an important part



of the discussion on connectivity. The latter point holds regardless of management report/commentary/MD&A having varied jurisdictional requirements and being under the purview of local regulation. We recognise, for instance, in the EU, the management report is guided by the EU Accounting Directive and the non-mandatory IASB Management Commentary Practice Statement is not endorsed.

- 28 Furthermore, the CSRD requires eligible companies to present the ESRS sustainability disclosure in a dedicated section of the management report. The content of this section is dictated by ESRS. This has been interpreted by some in the public consultation on the first set of ESRS as a limitation to the possibility of fully exploiting the benefits of integrated reporting. ESRS 1 allows companies to incorporate information by reference to other parts of the management report, including the management commentary. An executive summary including integrated information that would be placed in the management commentary could be incorporated by reference in the ESRS sustainability statements (and this is illustrated by Appendix H of ESRS 1). However, this is not expected to be a substitute for the content of the ESRS sustainability statements, i.e., the undertaking shall ensure that incorporation by reference does not impair the understandability of ESRS sustainability statements. The consequence is that the management commentary will likely play an important role in facilitating some form of integration of reporting for ESRS preparers. This further reinforces the need to fully explore the linkages between SR and the management report as part of the project.

Questions for EFRAG FR TEG

- 29 Does EFRAG FR TEG agree with the suggestion of the EFRAG Secretariat that connectivity between financial reporting and sustainability reporting includes connecting information in the management commentary/management report with FR information in financial statements and SR information in sustainability statements?

Update on and implications of IFRS Foundation connectivity-related discussions

ISSB Agenda consultation – Project on integration in reporting

Background

- 30 At its December 2022 meeting, the ISSB tentatively decided to seek stakeholder feedback on four potential projects in a Request for Information to be issued over the first half of 2023. One of the four potential projects was focused on connectivity in reporting and was initially described as a joint project with the IASB to:
- Develop comprehensive disclosure requirements and guidance that enable entities to report a connected discussion and analysis of their financial statements and sustainability-related financial disclosures. This project would also aim to provide clarity about how the components of general-purpose financial reports fit together.
 - Consider the feedback on the IASB's proposals on management commentary and explore similarities and differences between those proposals and the Integrated Reporting Framework, seeking to further build on the principles and concepts of the Integrated Reporting Framework. The project would also consider its relationship with IFRS S1 *General Requirements for Disclosure of Sustainability-related Financial Information* and findings in other projects.



- 31 A presentation of this project based on its initial scoping, and the possible interactions with the EFRAG research was included in the January 2023 paper for the joint EFRAG SR TEG and FR TEG meeting (see [agenda paper 04-01](#)).

Recent developments and re-orientation of possible ISSB project

- 32 In March 2023, the ISSB reconsidered the scope and framing of the project in the light of the final deliberations and tentative decisions made on connected information on its exposure -drafts on IFRS S1 and IFRS S2 *Climate-Related Disclosures* (hereafter [draft] ESRS S1 and [Draft] IFRS S2).
- 33 The ISSB concluded that much of the initially contemplated work for the project had already largely been addressed in particular by the latest revisions made to [Draft] IFRS S1 and [Draft] IFRS S2 (see analysis below in Section Recent tentative decisions made by the ISSB) and other initiatives already undertaken by the IASB (project Management Commentary) or the ISSB.
- 34 It was noted, in particular, that the broad concepts that enable integration in reporting, such as enhanced coherence and identifying linkages between different types of information in the reporting package, are already featured in various requirements and frameworks, including the requirements for connected information set out in [Draft] IFRS S1 and [Draft] IFRS S2, the Integrated Reporting Framework and the IASB's Exposure Draft Management Commentary.
- 35 Therefore, in order to be additive to the requirements for connected information already achieved by the ISSB and elicit more useful feedback in the RFI public consultation, the ISSB tentatively decided to rearticulate the project to be proposed in the RFI:
- (a) To expand its scope of the project to be more broadly focused on 'integration in reporting' (rather than 'connectivity') such that this project would support the pursuit of integrated disclosures beyond the requirements on connected information already contained in [Draft] IFRS S1 and [Draft] IFRS S2;
 - (b) To include the requirements of [Draft] IFRS S1 and [Draft] IFRS S2 related to connected information in the RFI in order to provide necessary context when considering the project on 'integration in reporting';
 - (c) To articulate the research project proposed in the RFI as an ISSB project that could be pursued jointly with the IASB, rather than presenting it only as a formal 'joint project' from the outset.
- 36 The rearticulated 'integration in reporting' project would seek to develop guidance to bring together sustainability-related financial information and other qualitative and quantitative financial information into a new set of integrated information through which investors and other users of an entity's reporting have a comprehensive, coherent and concise view of how an entity creates, preserves or erodes value. This project could also encompass establishing a corporate reporting framework that integrates disclosure across one or more documents.
- 37 It was noted that such a project would extend beyond simply creating 'connections' between financial statements and the sustainability-related financial disclosures established by [Draft] IFRS S1 and [Draft] IFRS S2. In making its tentative decisions, the ISSB made a fundamental distinction between the concepts of 'connectivity' and 'integration' by which:



- (a) The concept 'integration in reporting' can be used to describe the mechanism for bringing together different sources of decision-useful information in general-purpose financial reports and combining them to produce a coherent set of disclosures that minimises duplication and demonstrates the interdependencies, synergies and trade-offs that exist between them.
 - (b) The process of 'integration in reporting' goes a step further than connecting information with the potential for unlocking additional layers of value achieved through the practice of integrated thinking and breaking down internal silos.
 - (c) The concept of 'connectivity of information' creates the conditions for integration by supporting the process of bringing together information that is relevant to value creation.
- 38 The ISSB tentatively decided to present the potential project on integration in reporting as an ISSB project that could be pursued jointly with the IASB, rather than presenting it as a formal joint project.
- 39 Consequently, in its forthcoming RFI consultation on agenda priorities, the ISSB will ask its stakeholders for feedback on:
- (a) The priority and urgency of the potential project on integration in reporting relative to the other potential research projects included in the request for information;
 - (b) Whether the potential project on integration in reporting should be a formal joint project with the IASB, or an ISSB project that could draw on input from the IASB as needed; and
 - (c) Whether the potential project on integration in reporting should build on and incorporate concepts from the IASB's Management Commentary project, the Integrated Reporting Framework (which has been a joint responsibility of the IASB and the ISSB since the IFRS Foundation consolidated with the Value Reporting Foundation in 2022), both of those documents or from other sources.

EFRAG Secretariat comments

- 40 The EFRAG Secretariat observes that the envisioned potential ISSB project on integration in reporting will address issues that were earmarked as being within the possible scope of the second phase of the EFRAG research project (as explained in the proposed project scoping paper at the February 2023 joint EFRAG FRB- FR TEG meeting).
- 41 While focusing on the objectives of contributing to the enhancement of FR and SR requirements and reporting practices including under both ESRS and ISSB, EFRAG's project is also intended to be complementary to the future ISSB project on integration in reporting. As noted at the January 2023 joint EFRAG SRB- SR TEG meeting, the phasing of EFRAG's research allows for a timely start of the project, before the IFRS or ISSB Sustainability Standards become applicable and without having to wait to observe actual sustainability statements disclosures made by entities under the mandatory requirements to identify practical and conceptual challenges of connectivity. This remains true even with the re-orientation made by the ISSB as described above. EFRAG expects to contribute to and benefit from the ISSB project on connectivity while conveying a European voice.
- 42 In this regard, the EFRAG Secretariat notes that the potential framing of 'connectivity' as a distinct and narrower notion than 'integration of reporting' and a potential project



on the latter aspect may necessitate a review of the appropriate timing and scope of the second phase of the EFRAG project to ensure non-duplicative efforts.

Questions for EFRAG FR TEG

- 43 Should the potential distinction between the terms connectivity and integration in reporting have any bearing on a) how EFRAG describes its research project; b) the possible timing and scope of phase 2 of the EFRAG project?

ISSB tentative decisions on connected information [Draft] IFRS S1 and [Draft] IFRS S2

- 44 At its meetings on October 2022, November 2022 and January 2023, the ISSB redeliberated requirements contained in [drafts] of IFRS S1 and IFRS S2 related to connected information.
- 45 The purpose of this section is not to have a detailed discussion by EFRAG FR TEG on the ISSB's redeliberation and tentative decisions but only to highlight whether and how some of the concepts or rationale used in making the connectivity-related tentative decisions could usefully inform EFRAG's research project on connectivity.

Requirements on connected information in IFRS S1 and IFRS S2

- 46 Similar to ESRS requirements (see Paragraphs 49 to 52 below), [Draft] IFRS S1 and [Draft] IFRS S2 included requirements that establish connections between sustainability-related financial disclosures and the financial statements (irrespective of the generally accepted accounting principles used to prepare the financial statements). Specifically, IFRS S1 requires that sustainability-related financial disclosures that are prepared in accordance with the ISSB Standards:
- (a) Be prepared for the same reporting entity and reporting period as the related financial statements;
 - (b) Be provided at the same time as the financial statements and within the general purpose financial report (which also includes the financial statements);
 - (c) Include financial data and assumptions that are consistent with the corresponding financial data and assumptions in the financial statements, to the extent possible, considering the requirements of IFRS Accounting Standards or other relevant GAAP; and
 - (d) Discuss significant differences between the financial data and assumptions the entity uses to prepare its sustainability-related financial disclosures and the financial data and assumptions the entity uses to prepare its financial statements.
- 47 [Draft] IFRS S1 and [Draft] IFRS S2 required an entity to disclose **the current and expected effects** of its sustainability-related risks and opportunities on its financial position, financial performance and cash flows for the reporting period **and the 'anticipated effects over the short, medium and long term'**.
- 48 [Draft] IFRS S1 and [Draft] IFRS S2) proposed that an entity shall disclose quantitative information, either single amounts or a range, unless it is unable to do so. If an entity is unable to provide quantitative information, it shall provide qualitative information.
- 49 The feedback received by the ISSB on these proposals was generally supportive and it included the following comments:



- (a) Some respondents highlighted **a risk of duplication** of information with the financial statements as there was no clear and shared understanding of the type of quantitative or qualitative information entities shall provide in response to the proposed 'current and anticipated financial effects' requirements.
 - (b) Some respondents noted that clarity is needed on the **criteria for when quantitative information is required** and when an entity would only disclose **qualitative information** because the entity is unable to provide quantitative information;
 - (c) Some respondents noted that an entity's circumstances (such as skills, capabilities or resources available to the entity) could prevent it from disclosing information in relation to anticipated financial effects of sustainability-related risks and opportunities;
 - (d) Some respondents noted that illustrative examples would be useful to help entities assess whether they have met the requirements.
 - (e) Concerns about measurement and outcome uncertainties including the anticipated financial effects on an entity's financial performance, financial position and cash flows.
- 50 To illustrate the 'duplication concerns' raised by some, it was noted that providing information about current and anticipated effects of sustainability-related risks and opportunities effectively implies that the entities disclose how sustainability-related risks and opportunities:
- (a) **Have affected an entity's financial position, financial performance and cash flows for the period:**
 - (i) This may duplicate the information already contained in the financial statements. Although climate risks and opportunities are not specifically covered by IFRS Standards, they are covered to the extent that they affect an entity's financial position, financial performance and cash flows of an entity.
 - (b) Present a significant risk of a material adjustment to the carrying amounts of assets and liabilities reported in the financial statements **within the next financial year.**
 - (i) This may duplicate/ interact with the requirements for instance in paragraph 125 of IAS 1 *Presentation of Financial Statements* which requires an entity to provide "...information about the assumptions it makes about the future, and other major sources of estimation uncertainty at the end of the reporting period that have a significant risk of resulting in a material adjustment to the carrying amount of assets and liabilities within the next financial year".
 - (c) Are expected to affect an entity's financial position and financial performance over time, given its strategy to address sustainability-related risks and opportunities.
- 51 The ISSB considered examples illustrating each of these situations at its November 2022 meeting (a selection of which is reproduced in Appendix 1 to this paper) to illustrate how these connections may be explained with little duplication of information or by cross-reference to the related financial statements



ISSB re-deliberations to address the concerns raised

- 52 The ISSB agreed that clarifications were necessary while reiterating that the objective in developing the requirements in the EDs was not to duplicate the information in the financial statements or require disclosure of new or different uncertainties, but to explain how sustainability-related risks and opportunities give rise to such uncertainty and **as a means to connect information** about sustainability-related risks and opportunities and information in the financial statements (including through the use of cross-references).
- 53 To address the feedback received the ISSB tentatively decided at its January 2023 meeting to amend [draft] IFRS S1 and [draft] IFRS S2:
- (i) To clarify that if the information in an entity's financial statements has been affected or is expected to be affected by sustainability-related risks and opportunities, the entity would be required to explain the **connections between those risks and opportunities** and their current and anticipated financial effects. In explaining these connections, the entity would be required to **avoid unnecessary duplication** and would be permitted to provide information by cross-reference to the general-purpose financial statements.
 - (ii) To clarify that an entity would be required to provide **both quantitative and qualitative information** about the current and anticipated effects of sustainability-related risks and opportunities on the entity's financial position, financial performance and cash flows. If the entity were unable to provide quantitative information, it would be required to provide qualitative information.
 - (iii) To clarify **situations when an entity is able/unable to provide quantitative** information about the financial effects of a particular sustainability-related risk or opportunity (taking in particular into consideration (a) whether the financial effects are separately identifiable; (b) whether a high level of outcome or measurement uncertainty is involved in quantifying the financial effects; and (c) whether the entity has the skills, capabilities and resources to provide quantitative information about those effects).
 - (iv) To clarify that if an entity is unable to provide quantitative information about the financial effects of a particular sustainability-related risk or opportunity, the entity is required to:
 - explain why it is unable to provide quantitative information about the financial effects of that sustainability-related risk or opportunity;
 - provide qualitative information about the financial effects of that sustainability-related risk or opportunity, including identifying line items, totals and subtotals within financial statements that are likely to be affected by that sustainability-related risk or opportunity; and
 - provide quantitative information about sustainability-related risks and opportunities—including that particular sustainability-related risk or opportunity—at the lowest possible level of aggregation at which the entity is able to provide that information.



Comparison with [Draft] ESRS

- 54 A review of the requirements on connected information contained in IFRS 1 was presented at the January 2023 joint meeting of the EFRAG SR TEG and FR TEG (see [agenda paper 04-01](#)). It was assessed that the IFRS S1 requirements on connected information were aligned with those of the ESRS.
- 55 As noted in the analysis of elements of connectivity in the earlier part of this paper- Paragraph 11, [Draft] ESRS 1 (Paragraphs 119-130) outlines approaches to establish the connection of information in sustainability statements with financial statements. These include:
- (a) Description of relationships between different pieces of information;
 - (b) Use of cross-referencing when the sustainability statements;
 - (c) Reconciliation to financial statements information;
 - (d) State consistency of underpinning assumptions.

EFRAG Secretariat comments

- 56 As both ESRS and ISSB requirements are within the scope of the EFRAG research project, Phase 1 of EFRAG’s project will consider both the requirements of ESRS and IFRS S1 and S2 related to connected information.

Questions for EFRAG FR TEG

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| 57 Do EFRAG FR TEG members have any comments on the ISSB tentative decisions related to connected information? |
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Use of EFRAG CAP

- 58 As noted, EFRAG CAP is expected to be operational in Q2 2023. As part of the introduction, the EFRAG Secretariat will update EFRAG CAP on the objective, scope and two-phase approach of the research project as approved by EFRAG FR TEG and FRB (see summary in the background section above) and further discussed at this meeting. In addition, we propose to consult the panel on
- (a) the operationalisation (including establishing an inventory of anchor points) related to the agreed connectivity elements for the first phase of the EFRAG research project.
 - (b) good examples of the elements of connectivity selected for the first phase of the project.
- 59 When collecting the input of EFRAG CAP, the elements of “connectivity” agreed by EFRAG FR TEG could be taken as a given. Alternatively, the EFRAG Secretariat could seek EFRAG CAP’s comments or further refinements in the articulation on the elements of connectivity applied for the first phase of the project (i.e., whether EFRAG CAP would have any comments on the scope of the project - see paragraph 58 above).



Questions for EFRAG FR TEG

- 60 Would EFRAG FR TEG find it useful to receive comments from EFRAG CAP on the selection of elements of connectivity to be considered in the first phase of the project (i.e. the scope of the first phase of the project)?
- 61 Does EFRAG FR TEG have any other suggested areas for consultation with EFRAG CAP?



Appendix 1: ISSB Illustrative examples

Introduction

62 To illustrate the challenges posed by disclosures about current and anticipated financial effects of sustainability risks and opportunities the ISSB staff prepared a number of examples that were discussed at the November 2022 meeting to illustrate situations whereby sustainability reporting risks and opportunities:

- (a) Have had a quantifiable effect on the current period financial statements;
- (b) Have not had a quantifiable effect on the current period financial statements;
- (c) Only qualitative disclosures are provided; and
- (d) The entity is unable to attribute sustainability-related risks and opportunities.

63 A few of the Illustrative examples are reproduced below.

Example 1 disclosure where there is an effect on the current period financial statements.

Example 1– As a consequence of the decision by the government of country C to ban the use of gas-powered hot water heating from 20XX, we made the decision to shut our production facility in location X in June 20XX.

In accordance with IFRS Accounting Standards, this decision triggered an impairment assessment, and the facility was written down, resulting in an impairment expense of CU580,000 for the period. Additionally, the useful economic life of the facility has been shortened and the carrying amount will be depreciated over the next 16 months. Note 7 of the financial statements sets out details of the impairment and note 9 provides more information about the property affected. Although we are endeavouring to offer all staff employed at the facility an alternative role in our organisation, we have also agreed to compensate any employee for whom we are unable to find a suitable new role. We have recognised a provision for the estimated costs of doing so in the current period. An expense of CU2.4m was recognised in the period, with a corresponding provision. This is set out in note 17 of the financial statements.

Example 2–disclosure with no current-period financial statement effects

Example 2–One of the biggest contributors to our Scope 1 GHG Emissions is our fleet of diesel-powered delivery vehicles. We estimate that they contribute approximately 65,000 tons of CO₂e annually. We lease all of our vehicles and the usual lease term is five years. We plan to replace each vehicle with a fully electric model when it reaches the end of its lease term. Accordingly, there are no implications for the current-period financial statements in relation to the accounting for these leased diesel vehicles. Financial information for the delivery fleet is in note 17 (property, plant and equipment) and note 19 (lease liabilities) of the financial statements



Example 3 - Quantitative anticipated financial effects on financial position and financial performance over time

Example 3 - We have decided to reduce the use of single-use plastics in our value chain by changing our product packaging. We currently use plastic to wrap our multiple packs of canned soup, vegetables and pulses. From 1 January 20XX we will use responsibly sourced cardboard. This change will require an investment in new packaging machinery. We are still considering potential models, but we estimate the cost to be between CU2.2m and CU3.5m. We expect to fund the acquisition in line with our financing target of 30 per cent through external borrowing and the balance from reinvesting free cash flow. The plastic packaging machine was nearing the end of its useful economic life and no changes to the rate of depreciation are required.

Example 4 - Qualitative Information: disclosure linking paragraphs 15, 16 and 22 of [draft] ESRS S1

Example 4 - We [parent company] have identified water scarcity risks, including the risk of droughts, in a key maize procurement region. We have entered into a research and development joint venture with a seed supplier to develop drought-tolerant maize so as to manage this risk. Financial information about the joint venture can be found in note 20 (investments in joint venture and associates). Despite the identification of this risk, current year maize yields remain strong. The financial information on maize production can be found in note 21 (inventories). As a result of the joint venture, the assets related to maize production have been reviewed for impairment and the company has concluded that no impairment on associated assets [in response to [draft] S1 paragraph 16] should be recognised in the current period financial statements. We [parent company] have increased the headcount in the risk department by 3 people to manage the risks and opportunities from this and other environmental and social risks. This will allow management to develop better information about risks it has identified and manages. The financial information about those employees is aggregated and summarised in note 30 (employee benefits expenses)

Example 5—disclosure when an entity is unable to attribute sustainability-related risks and opportunities

Example 5 - We have XX buildings in a region of country Z that are at risk of flooding. Reports prepared by the national weather service in that country suggest that climate change will cause an increase in extreme weather events that could lead to an increase in flooding. For those XX buildings, last year we experienced three occurrences of flooding. This year that increased to five occurrences of flooding. However, over the last 10 years, we had five flooding events in four different years. It is therefore unclear whether the increase from three to five floods is caused by a change in the climate or is part of normal cycles. During the year we have invested in flood protection measures at these sites, to the sum of CU 0.5 million, and that have been capitalised in Property, Plant and Equipment (note 5). Due to these measures, we do not see a need for an impairment.

