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## **EFRAG research project-connectivity between financial and sustainability reporting information**

### **Background reading paper only**

## Introduction

- 1 This paper gives an overview of the EFRAG research project on connectivity between financial reporting (FR) and sustainability reporting (SR) information (hereafter referred to as the “EFRAG research project”). The project is led by the EFRAG FR Pillar in coordination and with input from the EFRAG SR Pillar. A Connectivity Advisory Panel (EFRAG CAP) with more than 20 members and a balanced composition by category and expertise (sustainability/financial reporting) will be operational from late Q2/early Q3, and it will provide advisory input for the EFRAG FR TEG to consider.
- 2 The description of the project in this paper reflects the discussions held during the January 2023 EFRAG FR and SR TEG joint meeting, February 2023 EFRAG FRB and FR TEG joint meeting to approve the scope and approach, May 2023 EFRAG FRB and SRB joint meeting, and April and May 2023 EFRAG FR TEG meetings. It also reflects the discussions held by the EFRAG FRB, EFRAG FR TEG and the EFRAG Academic Panel in 2022.
- 3 The rest of the paper is structured as follows:
  - (a) Background
  - (b) Research objective
  - (c) Scope
  - (d) Approach
  - (e) Appendix 1: Other connectivity-related workstreams
  - (f) Appendix 2: Elements of Connectivity
  - (g) Appendix 3: Illustrative linkage of ESRS metrics and other information to financial statements line items

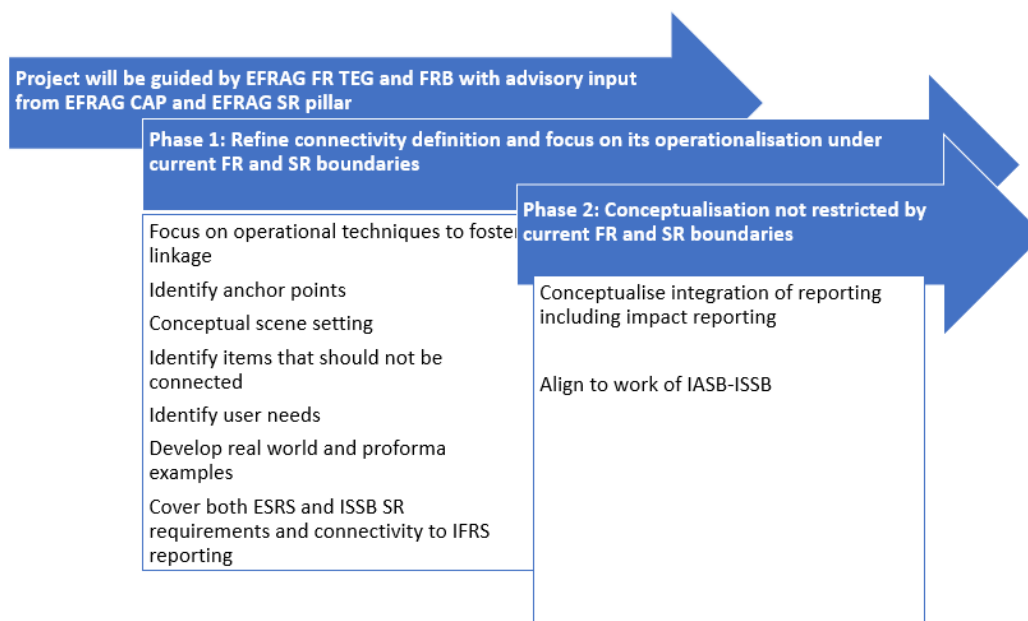
## Background

- 4 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 feedback to the May 2021 EFRAG agenda consultation identified the project as a high



- priority for EU constituents (it was the most supported new EFRAG proactive agenda project).
- 5 In February 2023, EFRAG FR TEG and the EFRAG FRB approved the scope and a two-phase approach to conducting the project. The first phase will have a practical orientation and focus on assessing user needs and operationalising connectivity within the current FR and SR boundaries<sup>1</sup>. A clarification of what the term “connectivity” means for the purposes of this project will also be provided. There will also be a need to align the terminology applied for the EFRAG research project with that applied by other stakeholders to avoid a cross-purpose use of terms.
  - 6 The precise scope of the second phase will be determined at a later date. The preliminary view is that this latter phase will not be limited to the conceptual boundaries of FR and SR and could address the integration of reporting. For the purpose of the EFRAG research project, the term integration of reporting connotes a yet-to-be-realised state of integration of reporting. It could entail a rethink of current FR and SR boundaries including after the possible development of a conceptual framework for SR information. It is not about encouraging the mandatory adoption of the current version of the International Integrated Reporting Council (IIRC) IR framework and its six-capital framework.
  - 7 Figure 1 below is a diagrammatic depiction of the EFRAG research project approach with key elements of the two phases.

**Figure 1: EFRAG research project approach**



## Research objective

- 8 The EFRAG research project could fulfil any of the following objectives (i.e., the below are not mutually exclusive):

<sup>1</sup> In the context of this paper, current FR and SR boundaries connotes existing legislative, regulated reporting, scope and placement requirements in respect of FR and SR information.



- (a) 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 Integration of Reporting. The research findings could be considered when addressing conceptual issues related to SR and also serve as input to the IASB narrow-scope project on climate-related risk in financial statements.
- (b) contribute to research/thought leadership on the topic of connectivity, which is a nascent and high-priority area for stakeholders.
- (c) 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) serve as an educational resource for a diverse range of stakeholders concurrent to ongoing significant developments in SR and its connection with FR.

## Scope

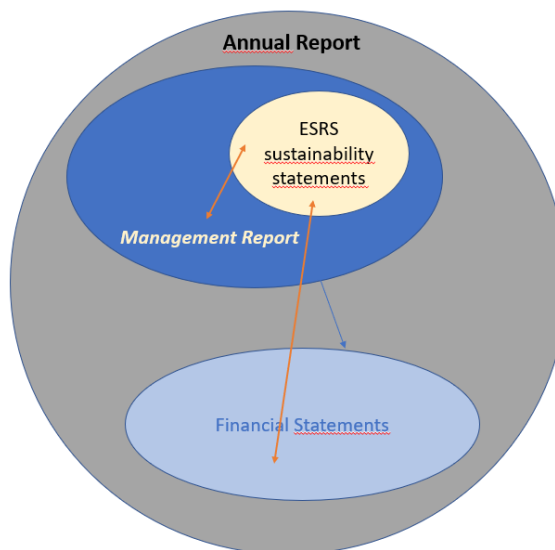
### Connection based on the placement of FR and SR information

- 9 The Figures below respectively depict the placement of FR and SR information under the EU's current reporting framework (Figure 2) as well as within the reporting architecture described by the IFRS foundation (Figure 3).

**Figure 2: EU FR and SR placement architecture (arrows depict the connections)**

#### EU FR and SR architecture

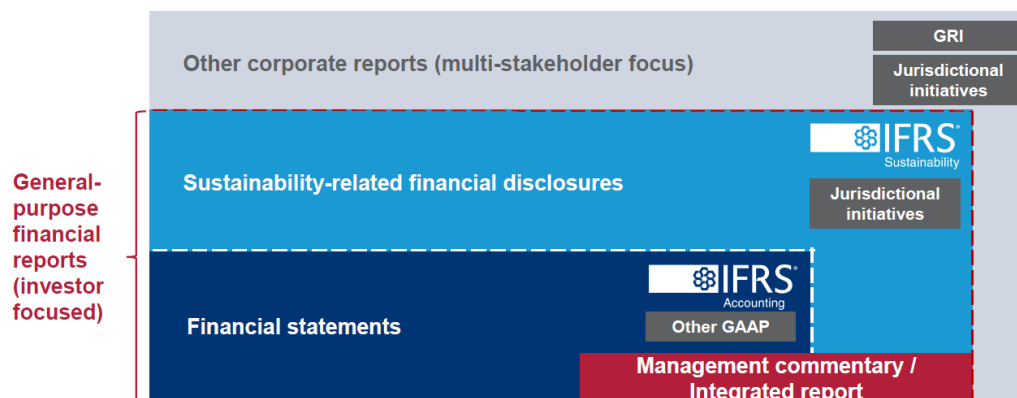
- Mandatory application of ESRS and location of sustainability information in a dedicated section of the Management Report
- ESRS sustainability statements under 'double materiality' lens (impact materiality + financial materiality)
- General principles in ESRS 1 of [connected information](#) are aligned with those of IFRS S1
- Entities in scope: large undertakings (IFRS and national GAAP applicants)



Source: EFRAG



**Figure 3: Reporting architecture described by IFRS Foundation**



Source: Slides used at the April 2023 IFRS Advisory Council Meeting

- 10 The EFRAG research project could potentially focus on the connection of:
- Sustainability reporting information (i.e., sustainability statements (ESRS), sustainability-related financial disclosures (IFRS S1 and S2)) to financial statements (**i.e., a very limited scope**);
  - Sustainability reporting information (i.e., sustainability statements<sup>2</sup> (ESRS) or sustainability-related financial disclosures (IFRS S1 and S2)) to information in other parts of the general purpose financial report (i.e., financial statements, information in the rest of the management report under EU reporting requirements);**
  - Sustainability reporting information (i.e., sustainability statements (ESRS), or sustainability-related financial disclosures (IFRS S1 and S2)) to information in the overall reporting package (i.e., information in other parts of the general purpose financial report and other regulated information and reports) (**a very broad scope**).
- 11 It is envisioned that, as described in paragraph 10 (b) above, the scope of the EFRAG project will primarily encompass connections between **sustainability reporting information (i.e., sustainability statements (ESRS) or sustainability-related financial disclosures (IFRS S1 and S2)) financial statements and information in the rest of the management report**. This scope is consistent with the view in the Basis for Conclusions for Draft ESRS 1 (BC 42): "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."
- 12 However, the EFRAG research project will also consider connectivity based on the nature of information rather than only placement. Hence, relevant information within other sections of the reporting package (e.g., remuneration report) could still be in

<sup>2</sup> The mandatory location (as set in the CSRD) of the sustainability statements is in a separate section of the management report.

scope (e.g., to the extent that such information has been included in the sustainability statements through cross-referencing as allowed by draft ESRS 1).

## Interaction with and implications of IASB-ISSB and other initiatives

- 13 To ensure complementarity of the EFRAG research project's scope and outcomes with the work done by others (**see Appendix 1** for more details), EFRAG will closely monitor the following workstreams:
- (a) The IASB project on climate-related risk in financial statements. Depending on the findings of its outreach on the reasons why climate risk is sometimes not reflected in financial statements when it should, the IASB may undertake minor standard amendments or develop educational material and illustrative examples as an outcome of the project.
  - (b) Developments related to the potential ISSB project on integration in reporting. The scope and concepts of a potential ISSB project could have implications for Phase 2 of the EFRAG research project.
  - (c) Connectivity-related publications developed by other national standard setters (UKEB, FRC-UK, AcSB and AASB, ISA 720 requirements) and influential bodies/frameworks (TCFD); and
  - (d) ESMA publication on climate-related reporting in financial statements that will include illustrative examples.
  - (e) Other practitioner publications.

## Approach

### What does connectivity mean for the EFRAG research project?

- 14 **Guided by ESRS and ISSB requirements:** The ESRS and ISSB requirements include connectivity requirements and these will be the foundation of what the EFRAG research project describes<sup>3</sup> as connectivity. IFRS S1 states that sustainability-related financial disclosures shall:
- (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 as part of 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 generally accepted accounting principles (GAAP); and
  - (d) discuss significant differences between 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.
- 15 The draft ESRS Environmental Standards have requirements for disclosure of potential financial effects. Similarly, both IFRS S1 and S2 require information within

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<sup>3</sup> We describe rather than define the term connectivity as it has multiple dimensions and connotations and does not lend itself to an all-encompassing definition.



the sustainability-related financial disclosures to be linked to information in the financial statements by requiring disclosure of current and anticipated effects on the entity's financial statements due to sustainability-related (IFRS S1) and climate-related (IFRS S2) risks and opportunities.

- 16 Accordingly, considering the ESRS and ISSB requirements and principles of connection, Phase 1 of the EFRAG research project will also primarily<sup>4</sup> focus on the following elements of connectivity encompassing linkage, interrelationships and consistency:
- (a) Establishing the linkage and relationships of SR and FR information (see Paragraph 18 below) starting with identifying anchor points (see Paragraph 17 below).
  - (b) Connection through the disclosure of current and anticipated/potential financial effects of sustainability risks and opportunities (see Paragraph 17-a).
  - (c) where relevant, the same assumptions in FR and SR information should be applied.
  - (d) Same underlying data for FR and SR information.
  - (e) Same basis of preparation of FR and SR information.
  - (f) Explanation of differences in the scope and assumptions of FR and SR information.
- 17 **Identifying anchor points.** To establish points of connection, Phase 1 of the research project will identify anchor points (i.e., intersecting data points within the boundaries of both FR and SR). A starting point for identifying these anchor points will be to assess the content of the 12 draft ESRS (2 cross-cutting; 5 environmental, 4 Social, 1 Governance) and ISSB IFRS S1 and S2 requirements and their linkage to financial statements requirements. In so doing, the EFRAG project will;
- (a) take account of the practical implementation of the requirements for disclosure of current and potential/anticipated financial effects (i.e., sustainability risks and opportunities reflected in current or future financial statements) under the ESRS (i.e., ESRS environmental standards) and IFRS S1 and S2 Standards. That said, the project will consider the limits of connectivity associated with disclosures of potential financial effects. In some circumstances, these effects may never be reflected in the financial statements (see Paragraphs 23 and 24). For instance, these potential effects can be based on a multitude of assumptions, cover a lengthy time horizon and be highly uncertain (e.g., can be related to time horizons of longer than 50 years for climate risk). Furthermore, potential financial effects from sustainability risk that are derivable from current financial statements (e.g., assets at material physical risk) may never crystallise and translate to actual financial effects during future periods.
  - (b) consider non-monetary metrics that may be pre-financial in nature (i.e., may signal future period financial statements effects). For instance, the level of GHG emissions reported by an entity can be indicative of its potential future liabilities. Illustratively, Appendix 3 has ESRS monetary and non-monetary metrics related to ESRS E1 Climate Change, ESRS E2 Pollution, ESRS E4 Biodiversity, and ESRS S1 Own Workforce. In some cases, these metrics could be either

<sup>4</sup> In Appendix 2, we highlight other aspects of connectivity including those identified in the 2021 IR framework that may become applicable in the second phase of the EFRAG research project.

directly or indirectly connected to current or future financial statements information. That said, there can be difficulties in establishing the connection between SR non-monetary metrics and current or future financial statements (e.g., due to the difficulties in the valuation/translation of monetary impacts of social impacts).

- 18 **Operational techniques of connection:** The draft ESRS .119-130 and IFRS S1.43 requirements for connected information will inform the operational techniques of connection to be applied in the EFRAG research project and will include:
- (a) *Description of relationships between different pieces of information:* ESRS states that 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) Similarly, IFRS S1.42. states that an entity shall provide information that enables users of general purpose financial reporting to assess the connections between various sustainability-related risks and opportunities, and to assess how information about these risks and opportunities is linked to information in the general purpose financial statements.
  - (c) IFRS S1. 43 states that an entity 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 of general purpose financial reporting to assess connections in information, an entity might need to explain the effect or likely effect of its strategy on its financial statements or financial plans, or on metrics and targets used to measure progress against performance.
    - (ii) Furthermore, the entity might need to explain how its use of natural resources and changes within its supply chain could amplify, change or reduce its significant sustainability-related risks and opportunities. The entity may need to link this information to the potential or actual effect on its production costs, its strategic response to mitigate such 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. Information that describes connections shall be clear and concise.





- (d) *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.
  - (e) *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.
  - (f) *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.
- 19 **Identify user needs on connectivity**. User needs on connectivity will underpin both the identification of anchor points, what items should not be connected (see Paragraphs 21 to 24 below) and in considering the operational techniques of connection. These needs will be ascertained through the EFRAG CAP, of which about 25% will be users. Where necessary, additional outreach to other users including to the EFRAG User Panel will occur.
- 20 **Develop examples**. The project will identify and document examples of reporting practices and proforma examples on the application of the connectivity principle.

### What cannot be connected?

- 21 The EFRAG research project will also articulate which FR and SR information items should or can not be connected.
- 22 Lack of connection can be due to the differing nature of FR and SR information. Relatedly, below is a non-exhaustive list of differences in the nature of FR and SR information that can help in identifying what information items should or can not be connected:
- (a) *Reporting across the value chain*: FR information is limited to that of the reporting entity but SR considers impacts, risks, and opportunities across the value chain (e.g. for GHG emissions and risks of slavery practices).
  - (b) *Time horizons*: The time horizon for climate risk can be much longer than that typically applied in the recognition and measurement of financial statement line items. However, there are no limits to the length of time horizon applicable for FR information.
  - (c) *Extent to which forward-looking information is incorporated*: Both FR and SR have forward-looking estimates. However, FR is primarily focused on future





consequences of past actions whereas SR also encompasses future consequences of future actions. That said, FR information can also reflect future consequences of future actions (e.g., goodwill impairment tests that necessitate estimates of the terminal value of acquiree entities).

- (d) *Data reliability and estimation uncertainty*: Relative to SR where inputs are derived from outside the reporting entity, FR information is typically based on the recording of transactions under a more robust control environment (underpinned by a double-entry recording system). This has a bearing on the respective reliability and measurement uncertainty of FR and SR information. That said, notwithstanding the inherent uncertainty and data-gathering challenges associated with information on impacts, risks and opportunities across the value chain as required by SR, both FR and SR (and any reported) information should be reliable and of high quality. The assurance requirements and aligned timelines will likely enhance the reliability of SR.
- (e) *Materiality perspective*: FR information is required to be reported only when financially material. SR information is reported under the double materiality perspective (impact materiality<sup>5</sup> and financial materiality<sup>6</sup>) under the ESRS requirements and impact materiality perspective under the GRI Standards. There could be information items disclosed under an impact materiality lens that would not be disclosed from a financial materiality perspective. In theory, these items ought not to have a link to the current or future period financial statement effects. However, such items usually become financially material during future reporting periods (i.e., are pre-financial in nature and the concept of dynamic materiality is at play in practice).
- (f) *Extent of use of non-monetary units of measurement*: SR information predominantly comprises non-monetary metrics, which in turn affects the level of aggregation that is possible under SR, whereas FR information is primarily comprised of monetary metrics.
- (g) *Financial control versus operational control*: Financial control is the criterion for the recognition of assets and consolidation of subsidiaries in FR. It is also sometimes applied as the criterion for the consolidation of SR metrics (e.g., GHG emissions). However, the notion of operational control (when the reporting undertaking has the power to direct operational policies of an entity or assets), which is in some cases applied for the consolidation of SR metrics (e.g., GHG emissions) does not exist under FR requirements.

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<sup>5</sup> Draft ESRS 1.46 states that a sustainability matter is material from an impact perspective when it pertains to the undertaking's material actual or potential, positive or negative impacts on people or the environment over the short-, medium- and long-term time horizons. Impacts include those caused or contributed to by the undertaking and those which are directly linked to the undertaking's own operations, products, or services through its business relationships. Business relationships include the undertaking's upstream and downstream value chain and are not limited to direct contractual relationships.

<sup>6</sup> Draft ESRS 1.52 states that a sustainability matter is material from a financial perspective if it triggers or may trigger significant financial effects on the undertaking's development, performance, and position in the short-, medium- or long-term. This is the case, in particular, when it generates or may generate significant risks or opportunities that influence or are likely to influence the future cash flows. Future cash flows with other critical factors such as business model, strategy, access to finance and cost of capital, in turn are likely to influence the financial position and financial performance of the undertaking in the short-, medium- or long-term, including affecting the enterprise value. Risks and opportunities may derive from past events or future events and may have effects in relation to:

- (a) assets and liabilities already recognised in financial reporting or that may be recognised as a result of future events; or
- (b) factors of enterprise value creation that do not meet the financial accounting definition of assets and liabilities and/or the related recognition criteria but contribute to the generation of cash flows and creation/maintenance of enterprise value. The latter factors are generally referred to as 'capitals' in frameworks promoting a multi-capital approach.



- (h) *Conceptual framework*: Unlike for FR information, no conceptual framework for SR information exists.
- 23 There are limits to IFRS requirements including a) in the recognition of sustainability risks as provisions or liabilities (e.g., due to the threshold for recognition including the need for a past event to have occurred); and b) in recognising disclosed sustainability related investments as assets (e.g., due to measurement uncertainty). The 2021 EFRAG PTF-NFRS Appendix 4A report and other publications (e.g., UKEB and AcSB papers for the April 2023 IFASS meeting) further outline the current limits of IFRS requirements.
- 24 Linking sustainability risks and opportunities to financial statement line items is not always possible. This is because financial effects are not always attributable to individual sustainability-related risks or opportunities and may arise from multiple risks or opportunities. In effect, sustainability risks may not be separately identifiable (i.e., these risks may be inseparable from other reported risks such as macroeconomic risks).



## APPENDIX 1- Other connectivity-related workstreams

- 1 EFRAG will continue to monitor the following connectivity-related workstreams by the IASB-ISSB and other national standard setters to ensure the scope and outcomes of the EFRAG research project are distinctive and complementary to the work done by others.

### IASB project on climate-related risks in financial statements

- 2 Following the 2021 IASB Third Agenda consultation, the IASB added a project on climate-related risk in financial statements to its maintenance workplan.
- 3 In March 2023, the IASB initiated this project and will research to what extent its educational material published in 2020 is helping companies reflect climate-related risks in financial statements, and what actions, if any, it could take to improve information on these matters. At the April 2023 IFASS meeting, the IASB Chair highlighted that the scope of the project may be re-oriented to focus on long-term risks in financial statements and may thus capture a wider set of risks (including but not limited to climate risk) that are currently not being reflected in financial statements.
- 4 In May 2023, the IASB Emerging Economies Group received [a presentation on the project](#). The presentation indicated that the IASB is in the process of seeking input on
  - (a) **the nature of concerns** (i.e., inconsistent disclosures and insufficient information about climate-related risks in financial statements. Examples of concerns include the impairment of assets, recognition of liabilities, and perceived imposed restrictions by IAS 1.25 towards the disclosure of assumptions and other sources of estimation uncertainty);
  - (b) **causes of concerns** (i.e., whether it is unclear requirements in Accounting Standards, Lack of compliance, Limitations in IFRS Accounting Standards, User information needs beyond the objective of financial statements);
  - (c) **courses of action** (possible minor amendments to IFRS accounting standards, application guidance, new illustrative examples, educational material); and
  - (d) **expanding the scope of the project** (e.g., going beyond climate risk and including other long-term risks).

### ISSB potential project on Integration in reporting

- 5 The May 2023 ISSB [Request For Information \(RFI\) Consultation on Agenda Priorities](#) has framed 'connectivity or connection in reporting' as being a distinct and narrower notion than 'integration of reporting'.
- 6 Paragraphs A40 and A41 of the ISSB RFI state that "Integration in reporting takes the concept of connectivity a step further. Integration in reporting not only encompasses where, what and how information on value creation can be connected through conceptual and operational linkages (for example, in terms of compatibility of language and assumptions), but also includes the collective consideration of the interdependencies, synergies and trade-offs between:



- (a) the various resources and relationships reported on in general purpose financial reports; and
  - (b) how the value that an entity creates for itself and for its investors is inextricably linked to the value the entity creates for other stakeholders, society and the natural environment.
- 7 Integration in reporting can ensure that connections between financial and sustainability performance are explicitly, efficiently and effectively communicated in a manner that is more easily understood by an entity's investors.
- 8 It is too early to anticipate the precise scope of the potential ISSB project on "Integration in reporting". Nonetheless, a potential ISSB project may address issues that were earmarked as being within the possible scope of the second phase of the EFRAG research project. Hence, it will likely be necessary to consider whether integration of reporting as applied by the ISSB is synonymous with the use of the term in the context of the EFRAG research project (i.e., not being limited to the current application of the IIRC IR framework).

### Other NSS initiatives

- 9 At the January and April 2023 IFASS meetings, AASB, AcSB and UKEB presented papers on the connectivity between IASB and ISSB requirements. At the January 2023 meeting, UKEB presented a paper which identified several themes to be explored by the IASB and ISSB to foster connectivity and these include;
- (a) Differences and connectivity between the IASB and ISSB Standards;
  - (b) Conceptual framework-related themes (develop the Conceptual framework for SR or update the conceptual framework for FR to include SR concepts)
  - (c) Assets (develop additional application guidance on costs related to climate-related risks and opportunities, accounting treatment of carbon credits and financial assets with ESG-linked features, consider application guidance on impairment)
  - (d) Liabilities (ensure stakeholders understand financial statement implications of sustainability risks in sustainability report)
  - (e) Fair value measures (additional guidance to standards to assist entities to fully consider the potential impact climate-related matters may have on the fair value measurement of assets and liabilities).
  - (f) Disclosures (objectives-based disclosures)
  - (g) Management commentary
- 10 In reaction, to the identified thematic areas, IFASS members suggested the prioritisation of addressing conceptual framework-related themes (i.e., the development of a conceptual framework for SR), addressing the recognition of assets and liabilities, and disclosures (i.e., having objectives-based disclosures).
- 11 At the April 2023 IFASS meeting, presenting a paper on asset recognition and measurement, UKEB highlighted some of the key questions posed by users as a result of the disconnect between SR and FR information. These include:
- (a) to what extent were the potential impacts (material climate risks, mitigations and opportunities impacting the entity) considered in the entity's key judgments and assumptions?



- (b) have climate-related matters been considered in any impairment calculations?
  - (c) if an asset's useful life was reduced (e.g., replacement to attain net-zero targets), to what extent was depreciation accelerated?
  - (d) why aren't additional costs disclosed in SR recognised as an asset and amortised?
- 12 At the April meeting, AcSB presented a paper on provisions, which highlighted two concerns faced by users, namely,
- (a) determining when disclosure under IFRS S1/S2 triggers disclosure under IAS 37. Users posed several questions including;
    - (i) would the climate risks identified in TCFD reports impact existing provisions or lead to additional provisions in the financial statements?
    - (ii) can climate commitments outlined by entities be considered constructive obligations and trigger the recognition of provisions or disclosure of contingent liabilities?
  - (b) disclosure of commercially sensitive information. Both IFRS S1 and IAS 37 contain exemptions from disclosing commercially sensitive information where disclosure would be expected to seriously prejudice the entity's position. However, the IFRS S1 exemption only applies to opportunities and not risks (i.e., is asymmetric) while the IAS 37 exemption applies to contingent assets as well as to contingent liabilities (i.e., is symmetric). Hence, entities that are exempt from disclosing commercially sensitive sustainability risks in financial statements may have to disclose these risks in their sustainability financial disclosures. And users may question why information that is in sustainability disclosure is not in financial statements.



## APPENDIX 2: Elements of Connectivity

- 1 Besides the connectivity requirements in ESRS and ISSB requirements (see Paragraphs 14 to 15 in the main body) that will underpin the use of the term in the EFRAG research project, it is useful to consider the diverse connotations of this term for stakeholders (what we refer to as “possible elements of connectivity”) as listed in Table 1 below.
- 2 This analysis confirms the elements of connectivity considered for the EFRAG project (i.e., elements related to linkage, interrelationships and consistency as summarised in Paragraph 16 in the main body). Some elements may not have been considered for the EFRAG project so far but could still end up being applicable during either the first or second phase (e.g., XBRL/technology-enabled connectivity could be a means of achieving connectivity). Also, some of the elements outlined in Table 1 are closer to being objectives of connectivity and principles of how to achieve it.
- 3 In both the delineation in Table 1 and the description of the two phases of EFRAG’s project, integration of reporting is seen as an element of connectivity (i.e., a possible future state of connectivity). This is consistent with the characterisation of connectivity by several stakeholders. For instance, the Good Governance Colloquium on connectivity encompassed integrated reporting considerations as did an article on the stepping stones to connectivity by former IIRC and GRI Chairman, Mervyn King. However, as noted in Appendix 1-Paragraphs 5 to 7, the ISSB RFI agenda consultation makes a distinction between connectivity and integration in reporting.
- 4 The possible elements of connectivity have been identified from various sources including the IASB/ISSB (IFRS S1 and S2 requirements), 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 2021 IR framework includes connectivity of information as one of the seven guiding principles underpinning the preparation and presentation of an integrated report. Of note, the 2021 IR framework notes that the key forms of connectivity of information include the connectivity between
  - (a) *The content elements:* The integrated report connects the Content Elements<sup>7</sup> into a total picture that reflects the dynamic and systemic interactions of the organisation as a whole (e.g., linking organisation strategy and business model with changes in its external environment)
  - (b) *The past, present and future*
  - (c) *The capitals* including the interdependencies and trade-offs between the capitals and how their availability, quality, and affordability affect the ability of the organisation to create value.
  - (d) *Financial and other information* (e.g., the impact of customer relationships and customer satisfaction on revenue and profit growth)
  - (e) *Quantitative and qualitative information*- both are necessary to represent an organisation’s ability to create future value and to contextualise each other.

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<sup>7</sup> The content elements include a) organizational overview and external environment; b) governance; c) business model; c) risks and opportunities; d) strategy and resource allocation; e) performance; f) outlook; and h) basis of preparation.



- (f) *Management information, board information and information reported externally.*
- (g) *Information in the integrated report, information in the organisation's other communications, and information from other sources.*



Table 1: Elements of connectivity (Highlighted in Blue are those that are elements of connectivity for Phase 1)

Possible element	Description	To be considered in EFRAG Project
<b>Linkage and interrelationships</b>		
Linkage between content elements (derived from ESRS and IFRS requirements and 2021 IR framework)	Showing how SR and FR information is linked. (E.g., through cross-referencing, reconciliations, and statement of consistency).	Yes
Future financial effects (2021 IR Framework refers to the connection between past, present and future)	Disclosure of the anticipated financial effects of SR information. (E.g., requirements to disclose anticipated effects on sustainability-related risks and opportunities on elements in the financial statements).	Yes- This is an element of indirect connectivity
Describing common key factors	Describe the key factors affecting both financial reporting and sustainability reporting. That is, information about the key factors that have or could both affect a) the value the entity creates for itself (i.e., effect on future cash flows); and b) value creation or erosion from a double materiality perspective including impacts on people and the planet.	May be considered in Phase 1
Statistically linked relationships (i.e., correlated and causative links between different information)	Establishing correlated/causative statistical links between financial and non-financial performance indicators. For example, <a href="#">SAP has done this in its IR report</a> .	Could be considered as describing relationships in Phase 1 or also considered in Phase 2



<b>Consistency</b>		
Making use of the same underlying data	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)].	Yes- This is an example of direct connectivity
Same assumptions	Financial reports and sustainability reports are based on the same set of assumptions (and sensitivities). (For example, the same assumptions about climate change developments).	Yes- This is an example of direct connectivity
Different assumptions	Different assumptions and resulting differences are explained.	Yes
Similar approach to recognition/disclosure	Disclosures of sustainability risks should also be disclosed or recognised in the financial reporting (and vice versa).	Proposing changes to existing IFRS requirements is outside the scope of Phase 1
Similar requirements on 'commercial sensitivity' information (AcSB paper for April IFASS meeting)	The requirements for exemptions to disclose commercially sensitive sustainability risks and opportunities should be the same in financial reporting and sustainability reporting.	Proposing changes to existing IFRS requirements is outside the scope of Phase 1



Consistent story	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.	Possibly in the scope of Phase 1 as part of describing relationships
Consistency between external and internal management reporting (source: 2021 IR framework)	Quantitative indicators are consistent with the indicators used internally by management and those charged with governance.	No. Without access to internal management information, it will be difficult for the EFRAG project team to ascertain this type of consistency
<b>Consistent basis of preparation</b>		
Same reporting entity	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).	Yes
Disclose differences in scope of FR and SR information	The differences in scope of information are explained.	Yes- Explaining differences is in scope
Same reporting period	The reporting period, including the reporting date, is identical for financial reporting and sustainability reporting.	Yes
Similar approach for events after the reporting date	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	Yes



	were influenced by IAS 10 <i>Events After the Reporting Period</i> requirements).	
Similar approach for changes in estimates	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).	Yes
Similar approach for changes in preparation and presentation practices	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).	Yes
<b>Complete information on value creation</b>		
No information gaps	Ensures that information that is significant for the primary users of financial reports and users of sustainability reports is provided in the reporting package of sustainability reporting and financial reporting.	
True economic state	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. This aspect is evident whenever stakeholders express views on the disconnection between FR and SR and	The relevance of this aspect for Phase 1 will be ascertained while assessing user needs



	refer to missing <sup>8</sup> information in financial statements and inadequate picture for users to get a full picture of the entity's risks and value creation.	
Connection between quantitative and qualitative information (source 2021 IR Framework)	Both qualitative and quantitative information is needed to reflect the organization's ability to create value as each provides context for the other.	Implicit in the description of relationships as required by ESRS 1 and IFRS S1. Could be Part of Phase 1
<b>Clear communication</b>		
No (unintended) information overlaps	The same information is not included twice.	
Clear communication	Minimising the gap between the intentions of the organisation as stated in its reports and the perceptions of report users.	Implicit in other elements of connectivity
<b>Integration in reporting</b>		
Integration in reporting	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.  <i>"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."</i>	This could be an element of Phase 2 of the EFRAG project
<b>Approach to management</b>		
Integrated thinking between business functions	This is about connecting business functions. helping to break down internal barriers to	May be considered in Phase 2 of the project

<sup>8</sup> 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)





	working, monitoring and managing information and communicating its value-creation process	
<b>Process</b>		
Connectivity in process (Source IASB-ISSB slides)	Coordination between a standard setter's sustainability and financial reporting functions (e.g., IASB-ISSB staff and Board coordination, EFRAG SR and FR pillar cooperation and coordination)	Implicit in project execution with coordination between the EFRAG financial and sustainability reporting pillars.
<b>Connectivity enabled through XBRL</b>		
Interconnectivity between two domains	<p>Connectivity between two domains is achieved if:</p> <ul style="list-style-type: none"> <li>- The technical modelisations of the two domains are compatible, i.e., can be put in the same document without creating technical or interpretation issues.</li> <li>- The data from the two domains is co-usable, i.e., it is possible to exploit data from both domains using the same tools.</li> <li>- Actual connections between the domains have been drawn.</li> </ul>	May be included as part of operational techniques (Phase 1)



### Appendix 3: Illustrative Examples of Draft ESRS monetary and non-monetary metrics (Climate change, pollution, biodiversity and own workforce)

ESRS	Required disclosure metrics (monetary and non-monetary metrics)	Possible connection to IFRS financial reporting information as stated in ESRS	EFRAG Secretariat Comments
<b>ESRS E1 Climate Change metrics</b>			
<b>E1-5, E1-6</b>	Energy intensity based on net revenue, GHG intensity based on net revenue	Revenue in financial statements, segment reporting	These two metrics are examples of direct connectivity (i.e., revenue used in the ratio) is expected
<b>E1-8</b>	GHG Emissions		The application requirements illustrate how GHG emissions can be used in the calculation of potential liabilities. GHG emissions can be material from both financial and impact materiality perspectives. GHG Scope 1, 2 and 3 emissions can inform on an entity's susceptibility to transition risk (e.g., high emitters face a higher risk to their business model when authorities pursue net-zero goals).
<b>E1-8</b>	Internal carbon prices	Consistency with carbon prices used in carbon pricing schemes with useful life and impairment of assets and fair value of acquired assets	This is an example of indirect connectivity
<b>E1-9</b>	Assets at material physical and transition risk including stranded assets	Assets at material physical and transition risk including stranded assets	Direct connectivity- Information of assets at risk is expected to be derivable from current financial statements
<b>E1-9</b>	Net revenue vulnerable to material physical and transition risk	IFRS 15 revenue; segment reporting information	Direct connectivity- Information of revenue at risk is expected to be derivable from current financial statements
<b>E1-9</b>	Potential liabilities (e.g., due to failure to meet emissions targets)	Unrecognised liabilities; contingent liabilities IAS 37	May not necessarily translate to financial statements' liabilities
<b>E1-9</b>	Climate opportunities-Cost savings	Cost savings are undefined under IFRS requirements	Could be direct connectivity or indirect where reference is made to the related line item
<b>ESRS E2 Pollution metrics</b>			
<b>E2-4, E2-5</b>	Air pollutants, Water emissions, Inorganic pollutants, Ozone-depleting substances, Microplastics, Substance of concern generated		
<b>E2-6</b>	Potential financial effects from pollution-related risks	IFRS 15 revenue; segment reporting information	Direct connectivity- Information of revenue at risk is expected to be derivable from current financial statements



<b>E2-6</b>	Potential financial benefits from pollution-related opportunities	IFRS 15 revenue; segment reporting information	
<b>E2-6</b>	Substances of concern used based on revenue	IFRS 15 revenue; segment reporting information	Direct connectivity
<b>E2-6</b>	Operating and capital expenditures incurred from major incidents and deposits	IAS 37 Contingent Liabilities	
<b>E2-6</b>	Provisions for environmental protection and remediation costs	IAS 37 Provisions	May not necessarily translate to financial statements' liabilities
<b>ESRS E4 Biodiversity metrics</b>			
<b>E4-3</b>	Biodiversity offsets key performances		
<b>E4-3</b>	Financial effects of biodiversity offsets		
<b>E4-5</b>	Number and area (in hectares) of sites owned, leased or managed in or near protected areas or key biodiversity areas		
<b>E4-5</b>	Number of individuals of a species per specific areas		
<b>E4-5</b>	Area coverage per ecosystem		
<b>E4-6</b>	Potential financial effects from biodiversity and ecosystem-related impacts	IAS 37 Provisions, Contingent Liabilities and Contingent Assets	May not necessarily translate to financial statements' liabilities
<b>E4-6</b>	Potential financial effects from biodiversity and ecosystem-related risks	IAS 37 Provisions, Contingent Liabilities and Contingent Assets	May not necessarily translate to financial statements' liabilities
<b>E4-1 AR</b>	Suppliers' facilities in risk-prone areas (in percentage)		
<b>E4-1 AR</b>	Procurement from suppliers' facilities in risk-prone areas (in percentage)		Could be pre-financial
<b>ESRS S1 Own Workforce metrics</b>			
<b>S1-6, S1-7</b>	Total number of employees; Total number of employees' turnover; Total number of non-employees	IAS 37 Provisions, Contingent Liabilities and Contingent Assets	
<b>S1-8</b>	Total employees covered by collective bargaining agreements in percentage		
<b>S1-8</b>	The global percentage of employees covered by workers'- representatives		
<b>S1-9</b>	Gender distribution at the top-management level		
<b>S1-9</b>	Age distribution		
<b>S1-12</b>	Percentage of persons with disabilities		
<b>S1-13</b>	Percentage of employees that participated in regular performance and career development reviews		
<b>S1-13</b>	Average hours of training per employee		
<b>S1-14</b>	Percentage of employees covered by health and safety management system		
<b>S1-14</b>	Total fatalities during working hours		Could be pre-financial



<b>S1-14</b>	Rate of work-related accidents		Could be pre-financial
<b>S1-14</b>	Total of work-related ill health		Could be pre-financial
<b>S1-14</b>	Total days lost to work-related injuries and fatalities		Could be pre-financial
<b>S1-15</b>	Percentage of employees entitled to take family-related leaves		
<b>S1-15</b>	Percentage of entitled employees that took family-related leaves		
<b>S1-16</b>	Male-female pay gap		Could be pre-financial
<b>S1-17</b>	Total number of incidents of discrimination		Could be pre-financial
<b>S1-17</b>	Total amount of fines for social and human rights violations, incidents	IFRS 2.51 (a)	



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