This paper has been prepared by the EFRAG Secretariat for discussion at a public meeting of EFRAG FRB and SRB. The paper forms part of an early stage of the development of a potential EFRAG position. Consequently, the paper does not represent the official views of EFRAG or any individual member of the EFRAG FRB or EFRAG SRB. The paper is made available to enable the public to follow the discussions in the meeting. Tentative decisions are made in public and reported in the EFRAG Update. EFRAG positions, as approved by the EFRAG FRB, are published as comment letters, discussion or position papers, or in any other form considered appropriate in the circumstances.

EFRAG Connectivity Research Project

Definitions, concepts, and priorities for illustrations of connectivity

Issues Paper

Objective and context for the development of this paper

1 This issues paper outlines a tentative set of definitions, concepts and topical priorities that will underpin the illustrations of connectivity, and these will be included within the conceptual scene-setting chapters of the Discussion Paper for the EFRAG research project on connectivity between financial reporting and sustainability reporting (hereafter interchangeably referred to as the EFRAG connectivity research project). The contents are based on discussions and agreements with the EFRAG CAP and EFRAG FR and SR TEGs along with a review of literature including the ESRS 1 *General Requirements* and IFRS Sustainability Disclosure Standards (IFRS SDS – IFRS S1 *General Requirements for Disclosure of Sustainability-related Financial Information*) and various regulatory thematic reviews. <u>The content of this paper should be read in conjunction with agenda paper 03-02-*Objectives and Boundaries of Different Sections of the Annual Report*[1], which is also part of the conceptual scene setting and enunciates how the boundaries of different corporate reports are interrelated with the connectivity of the underlying information</u>.

2 We note that ESRS 1 and IFRS SDS have requirements for connecting sustainability reporting information to financial statements. <u>This paper's content has been informed by the aforementioned authoritative guidance and, thus, should not be construed as being either an alternative or additional guidance on how to apply connectivity in reporting.</u> As noted, <u>the content is meant to educate and set the scene for the Discussion Paper and to</u>

[1] A definition of the Annual Report will be included in updates to this paper

guide the selection and analysis of illustrations. This content has been developed because of the below four emboldened reasons.

3 ***Specifying the meaning of connectivity in the context of the EFRAG research project clarifies the Discussion Paper's scope***: EFRAG's engagement with stakeholders and a review of various publications highlight the multiple connotations associated with the term connectivity including complementarity, coherence, consistency, and integrated reporting. These terms are sometimes applied as synonyms for connectivity. Yet at other times they are either applied as elements of connectivity or as distinct notions from connectivity. Hence, to avoid confusion and cross-purpose communication whilst applying the term connectivity, it is useful to clarify its meaning in the context of the EFRAG research project.

4 We also note that connectivity is a nascent concept as it has only been recently incorporated into authoritative requirements (ESRS in the EU and IFRS SDS in adopting non-EU jurisdictions) that will be effective from 2024 (with the first year of reporting available in 2025). The term is not explicitly included in either the IFRS Accounting requirements or any other legal requirements that were applicable before the 2024 reporting year.

5 But connectivity is also a somewhat familiar concept as it is one of the seven guiding principles of the 2013 and updated 2021 International Integrated Reporting Council ('IIRC')-integrated reporting (IR) framework. Moreover, notions entwined within the ESRS and IFRS SDS description of connectivity such as the consistency of financial statements, the sustainability statement/disclosures and information in the rest of the management report were already baked into other authoritative requirements including the Transparency Directive and auditor guidance (ISA 720). And the term coherence was included as one of the characteristics of useful information in the 2021 Exposure Draft to revise the Management Commentary Practice Statement.

6 ***Connections made to (from) financial statements from (to) sustainability statement/sustainability disclosures are within the scope of the EFRAG research project***. The EFRAG February 2021 PTF-NFRS publication (*Proposals for a Relevant and Dynamic EU Sustainability Reporting Standard Setting*) recommended two-way connectivity as one of the six robust concepts for EU standard setting. The publication states:

(a) sustainability reporting standards should define anchor points to create connectivity to financial reporting together with the necessary reconciliations or cross-references. Anchor points may be direct when a monetary sustainability disclosure is derived from accounting data, and they may be indirect when sustainability disclosures simply need to be coherent with financial disclosures;

(b) conversely, financial reporting standards should consider anchor points from sustainability reporting, for instance when financial accounting standards require forward-looking estimates or risk disclosures.

7 With the enactment of ESRS and IFRS SDS including their connectivity requirements, to aid practical application, there is a need to illustrate connections that can be made from the sustainability statement/disclosures to financial statements. For the EFRAG research project, there is a concurrent need to illustrate connections of sustainability-related information in the financial statements to the sustainability statement/disclosures and the rest of the management report. Of note, the IASB has an active project on climate-related and other uncertainties in the financial statements predicated on the perceived inadequate reporting of climate-related information in the financial statements. As conveyed in the September 2023 EFRAG Secretariat Briefing, stakeholders pointed to the disconnect between the management report/sustainability disclosures versus the financial statements. Moreover, as evident from various thematic reviews (ESMA in October 2023, AMF, Mazars for 2021 and 2022 financial statements), it is currently possible to assess/illustrate the connectivity of financial statements to information in the rest of the Annual Report. In contrast, real-world illustrations starting from ESRS-prepared reports are currently constrained[2].

8 ***Need for concepts to guide illustrations of connectivity from the financial statements to outside the financial statements***: Along with the guidance from the IFRS Materiality Practice Statement, as noted in the 2019 and (updated in 2023 IASB educational article- *Effects of climate-related matters in the financial statements*), IFRS Accounting Standards have implicit requirements for entities to either reflect material climate and any other risk or to explain why a matter expected to be material by investors was not reflected in the financial statements. However, unlike the ESRS and IFRS SDS connection requirements, IFRS Accounting Standards have no explicit connectivity requirements.

9 Moreover, as we explain in the discussion of categories and concepts later in this document, there are limits on the extent to which the ESRS and IFRS SDS requirements for showing connections of information in the sustainability statement/disclosures to financial statements (e.g., cross referencing and reconciliations) can be conversely and analogously

[2] The main challenge of illustrating connections in the EFRAG research project Discussion Paper (whose publication date is H2 2024) is that there will be no real-world available reports based on ESRS and IFRS SDS until the 2025.

applied for showing connections from the financial statements to the sustainability statement/disclosures (i.e., due to legal risk and disclosure overload). While the EFRAG research may suggest considerations for establishing connectivity when starting from the financial statements' information, the responsibility for developing possible connection requirements will ultimately fall under the IASB.

10 ***Other questions/considerations raised by EFRAG CAP members***- These stakeholders have called for the Discussion Paper to indicate;

(a) why connectivity is important and if/how the concept is related to the qualitative characteristics of the Conceptual Framework for Financial Reporting (FR- Conceptual framework)

(b) the centrality of connectivity in collectively informing on how the company's strategy and business model affect the reported information.

11 Derived from the above, the remainder of this paper is structured as follows:

(a) What is connectivity **(Paragraphs 12 to 17)**

(b) What is being connected and why such connectivity is important? **(Paragraphs 18 to 26)**

(c) Connectivity categories and concepts **(Paragraphs 27 to 40)**

(d) Areas of focus (anchor points) **(Paragraphs 41 to 43)**

(e) **Appendix 1**: Role of technology in connectivity

What is connectivity

12 At a macro-level, a 2023 IFRS Foundation article makes a helpful distinction between connectivity in reports (information), connectivity in standard-setting products (reporting requirements), and connectivity in process with the below elaboration.

13 **Connectivity in information (reports):** The focus of the EFRAG research project is primarily on connectivity in reports (information). In paragraphs, we flesh out the related ESRS and IFRS SDS connection requirements.

14 **Connectivity in reporting requirements (standard-setting products):** This refers to consistency in required standards and the basis of preparation of reported information within the financial statements and sustainability reports. For instance, both the ESRS and IFRS SDS require the same reporting entity and reporting period as the financial statements. The two sets of requirements also have similar approaches for the treatment of events after the reporting date, changes in estimates, and changes in preparation and

presentation practices as the financial statements. Both IFRS S1 and ESRS requirements were influenced by IAS 1 *Presentation of Financial Statements*, IAS 8 *Accounting Policies, Changes in Accounting Estimates and Errors* requirements, and IAS 10 *Events After the Reporting Period* requirements. Furthermore, the qualitative characteristics of information of IFRS Accounting Standards, IFRS SDS and ESRS are based on the Conceptual Framework for Financial Reporting. The imperative of ensuring connectivity in standard-setting products falls upon standard-setting bodies (e.g. IASB. ISSB, EFRAG SR Pillar/EC, and other National Standard Setters). That said, based on developing practical illustrations of connectivity in reports, the EFRAG research project may identify where standard-setting requirements may be enhanced.

15 **Connectivity in process**: The term connectivity is also applied in the context of processes of providing guidance and preparing reporting information. Hence it captures institutional connectivity within and across the organisations responsible for financial reporting and sustainability reporting standard setting (e.g. IFRS Foundation[3] and other jurisdictional standard setters). It also captures integrated thinking within organisations. It is beyond the scope of the EFRAG research project to assess or illustrate connectivity in process. Nonetheless, the development of the EFRAG research project deliverables with input from a multi-stakeholder advisory panel and with collaboration between the EFRAG FR and SR pillars is itself an embodiment and recognition of the value of connectivity in process.

Connectivity versus integration in reporting

16 The May 2023 ISSB Request For Information (RFI) *Consultation on Agenda Priorities* framed ‘connectivity or connection in reporting’ as being a distinct and narrower notion than ‘integration of reporting’. The RFI states 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

[3] The importance of connectivity in the work of the IASB and ISSB is further highlighted in the feedback summary on connectivity (paragraph 9 page 3). In paragraph 11 of page 4, stakeholders’ calls for “interconnected standards” instead of simply “compatibility and avoiding potential conflicts”. Other relevant suggestions are being made in paragraphs 22-24 (pages 8-9) of the same document. https://www.ifrs.org/content/dam/ifrs/meetings/2024/january/iasb-issb-joint/ap2b-feedback-summary-connectivity.pdf

(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.

17 Of note, EFRAG's August 2023 comment letter response[4] to the ISSB agenda consultation conveyed that the immediate priority for the ISSB and IASB should be connectivity rather than integration in reporting. EFRAG also opined on the need for a sustainability reporting conceptual framework before a project on integration in reporting is undertaken. Of note, three-quarters of the respondents to the consultation either considered integration a lower priority than other projects or did not rank it higher or lower in priority.

What is being connected and why such connectivity is important

What is being connected

18 As detailed in agenda paper 03-03, connectivity in corporate reporting ought to focus on documents that have a well-identified nature, purpose, and established stature. Accordingly, as shown in Figure 1a below, in an EU context, the EFRAG research project focuses on the connection of information across the financial statements of EEA-companies prepared under IFRS Accounting requirements (i.e., as defined in IAS 1.10 consisting of the primary financial statements[5] and notes to the accounts), sustainability statement (including Taxonomy-Article 8 disclosures) in the management report, and rest of information in the management report.

19 The EFRAG research project will also focus on IFRS general purpose financial reports (applicable for some non-EU jurisdictions), which consist of financial statements (i.e. primary financial statements and notes to the accounts), management commentary and sustainability financial disclosures (see Figure 1b). Unlike under ESRS, sustainability-related financial disclosures under IFRS general purpose financial reports do not have specified

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[4] https://www.efrag.org/Assets/Download?assetUrl=/sites/webpublishing/SiteAssets/EFRAG%2520response%2520ISSB%2520agenda%2520consultation%2520230830.pdf

[5] A complete set of financial statements comprises: (a) a statement of financial position as at the end of the period; (b) a statement of profit or loss and other comprehensive income for the period; (c) a statement of changes in equity for the period; (d) a statement of cash flows for the period; (e) notes, comprising material accounting policy information and other explanatory information; (ea) comparative information in respect of the preceding period as specified in …; and (f) a statement of financial position as at the beginning of the preceding period when an entity applies an accounting policy retrospectively or makes a retrospective restatement of items in its financial statements, or when it reclassifies items in its financial statements in accordance with ...

placement requirements for sustainability-related financial disclosures. However, individual non-EU countries may have specific placement requirements.

20 The EFRAG research project is also considering connectivity based on nature rather than the placement of information. Hence, relevant information within other sections of the annual reporting package (e.g., remuneration report) will be in scope (e.g., to the extent that such information has been incorporated in the sustainability statement through referencing as allowed by ESRS 1).

21 In agenda paper 03-03, we enunciate on the differences in the treatment of sustainability reporting information that are in place under the EU corporate reporting framework (which encompasses information that is in other corporate reports and considers such information to be relevant and targets at broader users including investors) and IFRS general purpose financial reports (which considers sustainability financial disclosures combined with financial statements and management commentary as being what is targeted at investors).

Figure 1a: EFRAG research project- what is being connected under the EU

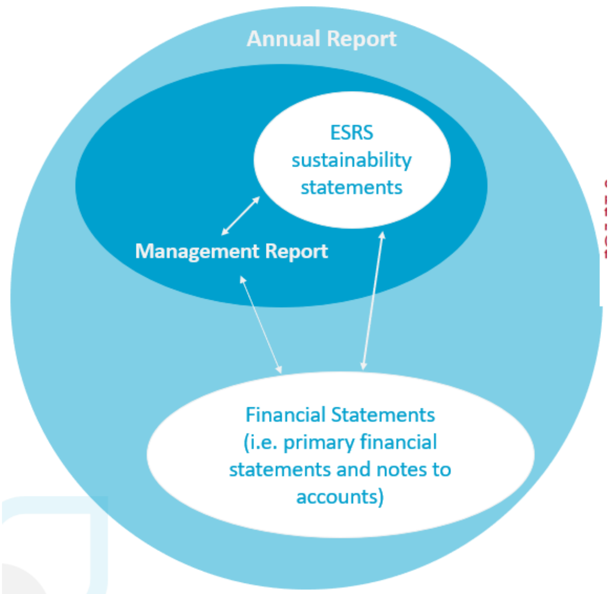


Figure 1b: EFRAG research project- what is being connected under general purpose financial reporting

Why connectivity is important

22 The different sections of the Annual Report have distinctive objectives (see agenda paper 03-03 on boundaries). For instance, the information in financial statements focuses on reflecting an entity's present rights to future economic benefits (assets) and present obligations to transfer economic resources (liabilities) predicated on the occurrence of a past event and with the entity having control over the assets (i.e., power to direct). Financial statements reflect the financial position and financial performance at the reporting date. This differs from the sustainability statement/disclosures that include anticipated financial effects (i.e., related to the entity's potential/future financial position and financial performance) and has concepts that are not applied for the preparation of financial statements (e.g., allowing the application of the notion of operational control for consolidation of metrics).

23 Moreover, based on the underpinning double-materiality perspective and the broader set of users of the sustainability statement (i.e., not only financial capital providers), the EU sustainability statement under ESRS will also include information that is material from an impact materiality perspective. Such information facilitates broader stakeholders' assessment of an entity's impacts on people and the planet. However, information that is material from an impact materiality lens may become financially material at a future date (i.e., also described as dynamic materiality[6] by some stakeholders or rebound effects by the EFRAG February 2021 PTF-NFRS report- *Appendix A4 Interconnection between Financial and Non-Financial Information*).

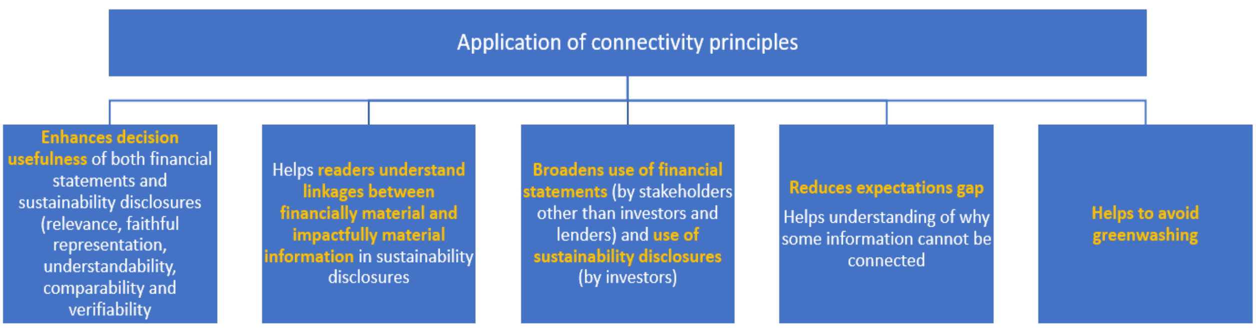
[6] Dynamic materiality recognises that whilst a company may have many positive and negative impacts on people, planet and social prosperity, a subset of those impacts can, in turn, positively or negatively affect the company's business model and therefore create or erode its enterprise value and financial returns to providers of capital.

24 Though the different sections of the Annual Report are distinctive, they are also complementary as they collectively inform on the effects of an entity's strategy, business model, risks and opportunities (including those deriving from impacts and dependencies on sustainability matters) on its financial position, financial performance, and future cash flows. As such, these sections can be seen as parts of a single composite report that informs on the value-creation story of the reporting entity and connectivity fosters their overall complementarity. This view was reflected in the 2022 Basis for Conclusions for Draft ESRS 1 (BC 42) which stated, "*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.*"

25 The 2021 EFRAG PTF-NFRS publication (*Proposals for a Relevant and Dynamic EU Sustainability Reporting Standard Setting*) similarly underscored the importance of interconnection across the different sections of the Annual Report. This publication noted the absence of a formal connection could lead to potential gaps, overlaps (i.e. duplication), and a lack of coherence in reported information. It could be surmised that potential gaps may arise whenever users' information needs are not met across these sections of the annual report while duplication of information could arise because the different sections of the Annual Report include financially material information that could be of a similar nature (e.g., effects of risks and opportunities on the entity's financial position and financial performance). As detailed further below in paragraphs 27 and 28, different sections of the Annual Report ought to be self-sufficient for their intended objectives, which may necessitate repetition of information. At the same time, unnecessary duplication should be avoided.

26 Including and besides the above, Figure 2 below sums up the expected benefits of connectivity conveyed by stakeholders including EFRAG CAP members.

Figure 2: Expected benefits of connectivity



Connectivity categories and concepts

27 Below is a summary of the connectivity-related categories and principles that are encompassed across the different guiding literature (e.g. ESRS, IFRS SDS, and several regulatory publications including ESMA, Norwegian securities regulator- Finanstilsynet). As noted earlier, these concepts will inform the illustrations of connectivity in the Discussion Paper of the EFRAG research project.

Overarching concepts

28 **Connectivity in standards (consistent basis of preparation) and process contributes to the connectivity of information**: Both the ESRS and IFRS Sustainability Disclosures require reporting of information with qualitative characteristics consistent with those of the IFRS conceptual framework. These standards also require the same reporting entity and reporting period as the financial statements. And they also have similar approaches for the treatment of events after the reporting date, changes in estimates, and changes in preparation and presentation practices as the financial statements. They were influenced by IAS 1 *Presentation of Financial Statements*, IAS 8 *Accounting Policies, Changes in Accounting Estimates and Errors requirements*, and IAS 10 *Events After the Reporting Period requirements*.

29 The consistent basis of preparation contributes to the connectivity of information. That said, while the above contributes to connectivity, as detailed in agenda paper 03-03, there are multiple differences between the requirements for financial statements and sustainability reporting that preclude connectivity (e.g., the recognition and measurement criteria).

30 **Clear and concise** disclosures as required by both IFRS S1 and ESRS contribute to the connectivity of information (i.e., understandability). The ESMA report[7] also considered “simple and clear” and “organised and well formatted” as principles for selecting examples. **Avoiding unnecessary duplication** including through the use of cross-referencing is part of clear and concise communication.

[7] ESMA, October 2023, [The Heat is on: Disclosures of Climate-related matters in the financial statements]

31 **Self-sufficiency of each section of the annual report per its stated purpose**: As noted earlier, these different corporate reports have distinctive[8] objectives albeit complementary objectives (i.e., the reports capture different versions of an entity's reality, and a user needs different reports to build the mosaic of the company's value creation story). In tandem, as alluded to by the October 2023 ESMA report, these reports are expected to be self-sufficient in providing information related to their distinctive objectives. And this may either necessitate repetition (albeit this should be done with tailoring/giving a flavour suited for the objective of the report) or incorporation by cross reference.

32 That said, compared to the sustainability statement/disclosures and the rest of the management report, **there are restrictions in incorporating information into the financial statements by cross reference**. For instance, there could be legal risk associated with incorporating (by cross-reference) forward-looking information into the financial statements. A workaround could be for entities to have a disclosure in the financial statements of the component of sustainability disclosure that is material for the financial statements.

Connectivity categories

33 **Explanation of strategic and value-creation-oriented relationships and effects**. As noted in ESRS1.123, this includes the linkage between strategy, business model and an entity's financial performance, financial position and other metrics and targets. IFRS S1.B44 states that connection can include a) an explanation of the combined effects of the entity's sustainability related risks and opportunities and its strategy on its financial position, financial performance, and cash flows over the short, medium and long term; b) a description of the alternatives that an entity evaluated in setting its strategy in response to its sustainability-related risks and opportunities, including a description of the trade-offs between those risks and opportunities that the entity considered. Below are several related concepts:

(a) **Complementarity (Disclosure of complementary narrative and quantitative information)** – As noted earlier, the different sections of the annual report collectively inform on the value creation and include financially material information. Complementarity is not explicitly stated but it is encompassed/implicit within the ESRS 1.123 and IFRS S1.B44 requirements, which include the following examples:

[8] For example, if company Y does a tax transparency report for NGOs particularly interested in tax transparency and establishing whether companies pay their fair share of tax. This report is an independent report and whilst it may pull numbers and narrative from other reports is stands on its own for these users.

(i) ESRS 1.123 example*: to allow users to assess connections in information, the undertaking 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. Furthermore, 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. It may need to link this information to the potential or actual effects on its production costs, to its strategic response to mitigate such impacts or risks, and to 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.*

(ii) IFRS S1. B44 examples: *An entity might face decreasing demand for its products because of consumer preferences for lower-carbon alternatives. The entity might need to explain how its strategic response, such as closing a major factory, could affect its workforce and local communities, and the effect of such a closure on the useful lives of its assets and on impairment assessments.*

(iii) *An entity might need to explain the potential effects of its decision to restructure its operations in response to a sustainability related risk on the future size and composition of the entity's workforce.*

(b) Another illustration of complementarity in the reported information could be disclosing the correlations and causal links of information in the different reports. This was the case when *SAP outlined the correlated links between financial and non-financial information in its 2021 Integrated report. The interactive chart showed the effect of changes in employee engagement on profitability*.

(c) **Coherent explanation and presentation[9]:** Coherence was included as one of the 2021 IFRS Practice Statement Exposure Draft for Management Commentary (ED) where it was noted that coherence contributes to the completeness, clarity and comparability of information. The ED conveyed that if a matter discussed for one area of content has implications for other areas of content, information is included to allow investors and creditors to understand the implications. Similarly, a

[9] The ESMA and Norwegian Finanstilsynet publications refer to coherence but without defining the term. This term was also one of the attributes of useful information in the 2021 EFRAG PTF-RNFRO report where it is stated that the term connotes clear links between reports.

November 2023 New Zealand XRB[10] staff paper noted coherence requires entities to present disclosures in a way that explains the context and relationships with other disclosures so that users can make connections between the two sets of information. The XRB report provided the following example showing the connection made in the New Zealand climate-related disclosures to the financial statements:

Current financial impact and cross-referencing to financial statements

Our storage warehouse was damaged by a flood, impacting all inventory supplies stored there. Those inventories were written down to net realisable value, as disclosed in Note X of the financial statements.

34 **Direct and indirect connectivity (linkage of monetary and other quantitative data points)**: ESRS connection requirements also specify ***direct and indirect connectivity*** that could be construed as linkage of quantitative datapoints done through cross-referencing and reconciliation for indirect connectivity. Examples include;

(a) *revenue amount in the GHG intensity metric can be directly linked to IFRS 15 revenue through cross-reference in the sustainability statement.*

(b) *reconciliation of revenue amount in GHG intensity metric to IFRS 15 revenue amount when it cannot be directly linked. This reconciliation will be in the sustainability statement.*

35 It is expected the overarching concept of clear and concise communication will be supported by disclosures of direct or indirect connectivity. We also note that direct and indirect connectivity may be more applicable for linking sustainability reporting information to financial statements than the other way around. Moreover, disclosure in the notes to the accounts of a reconciliation between a monetary amount in the financial statements to an amount in the sustainability statement/disclosures could be seen as obscuring other material information (i.e., contributing to disclosure overload).

36 **Consistency[11] of data, assumptions, and narrative information** (as reflected in ESRS 1.127-128 and IFRS S1.23). This includes relating forecasts to information of past and present and

[10] NZ XRB staff guidance, November 2023, Climate-related matters in Financial Statements

[11] The notion of consistency is included in existing auditor guidance, and it is also the transparency directive. Furthermore, this notion has been the focus of different regulators (AMF, ESMA, Finanstilsynet and UK FRC) in their thematic reviews of trends in the reporting of climate-related risks in the financial statements (including whether there is a disconnect with versus the information outside the financial statements).

disclosing information about **significant differences between data and assumptions used**. Connectivity as articulated under ESRS 1 and IFRS S1 goes beyond consistency as understood under audit guidance and the enforcers' thematic reviews of consistency of reporting.

37 **Intertemporal dimension**: Connectivity has a static dimension (i.e., connectivity of information located in different reports at a particular reporting date). It also has an intertemporal dimension where there can be a change in the reporting location of impacts, risks, or opportunities across different reporting periods (i.e., migration of items across different sections of the Annual Report over time). For instance, this could be due to the change in nature, quantifiability, magnitude/severity, or probability of occurrence of a particular risk or opportunity. It can also be due to impacts disclosed in one period becoming financially material at a future period (i.e., dynamic materiality). <u>Enabling the understanding and monitoring of the noted migration of information across reporting periods is a key element of connectivity</u> as it explains and highlights the evolving nature of the related information.

38 **Linking forecast information to past/present reported information**: Under ESRS requirements, another aspect of linkage across periods is captured by forecast information being related to past/present reported information.

Outcomes of applying connectivity requirements relative to qualitative characteristics

39 In addition to contributing to the **complementarity and coherence of the different sections of the annual report,** the application of connectivity requirements contributes to **information adherent to the qualitative characteristics of the conceptual framework** (i.e., relevance, faithful representation, and understandability) as noted below:

(a) *Relevance*: Connectivity via an explanation of linkage between strategy and business aims to tell a more complete story of the entity's value creation and in so doing provides relevant information.

(b) *Faithful representation*: Consistent assumptions across different reports, linkage of narrative information to current financial effects, and reconciliation of interrelated amounts could ensure faithful representation and lessen greenwashing.

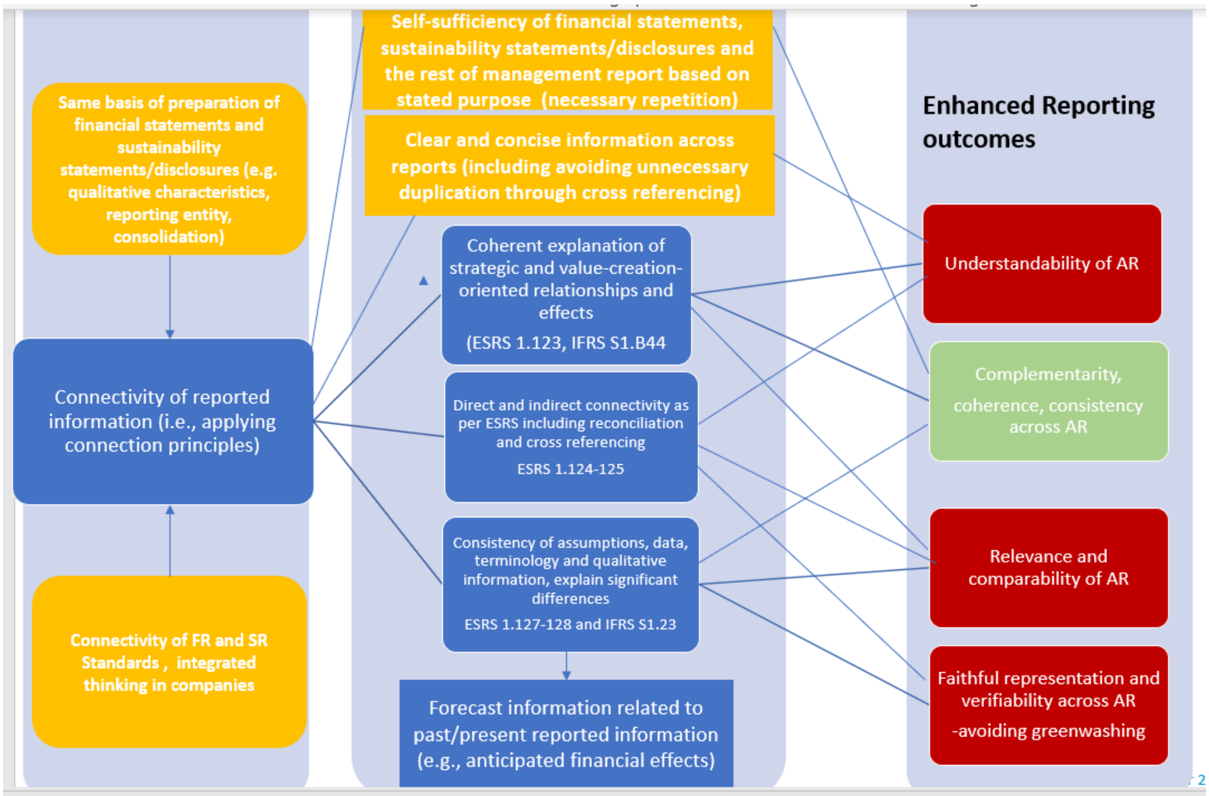
(c) *Verifiability*: linkage of narrative information to current financial effects, and reconciliation of interrelated amounts could ensure faithful representation and lessen greenwashing.

(d) *Understandability*: Connectivity by applying consistent assumptions contributes to understandability because any inconsistency between the two reports would confuse the reader. Cross-referencing between the various sections of the annual report helps ensure the ease of navigation through the information provided in the annual report. And avoiding unnecessary duplication avoids the obscuring of material information.

(e) *Comparability*: Comparability can be enhanced to the extent entities share common assumptions (benchmark references, carbon prices, timelines related to sustainability matters) and there is a consistency of assumptions underpinning the related sustainability disclosures and the measurement of assets and liabilities

40 Figure 3 below visually depicts the summary of concepts of connectivity that will be illustrated through examples and how they contribute to reporting that is adherent to the required qualitative characteristics of the information.

Figure 3: Principles of Connectivity of information that will be applied for illustrations/examples (Types of connectivity identified from ESRS and IFRS SDS; Orange- Overarching principles that contribute to connectivity of information; coherence and complementarity of AR sections is an outcome of applying connectivity, Conceptual framework related outcomes of applying connectivity principles)



Topics for prioritising illustrations

41 The priority topics (anchor points) for the EFRAG research project are set out in Tables 1 and 2. These topics were derived from an assessment of thematic reviews, ESMA Enforcement priorities, and discussions with EFRAG CAP and EFRAG FR and SR TEG.

Table 1: Anchor points: Connections from sustainability disclosures to financial statements and the rest of the management report

Type of illustration	Analytical considerations and points of note
Connections between the business model, strategy, risks and opportunities in sustainability disclosures and information in the financial statements.	Inspiration will be drawn from examples within ESRS and IFRS SDS; the EFRAG ESRS Materiality Assessment Implementation Guidance; and the December 2023 ISSB educational material (Nature and social aspects of climate-related risks and opportunities)
Article 8 Taxonomy investments connections to financial statements information	Is there direct/indirect connectivity of disclosed taxonomy KPI (i.e. CAPEX and OPEX to IFRS PPE)
Anticipated financial effects connections to financial statements' information (will also consider the description of risks and opportunities in the sustainability statement/disclosures)	Sustainability matters with future financial effects may include: • potential liabilities (constructive obligations from net-zero commitments, environmental and decommissioning liabilities, health and safety liabilities) • potential assets (R&D in transition-related assets and products, circular economy/recycled materials) There could be grey areas (i.e., whether any of the anticipated financial effects information ought to be disclosed in the financial statements under IAS 1 requirements) Disclosed anticipated financial effects may never crystallise in the financial statements. Need to consider when the information disclosed in sustainability disclosures ought to trigger recognition or disclosure in the financial statements EFRAG ESRS Materiality Assessment Implementation Guidance will provide inspiration for the development of mock-up examples; November 2022 ISSB staff papers had some hypothetical examples

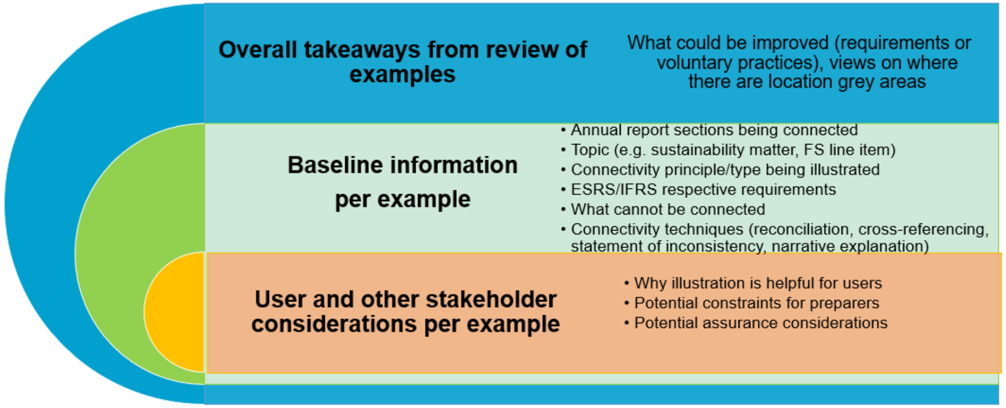
Type of illustration	Analytical considerations and points of note
Connection of human rights and employee benefits disclosed in sustainability disclosures to information in the financial statements	Can quantitative monetary amounts be linked to the financial statements? Are non-monetary metrics correlated with the financial statements information?
Other financially material information in the sustainability statement/disclosures (besides anticipated effects)	EFRAG ESRS Materiality Assessment Implementation Guidance will provide inspiration for illustrations

Table 2: Anchor points: Connections from financial statements to the sustainability statement/disclosures and the rest of the management report

Type of illustration	Analytical considerations
Significant judgements, major sources of estimation uncertainty and accounting policies	The October 2023 ESMA report underscores • the need for consistency between judgments and estimates disclosed in the financial statements and the related uncertainties, ii) the information included in other notes to the financial statements (e.g., impairment of non-financial assets) and iii) the information disclosed with regard to climate-related risks and uncertainties in the management report and sustainability disclosures/non-financial statements (e.g., CO_2 emissions). • Disclosure of quantified risks and major sources of uncertainty related to commitments and announced plans (e.g., net zero commitments) and potential mitigating actions • Information about material exposures to climate-related and other uncertainties (e.g., sensitivity analysis, balance sheet and P&L line items, breakdown of assets exposed to physical and transition risks) EFRAG FR TEG members have called for connectivity in the note of accounting policy choices and the equivalent disclosure in the sustainability statement/disclosures
The valuation of tangible and intangible non-financial assets, i.e., impairment, amortisation, useful lives, and residual value	Illustrations of disclosures that explain the link between financial statements and the information in sustainability-related disclosures (e.g. R&D investments in new products, stranded assets) Depreciation and amortisation: a) whether the estimates of remaining useful lives and residual values of assets in the financial statements were impacted due to value chain effects; and b) if applicable, why no financial statements' adjustments were necessary.

Type of illustration	Analytical considerations
	Impairment: a) whether climate-related matters were considered in relation to impairment indicators; and b) whether these matters affected fair value or recoverable amount estimates (i.e., discount rates and cash flow estimates). Research and development costs: material expenses and newly capitalised assets corresponding to material investments are highlighted in the sustainability disclosures.
Provisions, contingent liabilities, and disclosure of information	Sustainability-related matters reported in the sustainability statement/disclosures that may lead to provisions, contingent liabilities, and disclosures include: • Potential litigation due to environmental damage, human rights and labour safety violations • Regulatory requirements to remediate environmental damage (e.g., net-zero commitments) • Additional levies or penalties related to environmental requirements as well as contracts that may become onerous • Restructuring to achieve climate-related targets Disclosures on the effects on asset retirement obligations (e.g., changes to the useful life of current asset retirement obligations and the corresponding impact on the asset and liability, and assumptions of the useful life and repurposing of the asset for new asset retirement obligations) Need to consider when information disclosed in sustainability disclosures ought to trigger recognition of a provision or disclosure of a contingent liability or any other material information in the financial statements
Disclosures based on a qualitative materiality assessment	Examples where investors expect a matter to be material, but such a matter is not deemed material by a reporting entity and an explanation is provided. EFRAG project will monitor the qualitative materiality examples being developed under the IASB project on climate-related and other uncertainties in the financial statements
Segment reporting and disaggregation of revenue disclosure	If/how do changes in the strategy and business model aligned with sustainability-related goals affect the information disclosed in the segment and revenue disclosures?
Other matters that are highlighted in the 2023 ESMA enforcement priorities	ESMA expects issuers to explain how climate matters have been considered in the measurement of investment properties (e.g. transition and physical risks)

42 An appropriate number of illustrations/examples will be selected for each of the topics and the documentation in the below diagram will be included for each example.



43 Illustratively, for connections from the sustainability statement to the financial statements, an analysis of the risks and opportunities as well as current and anticipated financial effects associated with a company's net zero commitments would include the following:

(a) What can be found in the line items of financial statements as provisions and when?

(b) What can be found in the notes to the financial statements?

(c) What information cannot be found in the financial statements?

(d) What will we expect to find SR according to ESRS E1?

(e) Based on the above, what are the potential direct, and indirect connectivity and consistency items? How could these items be illustrated?

(f) If/how will items migrate from the sustainability statement/disclosures to the financial statements (i.e., what are the triggers)?

APPENDIX- ROLE OF TECHNOLOGY IN FOSTERING CONNECTIVITY

1 Technology has a role in fostering connectivity albeit it needs to be seen as primarily a tool of reflecting the underlying principles of connectivity. The 2021 EFRAG European Lab publication on Good Practices in Business Model, Risks and Opportunities Reporting in the EU (hereafter referred to as the 2021 PTF-RNFRO report[12]) included findings from a survey to preparers, which show they consider technology as having a role in creating links within and between different reports. The report also highlights:

(a) the use of interactive technology (visualisation and hyperlinks) to facilitate the connection of information. The report provides an illustrative company example;

(b) the use of natural language processing to identify the co-occurrence of information; and

(c) the use of XBRL to tag financial and non-financial information as a way of attaining connectivity.

Similarly, at the 2023 EFRAG Conference, the Head of ESMA underscored the use of digital tools as a mechanism of connectivity.

2 As noted above, and alluded to briefly in agenda paper 03-03, XBRL technology and tagging of both financial statements and the sustainability statement/disclosures present an opportunity to attain connectivity at a grassroots level. Specifically, the machine-readable format of the sustainability reporting is a required deliverable under the CSRD and the availability of the three taxonomies [IFRS Accounting Taxonomy for the financial statements, and ESRS and Article 8 (Taxonomy legislation) XRBL Taxonomies for the sustainability reporting information], which are embedded into the ESEF Regulation will create an ecosystem of accessible public data through the European Single Access Point (ESAP). In this context, technology plays an important role in supporting the connectivity of corporate reporting information. Some potential aspects to be focused on are:

(a) the creation of individual elements or even their specific data type classification [i.e. monetary elements such as "assets at physical risk"] within the sustainability

[12] Towards Sustainable Business: Good Practices in Business Model, Sustainability Risks and Opportunities Reporting in the EU. Examples are in the Supplementary Document: Good Reporting Practices.

taxonomy will facilitate the access and usability of data connected to the financial statements.

(b) potential creation of interoperability between the aforementioned financial reporting and sustainability reporting related taxonomies [e.g., through the reuse of elements from the accounting taxonomy, e.g. Revenue/Turnover and Assets].

(c) The presentation of anticipated financial effects of sustainability matters (ESRS), by combining financial statement line items with an ESRS dimension.

(d) The reconciliation between financial statement items and operating segments with ESRS Sectors and related data points (e.g. Revenue in ESRS SBM-1).

3 Moreover, at the May 2023 EFRAG-hosted EAA symposium (see report- Multi-stakeholder perspectives on Connectivity), it was noted that in the context of the IFRS Foundation's work on connectivity, the digital taxonomy of the Sustainability Disclosure Standards would be informed by the taxonomy used for the Accounting Standards to help achieve connectivity in the Standards.

4 XBRL could provide connection points as the need to tag information requires the use of shared terminology, such as on the definitions of revenue, provisions, segments and entity and it enables the use of consistent terminology.

5 From an analysis of information standpoint, XBRL and tagging in tandem with the use of AI to retrieve and consume information could help users to process both financial and sustainability information. However, it was noted that though useful, AI can sometimes lead to the loss of the context surrounding the information. Therefore, humans are still needed to perform the tags to ensure all material information is captured.