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Examples Development Approach

Objective

- 1 The objective of this paper is to provide the EFRAG FRB and EFRAG SRB with an overview of the approach being taken in developing examples/illustrations of connectivity for the EFRAG research project on *Connectivity between Financial and Sustainability reporting* (the Connectivity project). A Discussion Paper for this project is expected to be published in H2 2024. Illustrations/examples of connectivity have multiple benefits including that:
 - (a) They can support reporting practices by enabling companies to benchmark themselves and improve their reporting practices.
 - (b) They will help to convey, clarify, and enhance the articulation of the principles of connectivity.
 - (c) They may point to gaps or grey areas within existing requirements.
 - (a) They will educate stakeholders through practical illustration of applications and this could lessen the expectation gaps on what information can be connected.
- 2 As noted in agenda paper 03-02 (*Definitions, concepts and priorities for illustrating connections*), two-way connectivity is in the scope of the project (i.e. connectivity of information starting from the sustainability statement/disclosures to the financial statements and/or management report; and connectivity of information starting from the financial statement). And this will be reflected in the illustrations/examples of connectivity. The content of Agenda Paper 03-02 whereby the concepts (including categories of connectivity) will guide the EFRAG connectivity project's development of examples/illustrations. That said, it is expected that the aforementioned articulation of connectivity concepts will be enhanced based on the learnings from the development of illustrations/examples (i.e., an iterative approach will be in place).

- 3 The articulated approach in agenda paper 03-02 including the priority topics (or anchor points) reflects several discussions had with EFRAG FR and SR TEG and EFRAG CAP including the two EFRAG CAP subgroups focusing on underpinning concepts and examples development. The prioritisation of topics was also informed by the various thematic reviews outlined in the Appendix including the October 2023 ESMA report ([Disclosures of Climate-Related Matters in the Financial Statements](#)). Of note, the ESMA report pinpoints areas of focus and assessing illustrations of these areas would help identify good practices (i.e., for real-world examples of connectivity starting from the financial statements) The remainder of the paper is structured as follows:
- (a) Considerations for the development and presentation of connectivity examples (paragraphs 4 to 18);
 - (b) Prioritised topics for illustration of connectivity (paragraphs 19 to 23);
 - (c) Appendix 1: Related thematic reviews of reporting practices.

Considerations for the development and presentation of connectivity examples

- 4 As noted above, agenda paper 03-02 outlines the concepts (including the categories) of connectivity that will be illustrated through the examples. In this paper, we detail other considerations for the development of illustrations/examples of connectivity include the type of examples, target number, and documentation of examples. We note that, to the extent possible, the illustrations/examples will be based on the exchange of views with preparers (including through outreach).

Type of examples

- 5 **Real-world versus mock-up examples:** The discussions with EFRAG CAP and EFRAG FR TEG and SR TEG highlighted mixed views on the type of illustrations/examples (i.e., real-world versus mock-up examples) that ought to be included in the EFRAG Discussion Paper. On balance, there was agreement and strong arguments made to cover both types of examples for the reasons summarised in paragraphs 1 and 2 including that it will encompass illustrations/examples aligned with two-way connectivity from sustainability statement/disclosures to the financial statements and vice versa. Second, as connectivity is a nascent concept, illustrations/examples are an integral part of understanding what connectivity means and establishing connectivity in practice.
- 6 At the same time different concerns have been respectively raised for both real-world and mock-up examples. For the former, the main concern is that reporting that fully reflects ESRS or IFRS SDS requirements will only be available from 2025. On the other hand, for the

latter, there were reservations they would be simplistic and bereft of real-world complexity. Relative to mock-up examples, it is easier to reflect entity-specific circumstances with real-world examples. There was also a concern that mock-up examples might be construed as authoritative application guidance issued by EFRAG.

7 Hence, the takeaways from the EFRAG CAP and EFRAG FR TEG and SR TEG discussions is that at a minimum, there should be:

- (a) *real-world examples* to illustrate connectivity starting from financial statements information; and
- (b) *mock-up examples* to illustrate connectivity starting from sustainability statements/disclosures. Real world examples will also be considered wherever companies have disclosures based on the pre-ESRS and IFRS SDS guidance that overlaps or is proximate to ESRS and IFRS SDS requirements. For example, TCFD and GRI Standards) influenced the development.

8 To mitigate the concerns, there will be a need for caveats that make clear the purpose and non-authoritative nature of the examples and this also applies to real-world examples (i.e., making clear what works for one entity may not necessarily be the best (or acceptable) approach for another entity. Furthermore, the following suggestions were made:

- (a) It would be useful to compare what was currently reported by companies in the market and what would be ideal to be reported (i.e. real versus normative).
- (b) when developing mock-up examples, start initially from real-world examples and develop mock-up ones based on the same assumptions for different topics.

9 In conclusion, there was support to proceed with examples/illustrations, leveraging to the maximum extent possible real-world examples, but at the same time complementing them with the necessary mock-up disclosures.

10 **Reporting year:** Due to ESRS and IFRS SDS only being available from 2025, it has been agreed to use both information relating to the financial year 2022 and 2023. Information would initially be gathered based on the financial year 2022 and may be updated for 2023 information. Preference would be for the latest available report, also because there has been a heightened focus on connectivity and many companies have started their journey on this only recently.

11 **Country and sectoral coverage:** It was also suggested that the real-world examples be selected from predominantly EEA companies across diverse and highly impacted sectors. EFRAG CAP members are expected to provide examples (both real-world and mock-up

examples). Examples from non-European companies could be included (as IFRS Sustainability requirements are in the scope of the connectivity project) but it is expected that the bulk of examples in the Discussion Paper will be EEA companies. Multi-sectoral coverage including financial institutions is expected.

Target number of examples

- 12 While the preliminary target for the Discussion Paper is 30+ illustrations/examples, the discussions had with EFRAG CAP and EFRAG FR TEG and SR TEG have emphasised the need to adapt to a suitable number due to the difficulties in identifying or developing suitable examples. At the same times, it was noted that no example is perfect hence multiple examples can cover different aspects.

Analysis and documentation for each example

- 13 To justify the choice of and share the learnings gleaned from each example/illustration, it has been agreed the following should be analysed and documented per example. The following reflects **baseline information** which will be required for each example:

- (a) *Which sections of the annual report/ report types are being connected (i.e., financial statements, sustainability statements/disclosures, the rest of the management report)?*
- (b) *What topic is addressed?*
- (c) *What is the type of connectivity the example is illustrating (i.e., direct, indirect, consistency, explanation of value-creation relationships)? What is the approach to connectivity being conveyed (e.g., complementarity, coherence)? Are there any conflicts between the connectivity principles (e.g., cross referencing versus understandability)?*
- (d) *What are the related ESRS/IFRS S1, S2 and IFRS Accounting requirements?*
- (e) *What information or subset of information cannot be connected and why?*

- 14 The following documentation, relating to **users and other stakeholders considerations**, is more judgemental and the information to be provided will depend on the examples.

- (a) Users' analytical considerations
 - (i) Why is the particular illustration of connectivity useful for investors and other users of financial statements and sustainability statements/disclosures? What analytical questions faced by investors and other users of financial statements/sustainability reports are being addressed by the disclosure/application of the illustrated connectivity approach?

- (ii) For the mock-up examples, for instance, those that may be related to anticipated financial effects, what connectivity “techniques” would be most useful for investors and other users of financial statements and sustainability reporting?
 - (iii) What is the most suitable location for the illustrated disclosure (i.e. financial statements, sustainability statement, the rest of the management report)?
 - (b) Other stakeholder considerations
 - (i) What constraints may entities/preparers face in applying this approach to connectivity of the illustrated disclosure?
 - (ii) What if/any would be the enforcement and assurance considerations related to the disclosure (e.g., when cross-referencing occurs, if a sustainability disclosure under IFRS Sustainability requirements or TCFD framework is included in the notes to the accounts)?
 - (iii) What is the most suitable location for the illustrated disclosure (i.e. financial statements, sustainability statement, the rest of the management report)?
- 15 Illustratively, for connections from sustainability statements to the financial statements, an analysis of the 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 statements/disclosures to the financial statements (i.e., what are the triggers)?
- 16 There will also be illustrations of connectivity between IFRS accounting policies and ESRS principles/policies.

Overall documentation/analysis

- 17 Any recommendations for improvement or any additional relevant information to be suggested should be an overall conclusion looking at all the examples together rather than analysing this aspect for each example.

Presentation of illustrations/examples

- 18 The approach used by the EFRAG European Lab project task force on the linkage in the reporting of the business model, risks and opportunities (PTF-RNFRO) to link principles to examples in its 2021 report could be similarly applied. (The principles described in [Towards Sustainable Business: Good Practices in Business Model, Sustainability Risks and Opportunities Reporting in the EU](#) and Examples in the Supplementary Document: [Good Reporting Practices](#)). We will also consider whether to apply the same presentation as the EFRAG European Lab projects on climate-related reporting and PTF-RNFRO.

Prioritised topics for Illustrations of connections

- 19 As noted earlier, the illustrations of connectivity will show two-way connectivity and include:
- (a) Illustrations of connectivity from sustainability statements/disclosures to financial statements and/or the rest of the management report; and
 - (b) Illustrations of connectivity from financial statements to information outside the financial statements.

Illustrating connections from sustainability reporting to financial statements and the rest of the management report that will be prioritised

- 20 The sustainability reporting topics that are covered in the EFRAG research project are **climate and other environmental topics, workforce, and business conduct**.
- 21 While illustrating the connectivity from sustainability information to financial statements' information, the priority will be on illustrations of:
- (a) Explanations of strategic and value-creation oriented relationships; and
 - (b) Consistency of significant assumptions, data, and qualitative information including a focus on relation forecasts to information on the past/present and use of the same (or different) assumptions.
- 22 Illustrations of direct connectivity and to a lesser extent indirect connectivity will be considered may be deemed to be a lesser priority as these aspects are considered relatively straightforward as they could be deemed to be establishing "mechanical" connections (i.e.

merely linking data points across different reports without necessarily providing incremental information on the entity's financial performance, financial position, and value creation relationships). However, illustrations of these types of connectivity could be included when related to the prioritised topics (e.g. taxonomy-aligned investments) and also when a point related to the decision-usefulness of information for users can be raised based on the context/accompanying narrative information. They could be included if there are analytical considerations for users. For instance, for the GHG intensity and Energy intensity metrics based on revenue, an entity's consolidation of the numerator (GHG emissions or Energy consumption) may include amounts related to associates and joint ventures. For this situation, there may be questions on whether analytical adjustments/APMs may be expected to be provided by preparers.

23 Illustrations of connections from sustainability reporting information to financial statements and the rest of the management report will include the following topics:

- (a) Illustrations of connections between the business model, strategy, risks and opportunities in sustainability disclosures and information in the financial statements. This could be a note in the financial statements or a disclosure in the management report.
- (b) Illustrations of Article 8 taxonomy investments to financial statements information. This disclosure would be expected in the sustainability report.
- (c) Illustrations of how anticipated financial effects can be connected to financial statements' information.

These include information that may be financially material within sustainability disclosures but do not meet the definition of assets and liabilities within financial statements. Reference will be made to the anticipated financial effects identified in the topical Standards including but not limited to ESRS E1 *Climate Change* requirements. Other sustainability matters with future financial effects¹ may include:

- (i) Adverse nature/environmental impacts caused by the company's products (e.g., impacts of microplastic in groundwater, seawater; oil spills) without the company having restoration obligations.

¹ Drawn from the 2021 Project Task Force for Non-Financial Reporting Standards (PTF-NFRS) report

- (ii) Potential environmental liabilities and health & safety-related liabilities arising due to potential health problems caused by the company's products (e.g., alcohol, tobacco, medicine, hormonal damages).
- (i) Potential assets (i.e., Value of potential reuse of materials (circular economy) and sustainability-related research and development activities that are not recognised as intangible assets. For instance, the UKEB September 2023 connectivity report had an example from the pharmaceutical industry (i.e., where the development of new inhalers with a low global warming potential due to upcoming regulation was conveyed in the sustainability disclosure but there was no disclosure of capitalised assets in the financial statements).
- (d) Illustrations of human rights and employee benefits disclosed in sustainability disclosures. There will be a need to consider how these disclosures could be linked to financial statements' information.
- (e) Illustrations of other information (besides anticipated effects) that may be financially material in sustainability reporting but not in the financial statements. Inspiration will be drawn from the ESRS Materiality Assessment Implementation Guidance.

Illustrating connections starting from financial statements to information outside financial statements that will be prioritised

24 Financial statement information to be connected to sustainability statements /disclosures will include overarching illustrations of. The following topics are expected to be the prioritised illustrations:

- (a) disclosures of how significant judgments, and major sources of estimation uncertainty associated with sustainability risks and opportunities affect the carrying values of financial statement line items
- (b) The valuation of tangible and intangible non-financial assets, i.e., impairment, amortisation, residual lives, and residual value and how that is linked to information in the sustainability-related disclosures (e.g. R&D investments in new products, stranded assets).
- (c) contingent liabilities, provisions and disclosure of information related to net-zero commitments, environmental liabilities, and workforce-related liabilities. This may overlap with the anticipated financial effects discussed in the preceding paragraph.
- (d) disclosures based on a qualitative materiality assessment. Of note, in its project on climate-related and other uncertainties in the financial statements, the IASB is

Examples development approach - Issues Paper

exploring developing examples of qualitative materiality assessment related to climate-related and other uncertainties in the financial statements (see EFRAG agenda paper² for November 2023 TEG-CFSS meeting). Hence, practical examples in the EFRAG research project can complement the work of the IASB and other similar initiatives (e.g. examples developed by ESMA).

- (e) segment and disaggregation of revenue disclosure as a way of showing if/how changes in the business model aligned with the green deal objectives affect the information disclosed in the segment and revenue disclosures.
- (f) other matters that are highlighted in the 2023 ESMA enforcement priorities. For instance, ESMA expects issuers to explain how climate matters have been considered in the measurement of investment properties (e.g. transition and physical risks)

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https://efrag.org/Assets/Download?assetUrl=%2Fsites%2Fwebpublishing%2FMeeting%20Documents%2F2301301054051928%2F05-01%20-%20COUFS_EFRAG%20FR%20TEG-CFSS%202023-11-29.pdf

APPENDIX 1 - THEMATIC REVIEWS OF REPORTING PRACTICES

S/n	Report	Publication	Publication date	Sample	Sectors covered	Scope
1	Financial reporting by European companies on climate issues	Mazars	Jan-24	191 examples-94 companies	Financial institutions, services, transport, industrials, energy	EU-France
2	The Heat is On : Disclosures of Climate-related matters in the financial statements	ESMA	Oct-23	22 examples-22 companies	Chemicals, construction, energy, telecommunications, industrials	EU
3	Task Force on Climate-related Financial Disclosures: 2023 Status Report	TCFD	Oct-23	1365 reviewed-3100 with AI tool-21 examples from 21 companies	Energy, materials, banking, insurance, transport, agriculture, technology, consumer goods	Global (324 EU companies - 616 AI)
4	A Study in Connectivity: Analysis of 2022 UK Company Annual Reports	UKEB	Sep-23	16 examples from 9 unnamed companies	Electricity, travel and leisure, pharmaceuticals, energy, financial services, industrials, aerospace and defense	UK
5	CRR Thematic review of climate-related metrics and targets	FRC	Jul-23	20 companies reviewed-39 examples from 16 companies	Materials and buildings, energy, banks, asset managers	UK
6	Information on climate-related matters in annual financial reports	Finanstilsynet	Mar-23	11 companies-no examples	Energy, manufacturing, materials, consumer discretionary and real estate	Norway
7	Commentary: Climate-Related Risks Disclosures in the Notes to Financial Statements: Descriptive Evidence from Australia	AASB	Dec-22	Top 75 ASX companies with 7 examples from 7 companies	Financials, materials, industrials, communications, consumer goods, energy, real estate and others	Australia

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8	Overview of the information provided in the 2021 financial statements on the effects of climate change and the commitments made by companies	AMF	Nov-22	27 companies reviewed-19 examples from 18 companies (often more than one per example)	Energy, Construction and materials, automobiles and parts, banks, electronics and electrical equipment, real estate and others	France
9	Still flying blind: The absence of climate risk in financial reporting	Carbon Tracker	Oct-22	134 companies reviewed with 54 examples from 23 companies (often more than one per example).	Energy, industrials, transportation, consumer goods & services	Global (46 EU & UK)
10	Task Force on Climate-related Financial Disclosures 2022 Status Report	TCFD	Oct-22	1414 companies reviewed-13 examples from 13 companies	Energy, materials, banking, insurance, transport, agriculture-food-forest, technology and media, consumer goods	Global (359 EU companies)
11	Financial reporting of European companies on climate issues: Findings from 2021 financial statements	Mazars	2022	79 companies reviewed-66 examples from 40 companies	Energy, transport, heavy industry, Food & beverages, consumer goods, pharmaceuticals and others (excludes financial sector)	EU-France
12	Towards sustainable businesses: Good practices in business model, risks and opportunities reporting in the EU	EFRAG European Lab PTF-RNFRO	Oct-21	44 companies reviewed-30 examples from 22 companies	19 sectors overall: Financial, energy and utilities, manufacturing, food and beverages, others	EU
13	How to improve climate-related reporting. A summary of good practices from Europe and beyond.	EFRAG European Lab PTF-CRR	Feb-20	149 companies reviewed-58 examples from 30 companies	Materials, Energy, Banks, Capital goods, Software & services, Consumer goods, Pharmaceuticals, Insurance, Food & beverage and others	EU & Switzerland