

DRAFT INTERIM DELIVERABLE PAPER: *CONNECTIVITY & BOUNDARIES OF ANNUAL REPORT SECTIONS*

PRESENTATION TO EFRAG FR TEG and FRB-

AGENDA PAPER 08-01

15 MAY 2024



SESSION COVERAGE

- **Post- February 2024 meetings with EFRAG TEGs and Boards**
- **Update on Draft EFRAG Interim Deliverable- Connectivity considerations & Boundaries of different parts of Annual Report**
 - *Developed after discussions with CAP concepts (formerly principles) subgroup (Nov-Jan), and feedback from EFRAG FR and SR TEG and EFRAG FRB and SRB meetings in February 2024*
 - *FRB&SRB recommended the merging of previously labelled ‘Principles/concepts’ and ‘Boundaries’ papers and for these to be published as an interim deliverable.*
 - *Other suggested improvements including added executive summary, Table of contents, Use of Diagrams, signposting key takeaways for each chapter, eliminating duplication across the two prior papers*
 - *Written approval/comments are sought from SR TEG by 14 May 2024*
 - *The Draft interim deliverable will be presented for final FR TEG and FRB approval on 15 May 2024*
- **Appendix content (for information)- Boundary in practice- feedback on IFASS discussion - can net-zero commitments disclosures be in the financial statements?**

TAKEAWAYS- JOINT MEETINGS OF TEGs and FRB&SRB

Joint TEGs meeting on 15 February takeaways

- Concern expressed about labelling the content as “principles”, this will be confusing for stakeholders as may be construed as alternative guidance. Hence, content is described as concepts considerations, with a caveat emphasising it is not supplemental guidance
- Agreement on need for two-way/reciprocal connectivity (e.g., SR to Financial statements, and vice versa)
- Importance of outreach to preparers was underscored
- Other specific points raised have been incorporated into interim deliverable (including definition of anticipated financial effects)
- Mixed views albeit mostly support for including both real world and mock up examples (**Of note, 10+ early ESRS adopters identified**)

Joint FRB&SRB meeting on 28 February takeaways

- Merge previous “Principles” and Boundaries Paper and publish as interim deliverable, Defining Annual Report
- Clarity on broader purpose of connectivity including it being primarily a communication exercise
- Need for balanced portrayal of whether or not climate risk can be reflected in the financial statements
- GAAP agnostic approach in illustrations- albeit primary focus can be entities reporting under IFRS
- Mixed views expressed on mock up examples, concerns about illustrations from non-ESRS reporters, agreed to have both real world and mock-up examples



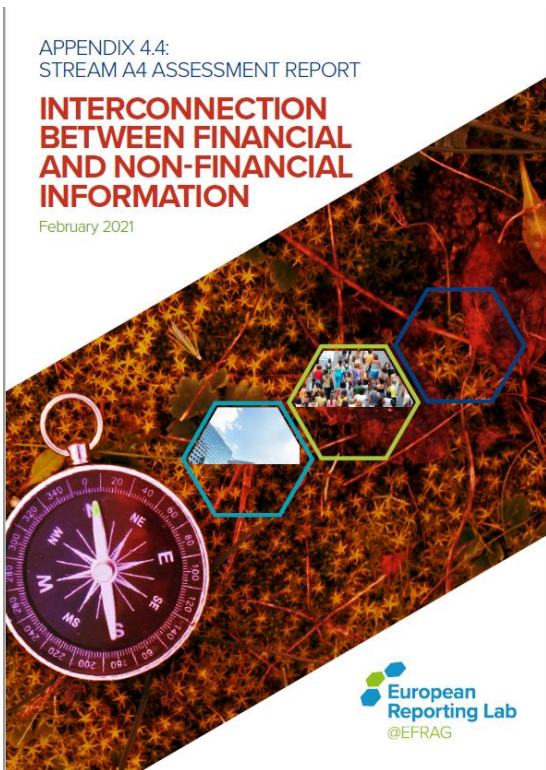
**POINTS OF NOTE:
DRAFT EFRAG
INTERIM
DELIVERABLE
PAPER
AGENDA PAPER
*08-02***

**EFRAG Connectivity Project: Draft Interim
Deliverable - 8 May 2024**

*Connectivity considerations & Boundaries of different
Annual Report sections*



IMPORTANCE OF CONNECTIVITY HIGHLIGHTED ACROSS MULTIPLE EFRAG PUBLICATIONS & EVENTS



EFRAG SECRETARIAT BRIEFING

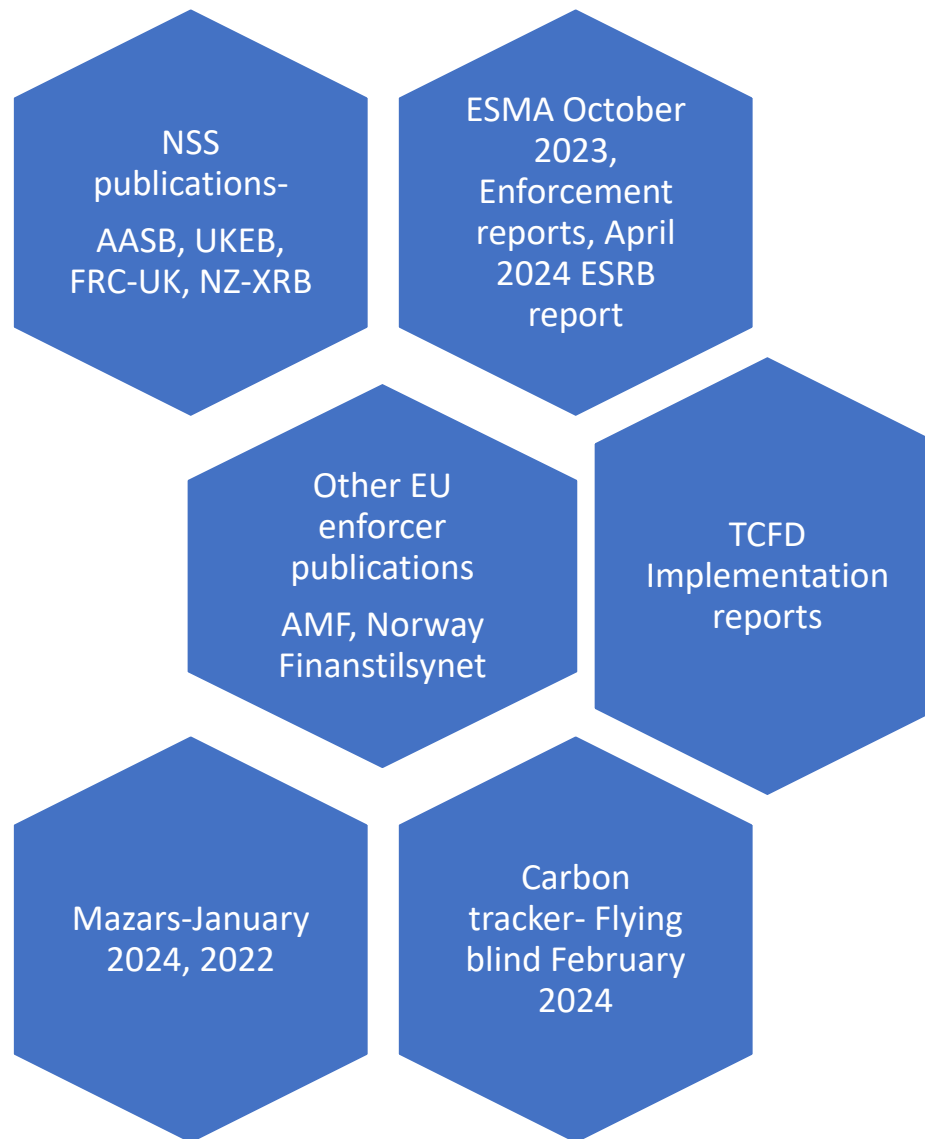
SUMMARY: EFRAG OUTREACH, LEARNINGS FROM REVIEWS OF EUROPEAN REPORTING TRENDS

SEPTEMBER 2023

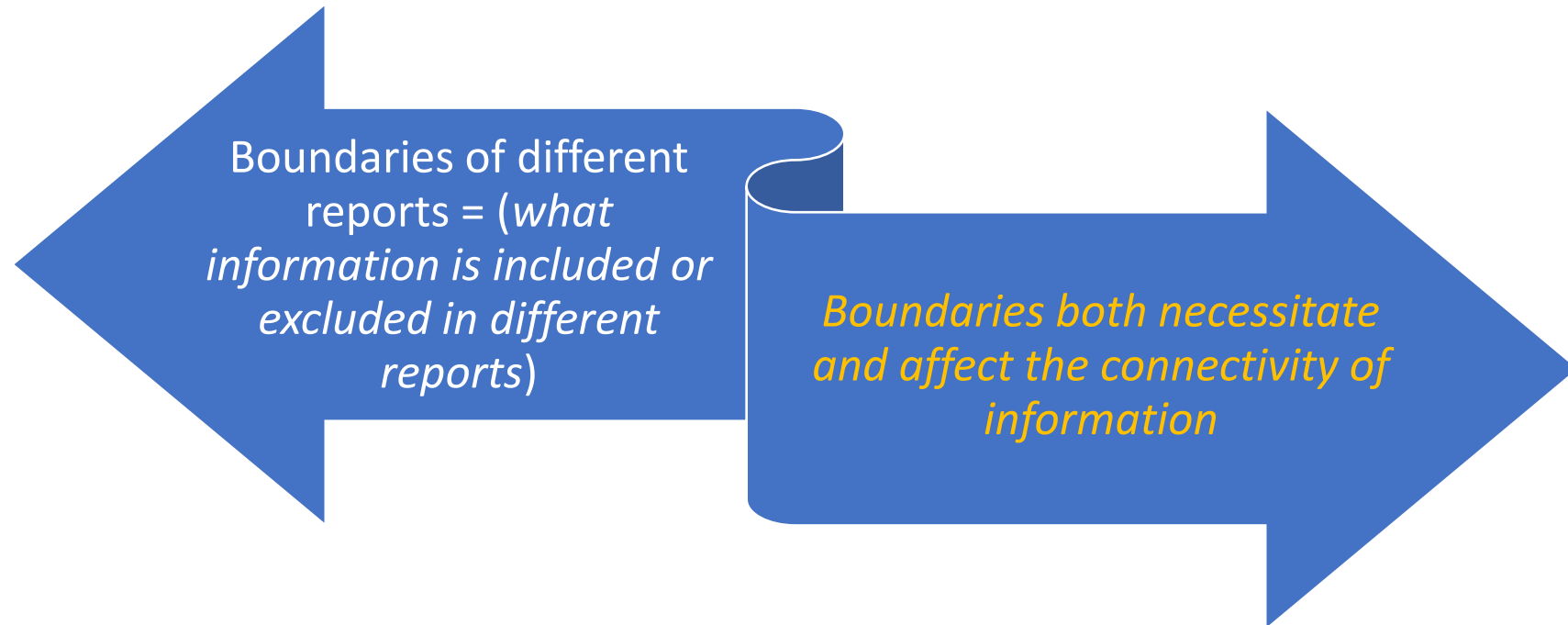


CONNECTIVITY WAS TOP RANKED PROJECT DURING 2021 EFRAG PROACTIVE RESEARCH AGENDA CONSULTATION

IMPORTANCE OF CONNECTIVITY HIGHLIGHTED ACROSS MULTIPLE NSS, REGULATOR AND OTHER STAKEHOLDER PUBLICATIONS



CONNECTIVITY AND BOUNDARIES ARE INTERRELATED



EXPECTATION GAPS ON WHAT CAN BE REPORTED ARISE DUE TO LACK OF CLARITY ON BOUNDARIES

PART 1: CONNECTIVITY CONSIDERATIONS

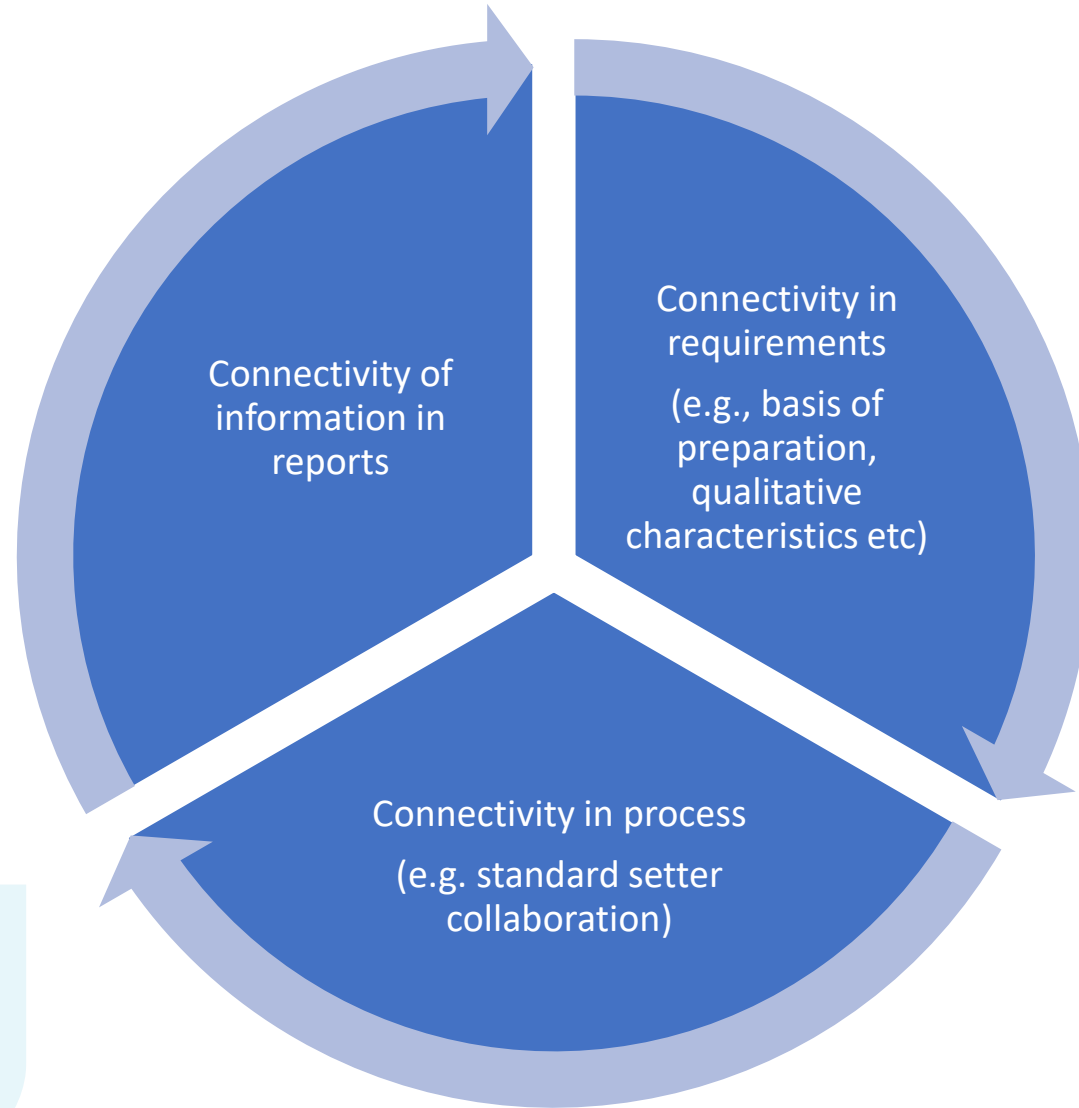
WHAT IS CONNECTIVITY?

WHAT IS BEING CONNECTED? (i.e. EU vs IFRS general purpose financial reporting)

CONNECTIVITY CONCEPTS & EFFECTS ON REPORTING

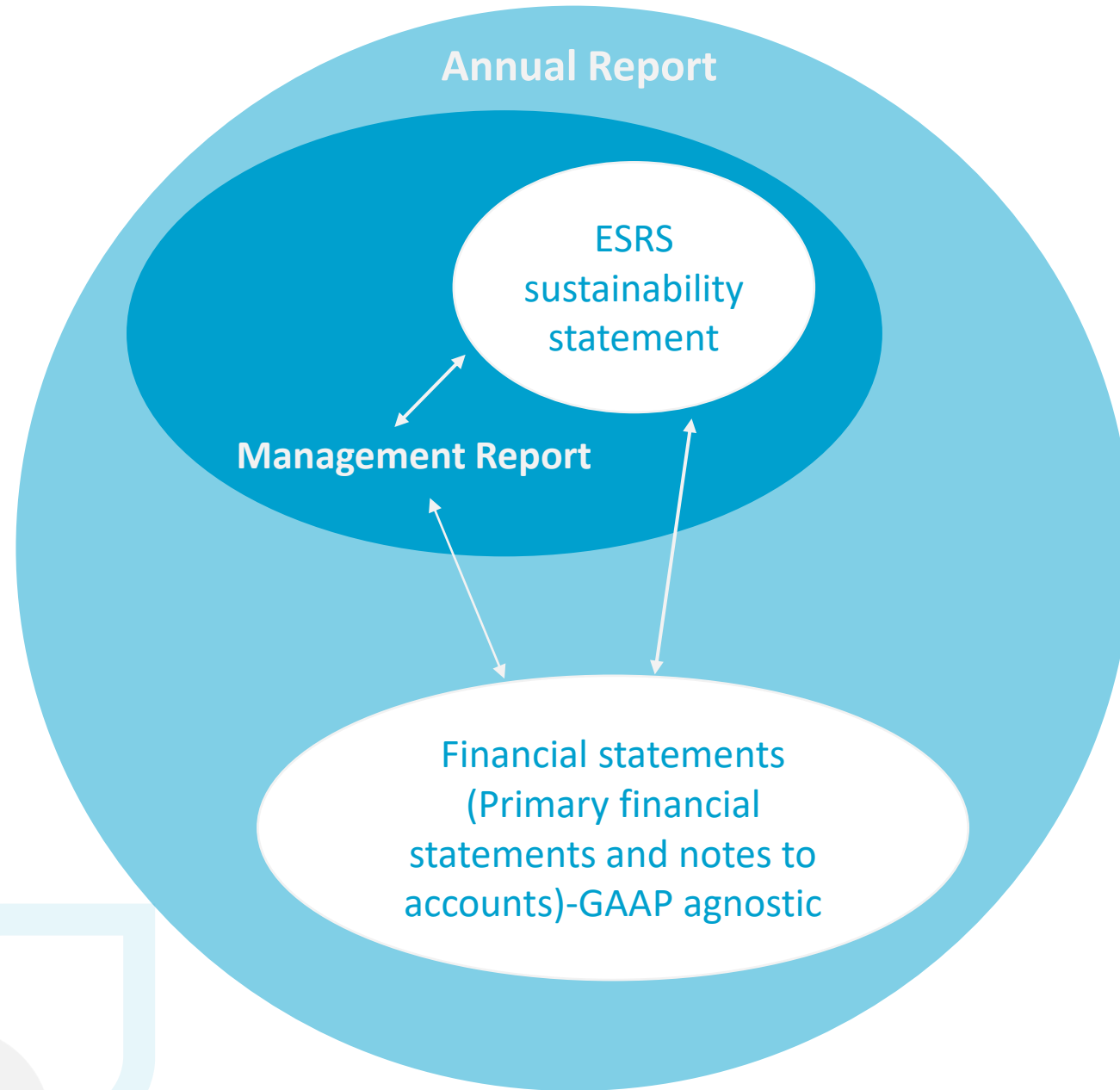
WHY CONNECTIVITY IS IMPORTANT

WHAT IS CONNECTIVITY



**Distinction between
connectivity versus
integration in reporting
versus existing IR
framework**

WHAT IS BEING CONNECTED UNDER EU CORPORATE REPORTING?



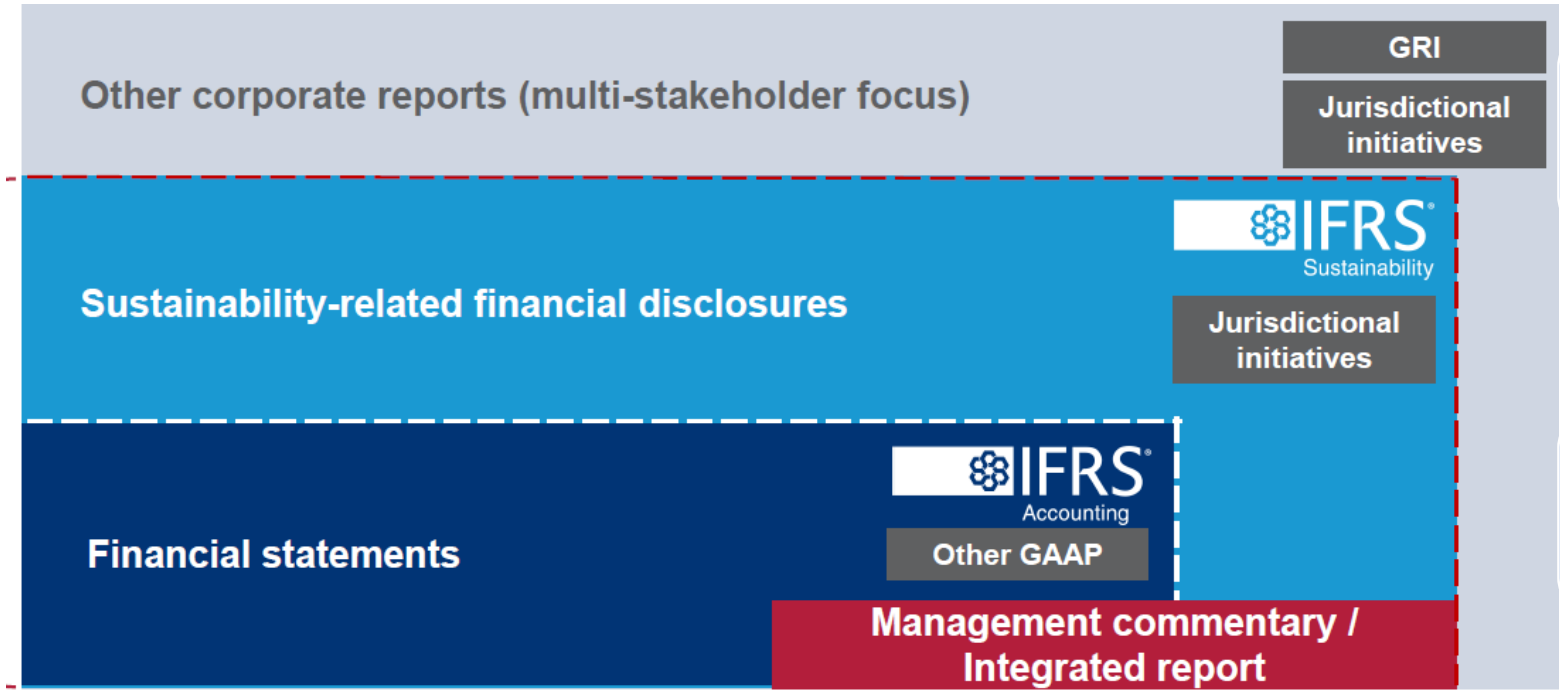
ESRS sustainability statement- SR (objectives, location and scope)

- Clear demarcation of SR versus financial statements objectives
- Clear placement within management report
- Entities in scope (large undertakings: IFRS and local GAAP applicants)

SR audience and materiality

- Broad set of users (including investors), investors deemed to consider financial and impact material information
- Double materiality perspective
- Same definition of financial materiality as financial statements

What is being connected under IFRS general purpose financial reporting



SR information (sustainability-related financial disclosures)

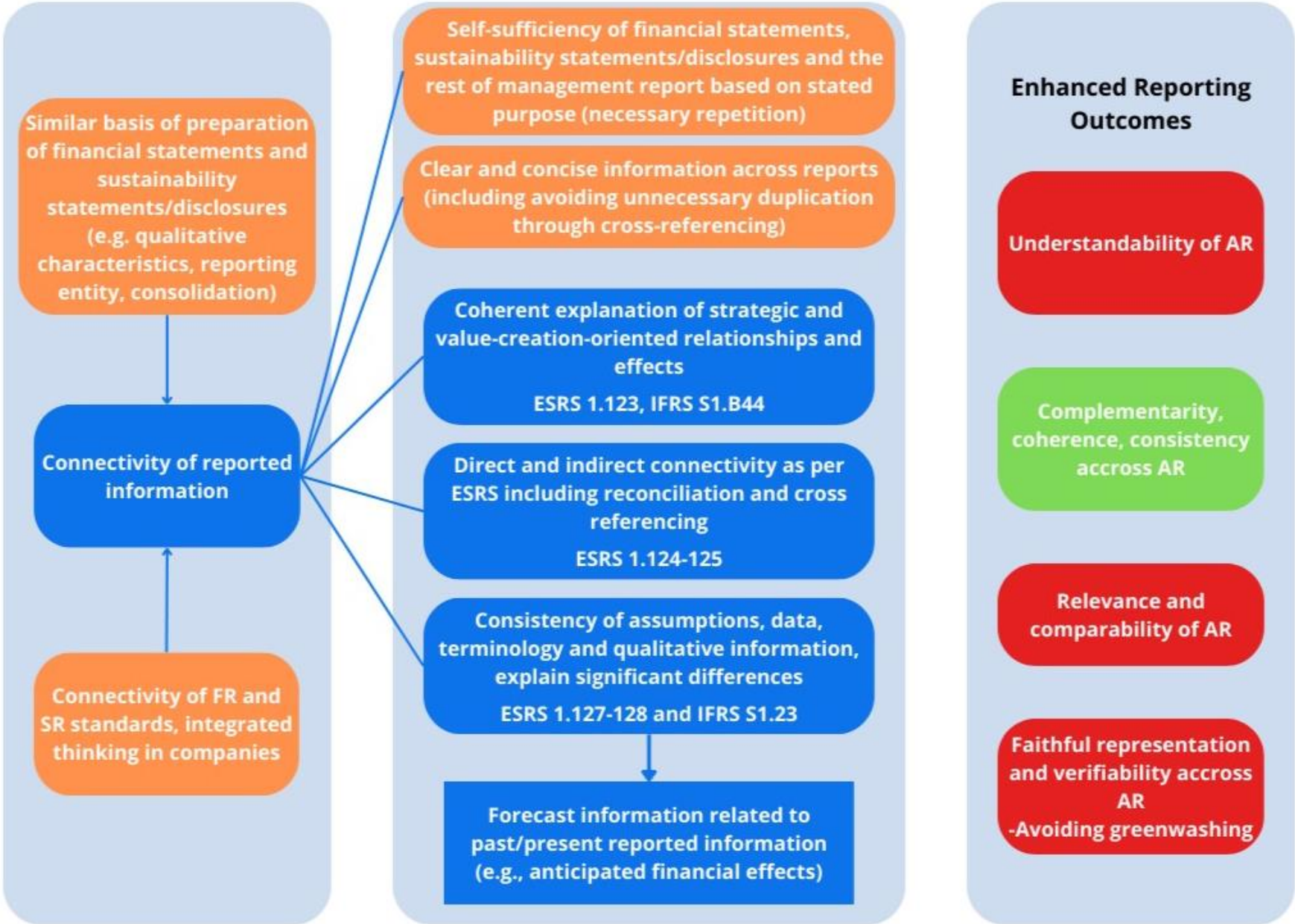
- Component of general purpose financial reporting, has same materiality as financial statements, management commentary
- Location agnostic (e.g., can be in notes to accounts)

Audience of SR information

- Same primary audience as financial statements (i.e., investors, lenders)



CONNECTIVITY CONCEPTS & EFFECTS ON REPORTING



- Two-way connectivity (i.e. SR to FS, and FS to SR) is in scope of the EFRAG connectivity project.
- **No explicit IFRS Accounting connection requirements.** Can ESRS and IFRS Sustainability standards connection requirements (SR requirements) be applied analogously? This question is pertinent for assessing illustrations of connectivity of financial statements information within EFRAG project.
- EFRAG connectivity project is not proposing guidance. It is the IASB's job to do that

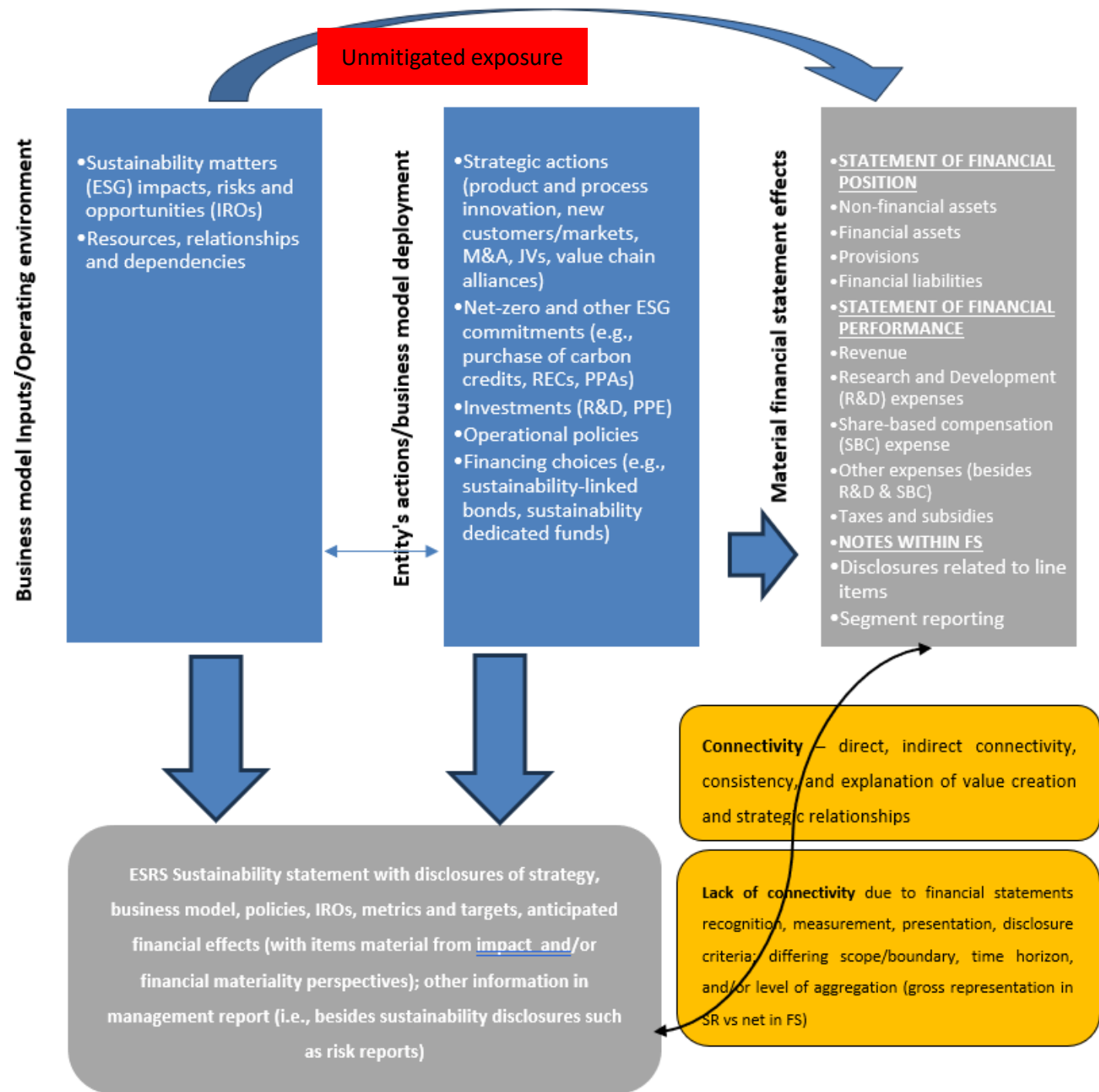
YES- SOME SR CONNECTION REQUIREMENTS CAN BE CONSIDERED FOR FS INFORMATION

- *Explaining relationships and ensuring consistency of assumptions could be applied to financial statements information*
- *No explicit prohibition to cross-referencing material information or signposting supplemental information outside the financial statements*

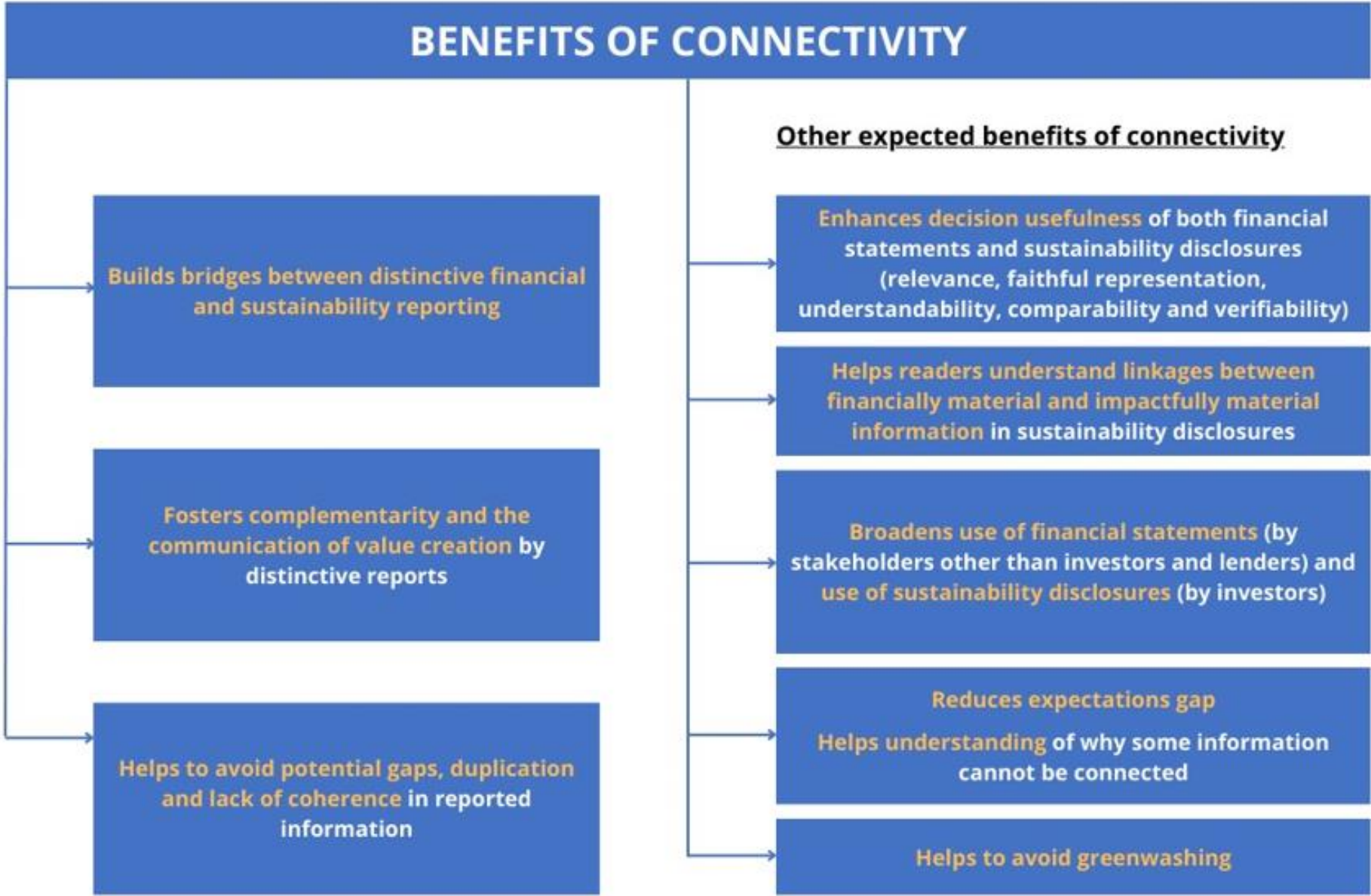
CONSTRAINTS TO APPLYING SR CONNECTION REQUIREMENTS FOR FS INFORMATION

- *Limits to cross-referencing forward-looking information (legal risk, excessive cross-referencing could impair understandability)*
- *View expressed within EFRAG CAP that indirect connectivity concepts (e.g., reconciliations to information outside the FS) are hard to apply towards financial statements information*

CONNECTIVITY LINKS BUSINESS MODEL, STRATEGY TO REPORTING



SYNTHESIS- WHY CONNECTIVITY IS IMPORTANT



**BOUNDARIES OF FINANCIAL STATEMENTS,
MANAGEMENT REPORT, SUSTAINABILITY STATEMENT**

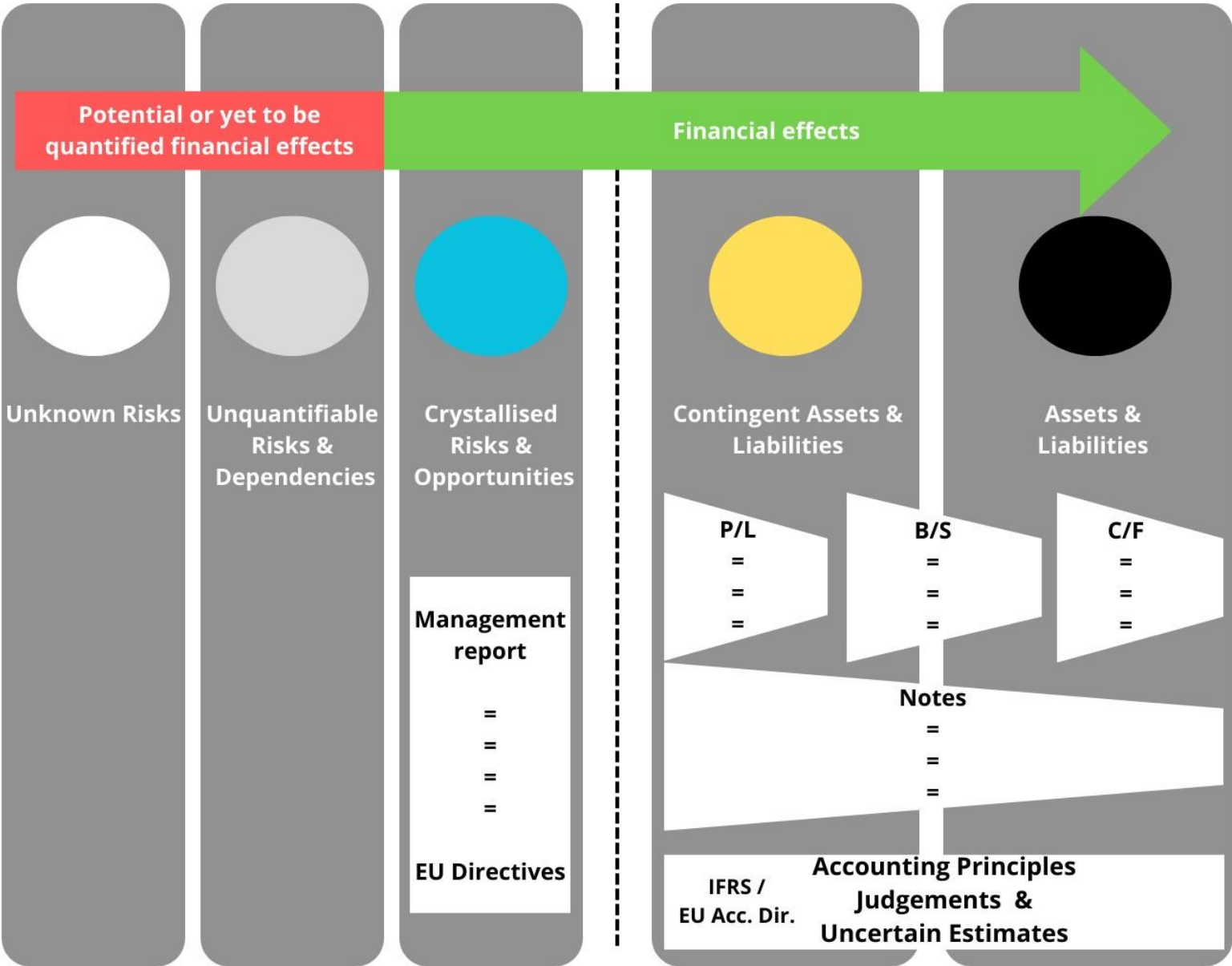
- Objectives & audiences of different corporate reports
- Materiality considerations (materiality is interrelated with objectives and audience of different reports)
 - *Impact materiality in SR, financial materiality in both FS and SR*
 - *Dynamic/evolving dimension of materiality and connectivity*
 - *Extent to which qualitative materiality assessment is applied in FS (i.e., applying IAS 1)*
 - *Possible grey areas on location of material information*
 - *E.g., net-zero commitments related disclosures, i.e. should disclosures be in SR only or in both SR and FS;*
 - *Necessary distinction between mere intentions vs a constructive obligation that is not a present obligation (valid expectation) vs constructive obligation that is either recognised as provision or disclosed as contingent liability based on current accounting requirements*
- Other factors (besides materiality) affecting boundaries and connectivity

OTHER KEY DIMENSIONS OF BOUNDARIES OF FS versus SR

- *Recognition, measurement, disclosure, presentation criteria in financial statement (FS)*
- *Differing level of aggregation (e.g., can arise due to gross exposure disclosure in sustainability reporting- SR versus mitigated/net exposure effects reflected in FS)*
- *Extent to which forward looking information is incorporated*
- *Time horizon typically applied for SR vs FS albeit there are no time horizon limits for FS*
- *Extent to which non-monetary metrics are incorporated*
- *Consideration of value chain in SR*
- *Allowing consideration of operational control while calculating metrics in SR*



DYNAMIC DIMENSION OF CONNECTIVITY/BOUNDARY- MIGRATION OF ITEMS ACROSS REPORTS OVER TIME





Questions for EFRAG FR TEG & FRB MEMBERS

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Q1: Do you have any comments and/or suggestions for enhancement of the interim deliverable paper structure and content?





APPENDIX:

**IFASS MEETING DISCUSSION TAKEAWAYS- A CASE STUDY ON BOUNDARIES
*NET-ZERO COMMITMENTS DISCLOSURES- can these be in the financial
statements***

IFRIC TENTATIVE AGENDA DECISION- NET-ZERO COMMITMENTS

NOVEMBER 2023 IFRIC MEETING

- Constructive obligations arising from net-zero commitments may exist if there are valid expectations
- Present obligation arising from past event and net outflow/transfer of economic resources required prior to the recognition of provision

MARCH 2024 IFRIC MEETING

- Based on consultation feedback, IFRIC confirmed tentative agenda decision
- Based on second submission (on whether contingent liabilities disclosures (IAS 37.86) can be provided for constructive obligations if not remote), IFRIC confirmed that **contingent liabilities disclosures would not be applicable for the fact pattern as there was no past event**. In other words, a past event (entity has emitted/polluted) is needed for both contingent liabilities disclosures and recognition of provisions.
- IFRIC confirmed need to consider other accounting effects (i.e., beyond recognising provisions or disclosing contingent liabilities) including assumptions related to useful lives, impairment.

IFRIC TAD FACT PATTERN

A manufacturer of household products publishes/states its commitment to reduce targets by 60% at a future date (in nine years) and to offset remaining emissions at the future date and thereafter by buying carbon credits and retiring them. The entity details its plans to modify its manufacturing methods to achieve the set target and management conveys this will be done profitably.

PREMISE : ANY ADDITIONAL USER INFORMATION NEEDS OUGHT TO BE *ADDRESSED THROUGH DISCLOSURES AND NOT THROUGH CHANGING REQUIREMENTS FOR RECOGNITION OF PROVISIONS*

STAKEHOLDER EXPECTATIONS OF NET-ZERO RELATED DISCLOSURES IN THE FINANCIAL STATEMENTS

- **Feedback to the IFRIC tentative agenda decision**: some stakeholders called for the following disclosures:
 - requirements for entities making climate-related commitments to disclose management’s key assumptions.
 - requirements for **entities to disclose information about capital expenditure projects** required to fulfil climate-related commitments, and **capital already committed to purchasing assets** to fulfil those commitments.
- **EFRAG CAP discussion** users have indicated **a disclosure of time-series of likely costs would be useful even if provisions are not recognised**
- **EFRAG FR/SR TEGs and FRB/SRB discussions**, there has been general agreement with the IFRIC clarification on recognition of provisions in the financial statements, and suggestions for disclosures have been made
 - **a view has been expressed it should be clear when items migrate from sustainability statement to the financial statements (i.e., triggers for recognition of provisions or disclosure of contingent liabilities)**
 - **a suggestion has been made for incorporation by reference of SR disclosures into the financial statements notes**

VIEWS ON WHETHER THERE SHOULD BE NET-ZERO RELATED DISCLOSURES IN THE FINANCIAL STATEMENTS- 1/4

View 1 (supportive): Yes, there should be related disclosures (i.e., on possible future outflows) in the financial statements if material to investors.

- If information is material to investors and consistent with objectives of financial statements, it should be disclosed
- **Financial statements should be self-sufficient and complete in context of their objectives** (see [January 2023 CRUF article- *Getting visibility on the financial statement effects of climate change*](#), which also comments on the expected respective roles of sustainability disclosures and financial statements and opines that instead of substituting FS information, SR may create awareness of gaps in financial statements information- aka have nudge effects).
- Some stakeholders have expressed concern that **qualitative materiality including investor expectations of material information for financial statements is not sufficiently considered** during the preparation of financial statements (see [UKEB September 2023 report](#))
- Some stakeholders expect the requirements of **IAS 1.31 could be applied to disclose such information.**

VIEWS ON WHETHER THERE SHOULD BE NET-ZERO RELATED DISCLOSURES IN THE FINANCIAL STATEMENTS- 2/4

View 1 (supportive) - continued: Yes, there should be related disclosures (i.e. on possible future outflows) in the financial statements if material to investors.

- Though IFRS S1, S2 and ESRS have requirements for the disclosure of anticipated financial effects (financial implications of transition plans in the short, medium and long term), these **requirements may not explicitly capture the specific information expected or assumed to be relevant for financial statements.**
- There is **no explicit prohibition to signposting supplemental (i.e., not material for the financial statements) information in other reports or including by cross reference material information for financial statement that is in other reports.**
- If disclosures on possible future outflows related to net zero are required and could be included by cross reference, it could be viewed as akin to the IFRS 7 incorporation of risk (credit risk and hedge-accounting-related) disclosures by cross reference.

VIEWS ON WHETHER THERE SHOULD BE NET-ZERO RELATED DISCLOSURES IN THE FINANCIAL STATEMENTS- 3/4

View 2a: (Against), disclosures should only relate to defined financial statements elements (including unrecognised items such as contingent liabilities),

- As confirmed by IFRIC in March 2024, before there is a past event, commitments (even if they are constructive obligations) **do not meet the definition of either provisions or contingent liabilities and therefore IAS 37 specific disclosure requirements do not apply.**
- **Why should constructive obligations arising from climate-related commitments be treated differently from other constructive obligations?**
- IAS 1.125 (disclosures of estimation uncertainty on carrying values) requirements need to be considered in the context of existing/defined assets and liabilities.
- The **application of IAS 1.31 may be constrained** due to possible disclosure overload concerns, and this requirement relates to or shall be considered for transactions, events and conditions affecting the current financial performance and financial position.
- Repetition may impose **double reporting burden for preparers. Users ought to be location-agnostic** with regards to material information (and during EFRAG discussions so far some have indicated they are).

VIEWS ON WHETHER THERE SHOULD BE NET-ZERO RELATED DISCLOSURES IN THE FINANCIAL STATEMENTS- 4/4

View 2b (Against in a most restrictive manner): disclosures should only relate to recognised financial statement line items

- Some stakeholders have this view. For instance, in the EFRAG Recommendations and Feedback Statement- *Better information on intangibles* ([see link](#)) issued following a public consultation on the related EFRAG discussion paper; the responses to **Question 9 on placement** convey that some stakeholders consider that disclosures should only relate to recognised financial statement line items. (That said, other views were also expressed on the matter in the Recommendations and Feedback Statement)
- Also, this view seems inconsistent with existing IFRS requirements which include disclosure requirements for contingent liabilities. Moreover, the guidance for developing and drafting disclosure requirements (developed after the completion of the '*Disclosure Initiative- Targeted Standards Level Review of Disclosures*' project) indicated that disclosures can include information about unrecognised assets and liabilities including information about their nature and the risks arising from them

BREAKOUT DISCUSSION QUESTIONS

QUESTION 1: *If at all (i.e., View 1 in slide 13), what disclosures related to net zero commitments would you expect in the financial statements and why? If you do not expect disclosures on these commitments in the financial statements (View 2a or 2b in slide 14 and 15), what are your reasons?*

QUESTION 2: *In your view, if at all, if/when can IAS 1.31 requirements be applied to justify including the expected disclosures on net-zero commitments in the financial statements?*

QUESTION 3: *What is your view on incorporation by cross reference into the financial statements of the disclosures of net zero commitments in sustainability reporting? What aspects of the related SR disclosures would be material for incorporation into the financial statements by cross reference?*

QUESTION 4: *If/when should information disclosed on anticipated financial effects of transition plans (i.e., potential liabilities) in sustainability statements/disclosures be also disclosed in the financial statements (i.e., what should be the triggers for financial statement disclosures)? This latter point was also raised in the April 2023 IFASS AcSB connectivity presentation (see [April IFASS meeting report](#) pages 35-36).*

IFASS BREAKOUT DISCUSSION TAKEAWAYS- 1/2

Views expressed were largely against net zero commitments disclosures in the financial statements

- These disclosures are expected to be portrayed under ESRS E1 and IFRS S2 disclosures*
- Users are meant to be agnostic on where information is disclosed, the Annual Report needs to be viewed as a package. That said, it could also be argued that having self-sufficient reports does not negate the complementarity of their information*

Need for caution on expectations of applicability of IAS 1.31 (catch all) requirements. In conversations with different stakeholder, different views on possible applicability of IAS 1.31 have emerged in discussions

- View 1: Unrestrained IAS 1.31 applicability- However, IFASS members feedback showed they considered this to be a misreading of the requirements (e.g., there is a reason why there are specific requirements, what is the purpose of SR information, applying it would be an overreach)*
- View 2: Can be applicable if investors reasonably expect information in financial statements (e.g., if there is disconnect between front end and back end overall portrayal of performance, risk and prospects)*
- View 3: Restrictive view – closer to never applicable, argue that it is hard to find cases where IAS 1.31 has been applied*

TAKEAWAY: VARIED INTERPRETATION/EXPECTATION OF IAS 1.31 UNDERSCORES IMPORTANCE OF ILLUSTRATIVE

EXAMPLES: IASB Project on Climate-related and other uncertainties in the financial Statements (Exposure Draft on illustrative (mock-up) examples expected in July 2024)

EFRAG connectivity project priority topics anchor points- could include examples of IAS 1

Participants reiterated constraints and conditions related to including information in the financial statements by cross-referencing (level of assurance, impairing understandability)

Suitable triggers of items moving from sustainability statement to the financial statements may vary across reporting periods

Overarching need for user outreach (SR disclosures + FS can be conjunctively presented, and user information gaps identified)