CONNECTIVITY IN REPORTING

OIC-EVENT- MILAN

14 OCTOBER 2024

EFRAG
Financial reporting

EFRAG CONNECTIVITY PROJECT MILESTONES

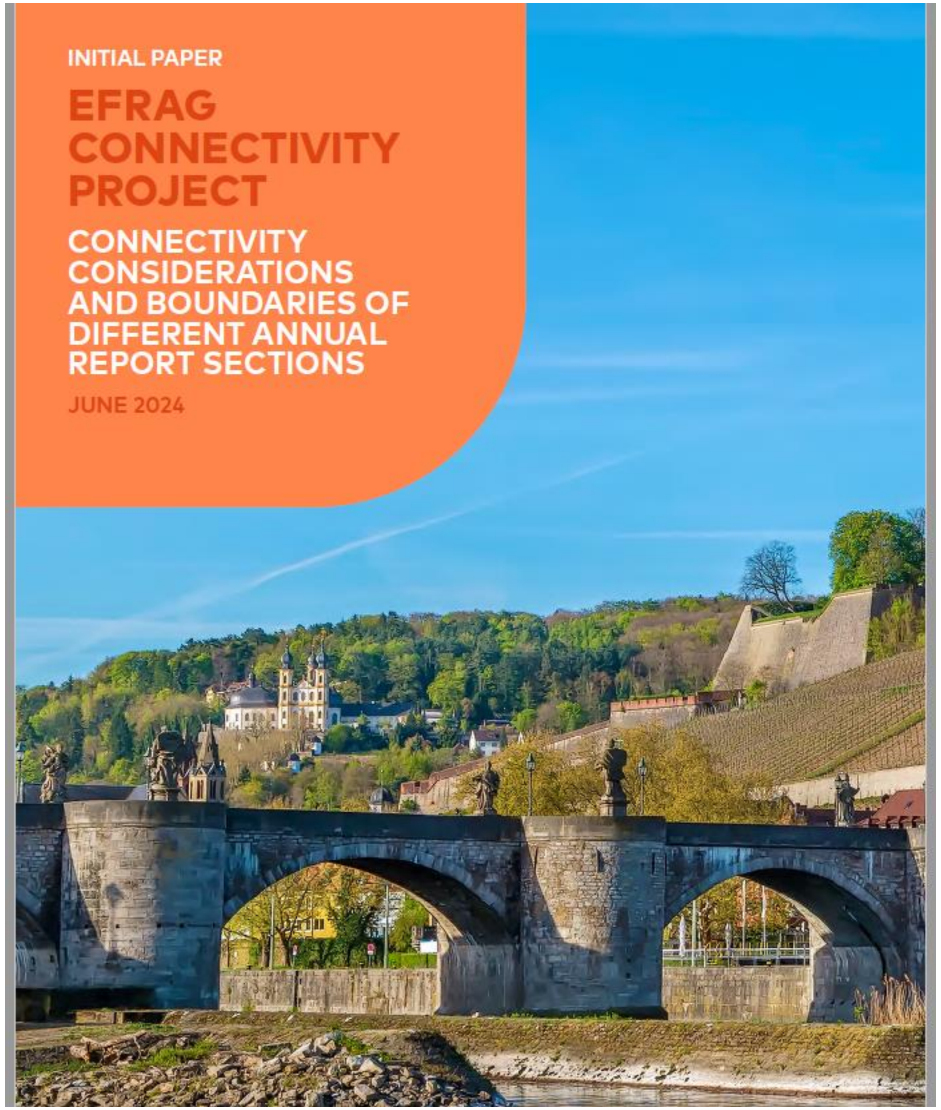
INITIAL PAPER PUBLISHED ON 28 JUNE 2024

'Connectivity considerations and boundaries of different Annual Report sections'

Video **providing initial paper's key takeaways from the perspective of EFRAG Connectivity Advisory Panel (CAP) leaders**

A DISCUSSION PAPER EXPECTED IN H1 2025 WILL INCLUDE

- **Conceptual issues and suggested solutions**
- **Practical illustrations and techniques of connectivity (mix of real world and mock-up illustrations)**
- **Questions for constituents**



SELECTED HIGHLIGHTS OF EFRAG INITIAL PAPER

CONCEPTUAL CONSIDERATIONS: BOUNDARIES OF ANNUAL REPORT

BOUNDARIES: DIFFERENT AR SECTIONS

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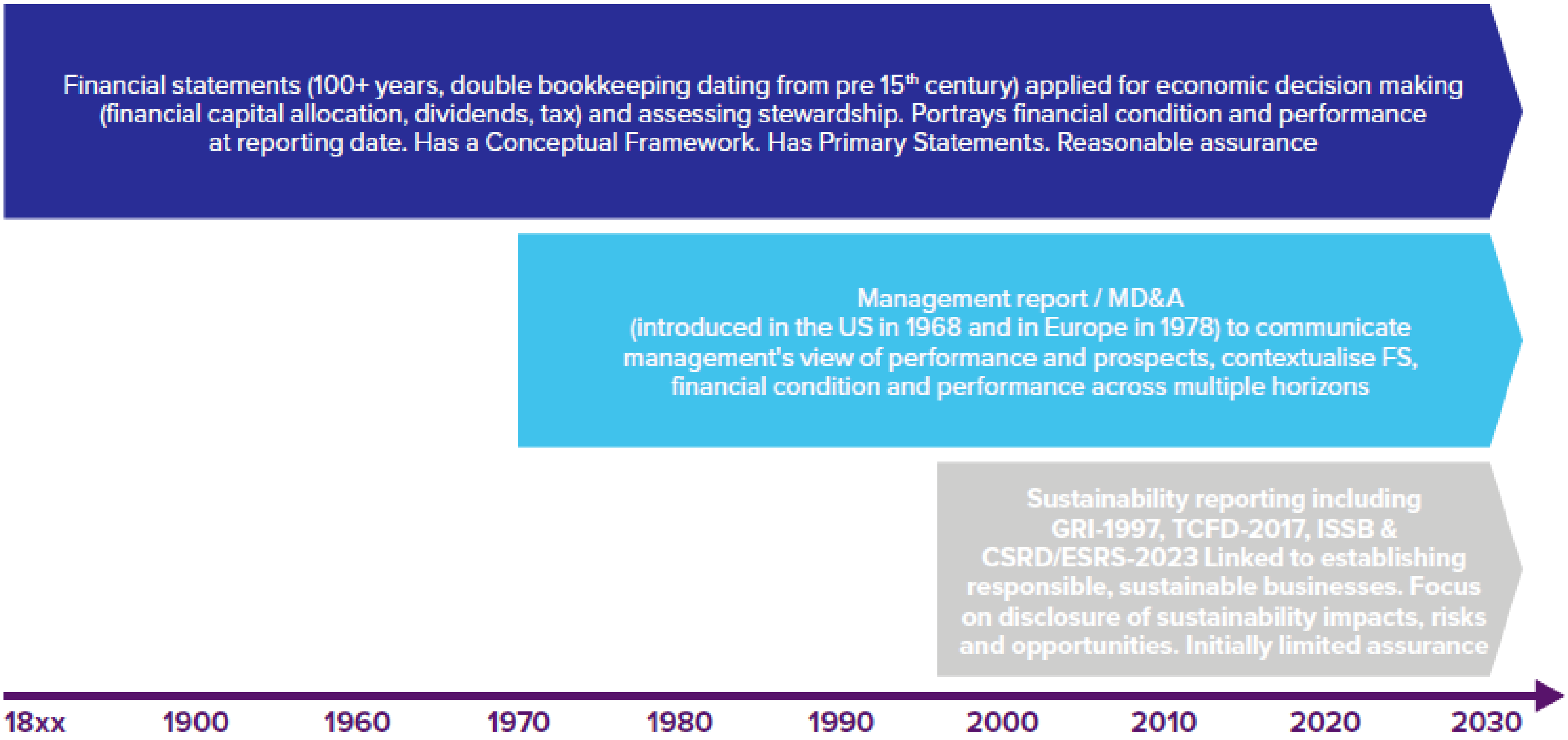

BOUNDARIES: KEY DIFFERENCES ACROSS DIFFERENT AR SECTIONS

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Financial statements (FS)
(Source: Conceptual Framework)

Reflects financial position, financial performance at reporting date (present assets and liabilities)

Primary audience of financial capital providers

Includes information material to FS users

Recognition of assets/liabilities depends on separability of items, existence/occurence and measurement uncertainty considered

Financial control-considered for reporting entity (determining entities in scope of consolidation) and recognition of assets

Management report
(Source: EU Accounting Directive)

Reflects entity's performance, position and development; it is traditionally a part of general purpose financial reporting with financial materiality perspective

Under CSRD, management report can be deemed to be part of general purpose sustainability reporting

Provides description of principal risks and uncertainties

Primary audience is knowledgeable user

Implicit that it has same reporting entity as FS

Sustainability statement
(Source: EU Accounting Directive and ESRS)

It is a section of the management report

Discloses entities' sustainability impacts, risks and opportunities

Discloses financial effects of IROs in short, medium and long term

Audience of stakeholders including investors and other users with interest in entity's impacts on planet and society

Financially and/or impactfully material information included

Same reporting entity as FS, consideration operational control in calculation of environmental metrics

DIFFERENTIATING DIMENSIONS

Objectives & Audiences

Materiality (whether impact materiality considered)

FS recognition and measurement criteria

Typical time horizon considered

Focus on current vs future financial position, financial performance

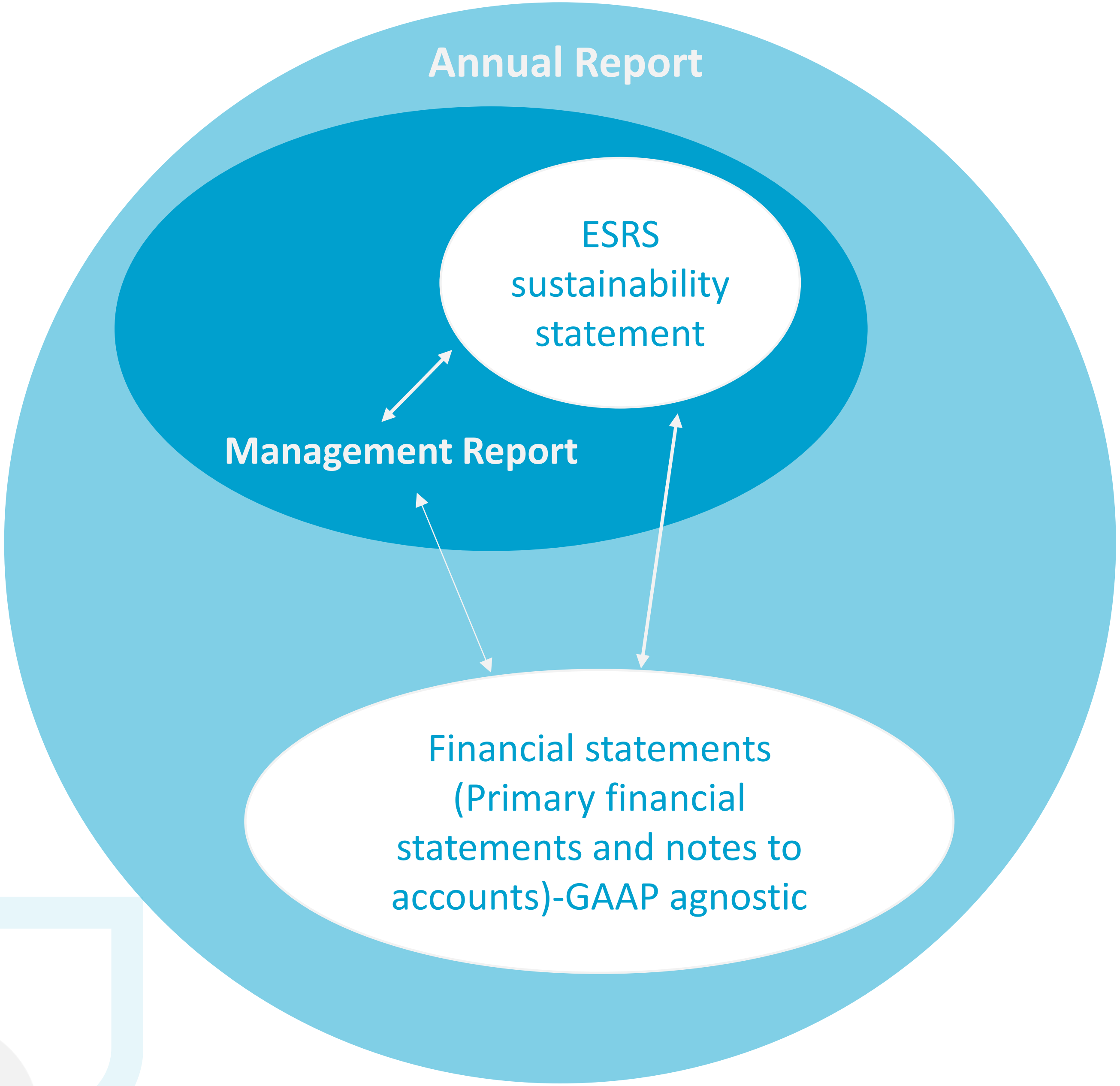
Consideration of operational control in calculation of SR metrics

Extent of explicit incorporation of value-chain impacts, risks and opportunities

Observations

- Materiality is interrelated with objectives and audience; similarity in the definition of financial materiality and difference of information in different AR sections stems from differences in their objectives
- Similarities: overlaps in information related to current financial performance and financial position; same reporting entity, informs financial capital allocation decisions and users' assessment of management's stewardship of entity's own resources
- Differences: FS does not focus on representing information related to future financial performance and financial position. Application of operational control in only SR extends the related reporting boundary beyond that of FS; sustainability statement informs on externalities, CSR (stewardship of planetary and societal resources)

CONTEXT OF CONNECTIVITY 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

CONCEPTUAL CONSIDERATIONS: ASPECTS OF CONNECTIVITY

DIMENSIONS OF CONNECTIVITY

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Overarching aspect- integration of information to convey value creation

- Communication/depicting the effects of strategic responses to (impacts, risks and opportunities) on sustainability performance, financial performance and financial position
- Entity's explaining how their strategy and business model, risks and opportunities are linked to financial position, financial performance, cash flows, other metrics and targets in short, medium and long term **(ESRS 1.123 and IFRS S1.35 and IFRS S1.B44)**
- Linking disclosures of risks entities face from reliance on resources/ dependencies to entities actions/ strategy to mitigate these risks and disclosed related current and anticipated financial effects **(ESRS 1.123 and IFRS S1.B43)**
- Explaining trade-offs between risks and opportunities faced when setting strategy **(IFRS S1.B44)**

Connecting interrelated quantitative and narrative information

- Linking quantitative via cross-referencing **(direct connectivity as per ESRS)** **(ESRS 1.124-125)**
- Linking quantitative information via reconciliation **(indirect connectivity as per ESRS)** **(ESRS 1.124-125)**
- Qualitative disclosures stating financial statements line items affected by disclosed risks and opportunities if unable to disclose quantitative current and anticipated financial effects **(IFRS S1.B40)**
- **NON-MANDATORY ELEMENTS BELOW**
- Not required, stakeholders have also suggested explaining why information cannot be connected (e.g., due to differing level of aggregation) could be useful
- Correlation and cause and effect links (voluntary practice, e.g., SAP past reports)

Other overarching aspects of connectivity

- **Consistency:** Consistent data, narrative/qualitative disclosures, assumptions and units of measurement (presentation currency) across SR and the financial statements **(ESRS 1.127-128 and IFRS S1.23)**
- **Coherence:** Presentation and disclosure of information within and across different corporate reports in a manner that gives a more complete picture of an entity's value creation while depicting the interrelatedness of the overall reported information **(Derived from IASB 2021 MCPS ED)** (same notion as complementarity)
- Disclosure and explanation of lack of consistency is an element of coherence

Connectivity at a point in time
(including current financial effects) (ESRS 2.48, IFRS S1.34-35)

vs

Intertemporal connectivity (over time)
(including anticipated financial effects (ESRS 2.48, IFRS S1.34-35) and disclosures that enable users to understand migration of items across reports over time- IFRS S1.B40-c)

Connectivity within a reporting period/across AR sections (**current financial effects**)

Connectivity across different reporting periods (**anticipated financial effects**)

CONNECTIVITY STRATEGIC DIMENSION

LINKING STRATEGY & BUSINESS MODEL TO REPORTING OUTCOMES

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Business model Inputs/Operating environment

- Sustainability matters (ESG) impacts, risks and opportunities (IROs)
- Resources, relationships and dependencies

Entity's actions/business model deployment

- Strategic actions (product and process innovation, new customers/markets, M&A, JVs, value chain alliances)
- Net-zero and other ESG commitments (e.g., purchase of carbon credits, RECs, PPAs)
- Investments (R&D, PPE)
- Operational policies
- Financing choices (e.g., sustainability-linked bonds, sustainability dedicated funds)

Material financial statement effects

- **STATEMENT OF FINANCIAL POSITION**
- Non-financial assets
- Financial assets
- Provisions
- Financial liabilities
- **STATEMENT OF FINANCIAL PERFORMANCE**
- Revenue
- Research and Development (R&D) expenses
- Share-based compensation (SBC) expense
- Other expenses (besides R&D & SBC)
- Taxes and subsidies
- **NOTES WITHIN FS**
- Disclosures related to line items
- Segment reporting

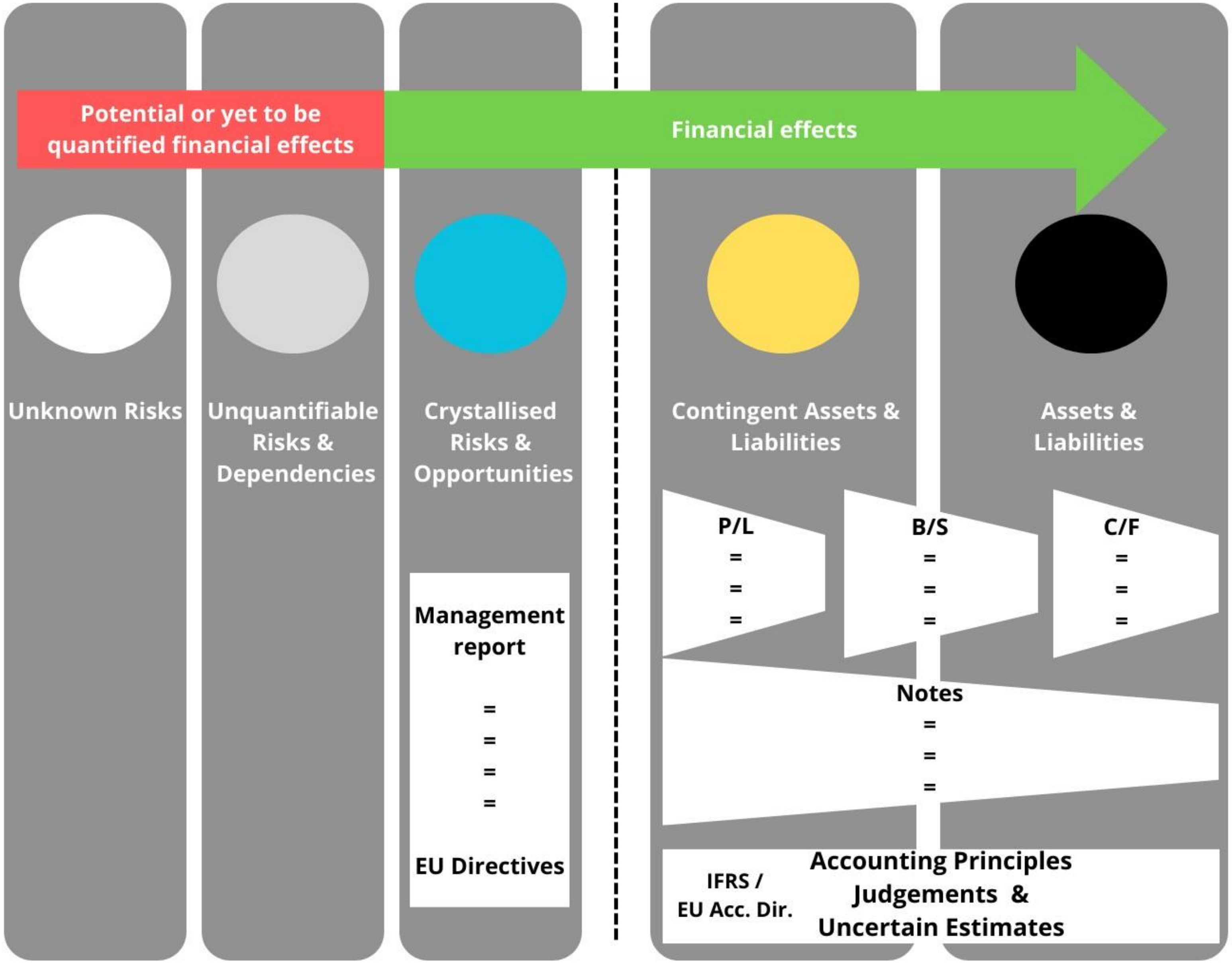
ESRS Sustainability statement with disclosures of strategy, business model, policies, IROs, metrics and targets, anticipated financial effects (with items material from impact and/or financial materiality perspectives); other information in management report (i.e., besides sustainability disclosures such as risk reports)

Connectivity – direct, indirect connectivity, consistency, and explanation of value creation and strategic relationships

Lack of connectivity due to financial statements recognition, measurement, presentation, disclosure criteria; differing scope/boundary, time horizon, and/or level of aggregation (gross representation in SR vs net in FS)

INTERTEMPORAL/DYNAMIC DIMENSION OF CONNECTIVITY

MIGRATION OF ITEMS (financial effects) ACROSS REPORTS/REPORTING PERIODS



Entity impacts; risks and opportunities; strategy& business model deployed (operational choices, risk mitigation and adaptation measures) have financial effects

Financial effects are reported across AR sections

Higher threshold of reporting financial effects in financial statements (e.g., a past event is needed)

DYNAMIC DIMENSION OF CONNECTIVITY: ANTICIPATED FINANCIAL EFFECTS

CURRENT vs ANTICIPATED FINANCIAL EFFECTS

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ANTICIPATED FINANCIAL EFFECTS IN SR DISCLOSURES: FUTURE-ORIENTED TIME HORIZON

Current reporting period

Short-term
Potential overlap/duplication of FS (IAS 1.125) disclosures and SR disclosures

Medium-term

Long-term

CURRENT FINANCIAL EFFECTS

Affecting current period primary financial statements line items+ disclosures

Guided by IFRS Accounting Standards, local GAAP

Recognition and measurement criteria of FS line items – **captures all time horizons (past & future)**

Current period financial performance and financial position

ESRS GLOSSARY DEFINITION OF ANTICIPATED FINANCIAL EFFECTS- Financial effects **that do not meet the recognition criteria for inclusion in the financial statement line items in the reporting period and that are not captured by the current financial effects.**

ESRS & ISSB REQUIREMENTS ON ANTICIPATED FINANCIAL EFFECTS

ESRS 2 *General requirements – Strategy & Business Model*-SBM-3, ESRS E1 *Climate Change*- E1-9 Metrics and Targets (material physical and transition risks), Other environmental topical standards

IFRS S1- Strategy; IFRS S2- Strategy, Metrics and Targets- Cross industry metrics

CURRENT FINANCIAL EFFECTS

Disclosures of assumptions and sources of measurement uncertainty affecting carrying values in next reporting period (IAS 1.125)

ANTICIPATED FINANCIAL EFFECTS- POINTS OF NOTE- 1/2

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Overlap/possible duplication, challenges- current vs anticipated financial effects

- Interaction with IAS 1.125 (i.e., requirements of disclosure on assumptions and sources of measurement uncertainty affecting carrying values within next reporting period)
- Possible challenge of distinguishing between anticipated vs current financial effects
- **Uncertainty of amounts** (i.e., due to existence/occurrence uncertainty and measurement uncertainty)

Possible reasons for non-disclosure of quantitative anticipated financial effects in current period SR

- Lack of separability from other risk factors
- Measurement uncertainty
- Systems, methodology and data availability constraints
- Immaterial long-term financial effects due to entity's mitigation/adaptation actions (e.g., **ESRS Materiality Assessment Implementation Guidance- Example in FAQ 9 see below**)

ANTICIPATED FINANCIAL EFFECTS- POINTS OF NOTE- 2/2

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Risks associated with new regulation only at play in the short-medium term, current portfolio of assets will be fully amortised in medium-term, and entity will have adapted new business processes and made investments to mitigate risk associated with new regulation.

→ **immaterial long-term financial effects**

Example on new regulation

A new regulation bans the use of microplastics within the production processes in the medium-term. The undertaking, using microplastics in its production, has identified a material risk from this issue in the short- and medium-term but not the long-term. The undertaking is adapting its production processes and investing ahead of the new regulation coming into effect.

Example on impaired assets

The financial effects of assets currently used that could become impaired in the long-term due to environmental changes could be not material as the assets will be fully amortised by the medium-term.

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EXAMPLES: CURRENT AND ANTICIPATED FINANCIAL EFFECTS

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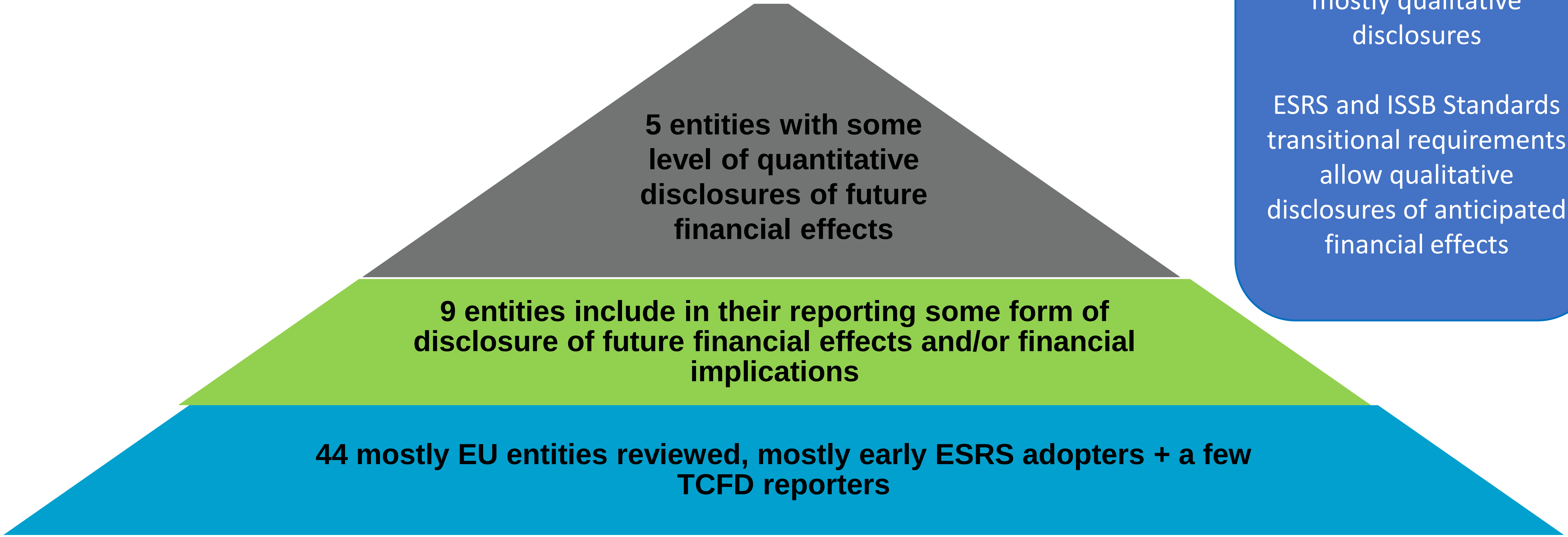
HEADLINE FINDINGS FROM PRELIMINARY REVIEW OF SAMPLE OF EARLY ESRS ADOPTERS+ FEW TCFD REPORTERS



At this stage, there are mostly qualitative disclosures

ESRS and ISSB Standards transitional requirements allow qualitative disclosures of anticipated financial effects

SWEDISH PROPERTY MANAGEMENT ENTITY CIRCUMSTANCES

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BUSINESS MODEL/ IROs/ACTIONS TAKEN

- Property management with 160 hotel properties in 12 European countries, the bulk are lease agreements, including with branded and unbranded hotels.
- Growing demand for eco-friendly and socially-responsible practices in the hotel and real-estate sector
- Many of entity’s assets are older assets with lower energy standards than new developments
- Stricter building EU laws from c2025 with zero energy requirements for all new buildings, Taxonomy regulation
- Entity has identified 7 areas of focus for sustainability including: **green properties; green operations; sustainable supply chains**
- *Actions/targets*: BREEAM certification of assets (80% of own operated hotels; and leased out properties); aims to reduce electricity consumption by 25%, gas by 20%, and water by 20% by 2030. Has 2.2 Billion CU in sustainability linked loans; 3.1% of capex & 5% of turnover is taxonomy aligned
- *ESRS double materiality assessment conclusion*: All 10 ESRS topic standards are material and that there are 24 material sustainability topics.

FINANCIAL EFFECTS

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Sustainability statement

Potential illustration of future effects albeit not categorised by company as ESRS Anticipated Financial Effects

	Risk/Opportunity	Indicator	Sensitivity analysis	Financial impact	Management
Physical risk	Higher electricity consumption due to increased ventilation, cooling etc. in Own Operations	Total electricity consumption per year (MWh)	Total electricity consumption increases by 10 percent compared with 2023	Electricity consumption increases by around 3,500 MWhin Own Operations	• Energy-efficiency improvements. • Investments in renewable energy, solar energy, geothermal heating, natural cooling etc.
	Higher electricity costs resulting from shortages, regulations, taxes etc. in Own Operations	Total energy cost per year (MSEK)	Cost of energy consumption increases by 50 percent compared with 2023	Electricity costs increase by around MSEK 50	
	Higher water costs in Own Operations	Total cost for water consumption (MSEK)	Cost of water consumption increases by 50 percent compared with 2023	Water costs increase by around MSEK 8	• Projects to improve water consumption efficiency
Transition risk	Decrease in value of buildings without environmental certification	Proportion of environmentally certified buildings	Decrease in market value of buildings wit-hout environmental certification	Reduced property value may have an impact on multiple factors, such as loan-to-value ratio and/or rents.	• Environmental certification of the property portfolio
	Regulations require investments in climate-smart technology	Cost of climate-related adaptations in the properties for air conditioning (MSEK)	The need for air conditioning increases for 10 percent of the portfolio	Climate adaptation costs increase by around MSEK 50	• Adding green provisions to leases with tenants
Opportunities	Increase in value of environmentally certified buildings	Proportion of existing buildings with envi-ronmental certification in Own Operations (12 buildings)	Market value of environmentally certified hotels increases by 10 percent	Around 1 percent increase in property value	• Environmental certification of the property portfolio and included in due diligence ahead of acquisitions
	Reduced energy costs through a higher proportion of energy produced internally in Own Operations	Proportion of electricity produced internally within the property portfolio (percent)	Proportion of electricity produced internally replaces proportion of purchased energy by 5 percent compared with 2023	Energy costs decrease by around MSEK 7, equivalent to 6 percent of total energy costs in 2023	• Investments in renewable energy • Energy efficiency improvements

The consideration/incorporation of scenario/sensitivity analysis information in anticipated financial effects disclosures is suggested by ESRS E1 and IFRS S1

No clear connection of quantitative disclosures to amounts in the financial statements, no mention of time horizon

PAPER AND PACKAGING ENTITY CIRCUMSTANCES

Material topics

Circular-Driven Solutions
- Circular economy
- Product quality and safety

Created by Empowered People
- Diversity, equity and inclusion
- Working conditions and human rights

Taking Action on Climate
- Climate change mitigation
- Climate change adaptation[1]
- Energy
- Biodiversity and fibre sourcing
- Water

Responsible Business Practices
- Business conduct[1]

Circular economy
- Opportunities: 1-2% revenue growth per annum; 85% to 100% recycled product profile by 2025

Climate action-
- Physical risk associated with forest assets
- Transition risk- fossil-fuel based plants are to be decommissioned, EU ETS, carbon taxes

FINANCIAL EFFECTS

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TCFD recommendations disclosures

Climate change in our financial statements

The impact of climate change is considered in the estimates of future cash flows used in the impairment assessment of goodwill, as detailed on pages 186-187. Climate change is, as detailed on page 188, included as a factor that impacts the conversion factor used in the assumptions for valuation of the Group's forestry assets and as a factor incorporated into the risk premium applied to mature and immature timber. Climate change was considered in the assessment of fair value of assets and liabilities acquired in business combinations, as detailed on page 202.

The Group accounting policies reflect the impact of climate change considerations in relation to the assessment of the residual values and estimated useful economic lives of property, plant and equipment, as detailed on pages 220-221, and in relation to the accounting policy applied for the valuation of forestry assets and the assessment of goodwill for impairment.

Climate change-related risks and opportunities

Climate change-related risks		Estimated financial impact (€m)	Timeframe			Scenario sensitivity		
			Short	Medium	Long	1.5°C	2°C	BAU
Physical risks	1. Higher wood procurement costs	90-180				●●	●●●	●●●●
	2. Risk of flooding	15-85				●	●●	●●●●
	3. South African plantation yield loss	15-20				●	●●	●●●
	4. Chronic changes in precipitation	10-15				●	●●	●●●
Transition risks	5. Energy supply costs	60-150				●●●●●	●●●●	●●
	6. GHG emissions regulatory changes (net impact)	30-85				●●●●●	●●●●	●●●
	7. Asset impairment risk	10-30				●●●●	●●●	●
Total climate change-related risks		230-565						
Climate change-related opportunities								
1. Changing customer behaviour		120-240				●●●●●	●●●●	●●
2. Reduced operating costs through energy efficiency		15-25				●●●●●	●●●●	●●
3. Sale of by-products		15-20				●●●●●	●●●●	●
Total climate change-related opportunities		150-285						

Anticipated onset of risk or opportunity

Estimated full impact of risk or opportunity

●●●●● High likelihood
●●●●
●●●
●●
● Low likelihood

Quantitative and qualitative disclosures: Financial effects climate change – related risks and opportunities, time horizon (Short-term is 3 years; medium 3-7 years; and long-term is 7+ years), likelihood, and potentially affected FS line items

FINAL THOUGHTS

SUGGESTED BROAD STEPS TO ENHANCE CONNECTIVITY AND CLARITY OF BOUNDARIES OF DIFFERENT AR SECTIONS