EFRAG Connectivity Project Draft Discussion Paper

Chapter 4: Application of connectivity in current reporting practices - Aggregated observations

1 *This chapter provides aggregated observations on the application of connectivity in current reporting practices based on a review of nearly 60 annual reports, feedback from outreach to stakeholders, and a review of external publications.*

Introduction

2 As part of its research project on connectivity, EFRAG has monitored and made observations on the extent to which connectivity is applied within current reporting practices. These observations have been aggregated and are based on the following:

(a) The review of the 2023 and 2024 annual reports of nearly 60 companies, which includes the 15 companies from which the 17 illustrations of connectivity in Chapter 3 were selected. It is acknowledged that the observations based on the illustrations are not generalisable to the reporting of companies. Generalisable findings on the trends in connectivity, including those available through academic studies, are still in the early stages of being developed and where these are available, we've referred to them;

(b) Feedback received from EFRAG's interviews with 15 stakeholders (53% of preparers, 20% of auditors and 27% of users) and a multi-stakeholder roundtable discussion (see report *Practical considerations for connecting financial and sustainability reporting*) held in April 2025; and

(c) The findings of thematic reviews of reporting practices in the publications of other organisations.

3 This paper is structured as follows:

(a) General comments;

(b) Connectivity mechanisms;

(c) Anticipated financial effects (intertemporal linkage); and

(d) Suggested questions to constituents to be included in the Discussion Paper.

General comments

4 *Connectivity journey is in early stages*: Overall, based on the review of nearly 60 annual reports, companies can be deemed to be in the early stages of their journey towards implementing connected reporting. This view has been conveyed in various fora, including during the April 2025 EFRAG roundtable event, where responses to a polling question showed that 52% of the participants considered that there was minimal improvement on connectivity in reporting over time (refer to Figure 1 in Chapter 3- agenda paper 04-02). Portrayals of the trends in connectivity are shown in some nascent academic studies including (a) a 2025 SFB/TRR paper which studied climate disclosure in financial statements, and (b) a large sample academic study on the level of connectivity across 787 European firms, which was done via a detailed review of both the sustainability reports and financial statements, and whose findings are in a 2025 working paper by Karlsonn, M.

5 *Connectivity is observed mainly in respect to climate-related matters*:

(a) Though ESRS encompasses sustainability-related matters related to environmental, social and governance topics, across the reviewed annual reports of nearly 60 companies, connectivity was mainly observed in respect of climate-related reporting. Hence, without prioritising climate-related reporting, only three of the 17 (18%) selected illustrations in Chapter 3 were not climate-related. This likely reflects the 'climate first' approach underpinning most of the available sustainability-related reporting frameworks and guidance (e.g., the IASB educational material, IASB ED examples on climate-related and other uncertainties in the financial statements, ISSB Standards, TCFD recommendations). Moreover, thematic reviews of reporting practices, including through the signalled enforcement priorities, and the reports of national standard setters and audit firms, have typically focused on climate-related reporting.

(b) During EFRAG's outreach discussions, preparers indicated that, from a connectivity perspective, it was generally easier for them to link climate-related information to financial statements compared to information on other sustainability matters, largely due to preparers having more practical experience with climate-related issues.

6 *Variation in the linkage of pre-identified financial statements and sustainability reporting anchor points*[1]*:* The objective of the EFRAG connectivity objective was to identify different aspects of connectivity (integration of information and coherence, consistency of narrative, data and assumption, and linkage of quantitative information (i.e., via direct and indirect connectivity as described in ESRS Set 1)) being applied for a selected set of anchor points, as discussed in Chapter 2. However, based on the reviewed annual reports of nearly 60 companies, it was challenging to find the related information in the sustainability reporting (e.g. related to the valuation of tangible and intangible non-financial assets, i.e., impairment, amortisation; useful economic lives; impairment (ECL) of financial assets for financial institutions;) to make the direct connection to some of these financial statements anchor points.

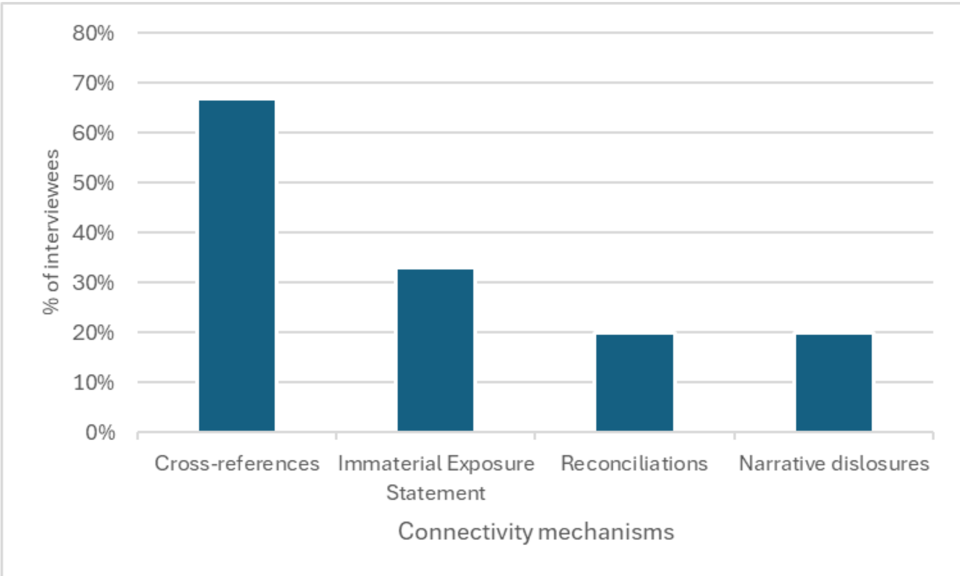
[1] Anchor points are data and/or qualitative or quantitative information that allows the connection of sustainability reporting disclosures and financial statements information

7 Conversely, it was also challenging to identify connected sustainability-related information related to the disclosure of sources of uncertainty in estimation of carrying value as per paragraphs 125 and 129 of IAS 1 *Presentation of Financial Statements* (paragraphs 31A and 31E of IAS 8 *Basis of Preparation of Financial Statements*), and the application of qualitative materiality assessment under paragraph 31 of IAS 1 (paragraph 20 of IFRS 18), based on the review of nearly 60 annual reports. We did not observe any instance in which there were disclosures under IAS 1.31 requirements (except for immaterial exposure statements as mentioned in paragraph 14 below). It was also challenging to find disaggregation of revenues under IFRS 15, and segment disclosures of material sustainability-related matters (see comment in paragraph 26 below).

Connectivity mechanisms

8 Based on EFRAG's outreach interviews with preparers, auditors and users, the most used connectivity mechanisms indicated by the stakeholders were the following:

Figure 1: Most used connectivity mechanisms



Positive observations on mechanisms of connectivity

9 Some *level of coherence and integration of information, importance of narrative explanations*: Illustrations on coherence were easily identifiable from the nearly 60 companies' annual reports, albeit there being variation in how companies describe their strategy, business models, IROs (see paragraph 22 below on IROs), actions, and targets; and the linkage made of these aspects to financial statements' effects. For instance, six out of the 17 connectivity illustrations in Chapter 3 reflect coherence between financial statements and sustainability reporting information. At the same time, as noted in paragraph 21(a), the financial implications of the entity's sustainability-related actions were often not quantified, which posed a challenge to the coherence of information across reports. Stakeholders in EFRAG's outreach emphasised the importance of coherence across financial statements and sustainability reporting for the reader to see how different parts interrelate. Moreover, stakeholders indicated that narrative information helped to provide context and link financial and non-financial information. Users viewed them as beneficial, particularly when used alongside reconciliations and/or quantitative information.

10 *Well-specified time horizon disclosures (as part of the communication of strategy and business model)*: Related to the above paragraph, all 15 companies, from which the 17 illustrations in Chapter 3 were drawn, had a clear specification of what is meant by short-, medium-, and long-term. This helped to contextualise the reported financial effects and other quantitative data in both the sustainability report and financial statements.

11 *Consistency of information identified*: Illustrations of the consistency of quantitative data, assumptions, and narrative information were easily identifiable. This is unsurprising given the emphasis on consistency that pre-dated the inclusion of mandatory connectivity requirements, and as it is also a focus of assurance. Relatedly, in the ESMA 2024 Report on Corporate Reporting Enforcement and Regulatory Activities, based on a sample of 27 entities, 77% of the reviewed entities provided qualitative and/or quantitative disclosures regarding material climate-related matters within financial statements and the management report, non-financial statement or (where applicable) the prospectus. There were no significant inconsistencies identified between the assumptions used in estimations and measurements related to climate matters applied, either within the financial statements or across the different parts of the annual report.

12 *Cross-referencing is the most commonly used connectivity mechanism currently applied*: EFRAG's outreach feedback indicated that the most used connectivity mechanism is cross-referencing, as indicated by 67% of the interviewees. The interviewees viewed cross-referencing, when used appropriately[2], as a pragmatic method for avoiding duplication across different report sections. The outreach findings are confirmed by the 2025 EY CSRD Barometer, whereby incorporation by reference was found to be applied by 99% of the entities studied[3]. Similarly, a large sample academic study on the level of connectivity by 787 European firms, whose findings are in a working paper by Karlsonn, M, showed that cross-referencing occurred in 42% of the observations (i.e. over a two-year period).

13 *Illustration of direct and indirect connectivity through the EU taxonomy investment-related disclosures*: Across the reviewed annual reports of nearly 60 companies, there were numerous cases of EU taxonomy investment-related disclosures that were linked to the financial statements via cross-reference or reconciliation. Though seemingly common, it is noted that, under the revised ESRS Exposure Draft, cross-referencing via direct and indirect connectivity (including those related to EU taxonomy investments) is proposed to be optional. 20% of the interviewees from EFRAG's outreach explicitly considered reconciliations helpful in aligning financial and sustainability data, despite frequent challenges caused by differences in reporting methodologies and structures.

14 *Immaterial-exposure statement disclosures*: These were readily identifiable in the annual reports reviewed, and they are a point of discussion among stakeholders, as shown below.

(a) 33% of the stakeholders from EFRAG's outreach considered the immaterial-exposure statements to be useful, even though some preparers did not consider this mechanism to be the most appropriate, as there was a risk of being generic and covering non-material information or irrelevant information (for example,

[2] For example, when providing sufficient narrative or context

[3] Mandatory metrics and information were included in other parts of the annual reports. A referencing of SBM-1 and GOV-1 to 4 disclosure requirements was noted.

misleading users to interpret immaterial data as material). These statements were frequently observed in the reviewed annual reports.

(b) An academic study (Agrawal, Bayne, Hellman, and Wee, 2025)[4] (hereafter referred to as Bayne et al, 2025) that reviewed the 2022 reporting of a sample of 80 entities (including 20 entities from the EU) found that there was an immaterial-exposure disclosure in 19% of the companies.

15 *Navigation tools, including ESRS content indexes and dedicated sustainability-related (mostly climate-related) notes in the financial statements*: Though not included in the illustrations in Chapter 3, these were included in several annual reports to help with the navigability across different parts of annual reports. Relatedly, a few entities presented a concise summary of topics (usually in a tabular format) that intersect information in the financial statements and the sustainability statement or the rest of the management report.

16 *Explaining what cannot be connected, including explanation of similarities or differences in the scope of financial statements and sustainability statement/disclosures*: Across all 15 companies, from which the illustrations of connectivity in Chapter 3 were excerpted, there were dedicated notes explaining the boundaries between the sustainability statement and the financial statements. These were useful to understand the different scopes of consolidation of the information reported in different parts of the annual report.

17 Moreover, based on the reviewed annual reports of nearly 60 companies, there were observed cases of companies explaining the differences in assumptions applied for the financial statements' asset impairment versus those for the potential asset impairment in the scenario analysis disclosed outside the financial statements.

18 There were also cases where the sustainability disclosure had more granular information than the financial statements (e.g. loans that were subject to physical risks). In these cases, the disaggregated information was material in the context of the sustainability report, and a similar level of disaggregation in the financial statements would likely risk obscuring other material information.

19 *Some insightful governance disclosures (connectivity in process)*: For eight of the 15 companies from which the illustrations were drawn, there were disclosures about the governance structure showing the different responsibilities, at the management and operational level, for managing sustainability matters. EFRAG’s outreach has indicated that these disclosures are useful for investors as they give comfort that sustainability-related risks are being well managed by the entity.

Considerations to enhance connectivity

20 Chapter 5 has a broader examination of considerations to enhance connectivity, including that gleaned from the feedback from constituents. Below are some considerations based on the review of the annual reports of nearly 60 companies, from which the 17 illustrations were drawn.

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[4] Agrawal. P., Bayne. L., Hellman. N., and Wee. M., 2025. Connectivity and Boundaries of Climate-related disclosures in Annual Reports. Academic IAAER-KPMG Academic Research Working Paper. University of Western Australia, Stockholm School of Economics, and Australian National University.

21 *Some way to go in ensuring holistic communication:* From the illustrations reviewed, there is some way to go in ensuring holistic communication that allows readers to link strategy, IROs, entity actions and reported metrics and financial effects. For instance:

(a) *Limited quantification of financial effects:* In general, in the sustainability reporting, there was limited quantification of the financial implications of actions, including commitments, investments, even when these had financial statements' effects.

(b) *Investment disclosures:* Investment disclosures (including the taxonomy disclosures) rarely shed light on the entity's strategic objectives and its net-zero commitments. Moreover, these disclosures are often not adequate to assess the return on invested capital by the company, which users have signalled would also be useful for them.

(c) *Reporting on research and development (R&D) expenditures:* In the sustainability disclosures, it was challenging to identify narrative or quantitative information about the sustainability-related R&D investments that were not recognised as assets, presented as a separate line item in the income statement or disclosed in the notes to the financial statements.

22 *Varied quality in the reporting on IROs:* Based on the annual report review of nearly 60 companies, there was varied quality in the reporting on IROs, and in some cases, for material topics identified, there were generically worded risks and opportunities. That said, it is discernible that the sustainability standards are helping in getting common terminology (e.g., IROs, description of materiality). Entity-specific, clear, concise IROs that are linked to potential financial effects would be helpful.

23 *Challenges with cross-referencing were noted*:

(a) *Uninformative cross-referencing*: Based on the review of the possible illustrations of connectivity, there was uninformative mutual cross-referencing (i.e., sustainability reporting disclosures which refer to a specific note in the financial statements and that note in turn only stated that it considered the sustainability reporting disclosures).

(b) EFRAG's outreach with stakeholders acknowledged the following challenges:

(i) *Excessive referencing:* This, particularly when lacking methodological clarity, could confuse rather than provide clarity.

(ii) *Lack of cross-referencing resulting in duplication*: Cross-referencing between the sustainability statements, financial statements and other reports has been seen as complicated. This is because there may be duplication of sustainability-related information in the financial statements, as cross-referencing under IFRS Accounting Standards is generally limited.

24 *What cannot be connected:* In only two of the 17 illustrations did material sustainability matters get depicted in the segment disclosures. Similarly, a large sample academic study on the level of connectivity by 787 European firms, whose findings are in a working paper by Karlsonn, M, showed that sustainability matters were only disclosed in 1% of the observations (i.e. over a two-year period).

25 *Reporting boundaries*: Based on the review of the connectivity illustrations, there may be a misinterpretation of sustainability metrics due to the application of different

organisational reporting boundaries for sustainability statement/disclosures and financial statements – some sustainability metrics are calculated based on mixed data coming from both financial reporting and sustainability reporting. For instance, GHG intensity = GHG emissions (SR info)/ Revenue (FR info). This metric has a different scope of consolidation for financial statements and sustainability reporting purposes (under ESRS Set 1, which is currently under revision).

Anticipated financial effects (intertemporal linkage)

26 Where applicable, the observations on anticipated financial effects are based on ESRS Set 1. Currently, there is a revision of ESRS, and this topic is under review, and more comprehensive feedback from stakeholders will be obtained from ESRS ED feedback. In this regard, it is noted that during EFRAG's outreach, users and several other stakeholders have indicated that the disclosures of anticipated financial effects in the sustainability statement/disclosures are useful for the analysis of the companies' prospects and risk profile. Users have noted that even if this type of disclosure is currently rare, if disclosed by a reporting entity, they can use it to engage with the management of the reporting entity's competitors.

Considerations on anticipated financial effects

27 Based on the review of nearly 60 annual reports, disclosures on anticipated financial effects are rare due to transitional provisions under ESRS[5] and ISSB Standards.

28 For illustrations which had some disclosures on anticipated financial effects, the following is noted:

(a) *Incoherence with current period financial statements:* For some illustrations, there was a disconnect between the significant amounts portrayed in the anticipated financial effects disclosure reflecting short, medium and long-term and the company concurrently conveying that there were no material effects in the current period financial statements.

(b) *Understandability of information*: There was unclear terminology being used, and it was difficult to gauge the methodology used to quantify the numbers and/or whether the effects related to future balance sheet items, expenses, cash items or non-cash items; or whether they refer to maximum exposure or expected value of the financial impact.

Suggested questions to constituents to be included in the Discussion Paper

29 The following are suggested questions to constituents based on Chapter 4:

(a) whether constituents agree with the aggregated positive observations and considerations for enhancing connectivity; whether other aspects should be considered, e.g. cost vs benefits of providing the information (paragraphs 4 to 28);

[5] In their first reporting year, companies will be allowed to omit reporting on anticipated financial effects from all climate and other environment-related impacts, risks and opportunities.
Companies may limit their disclosures on anticipated financial effects to qualitative disclosures for the first three years of reporting (with limited exceptions and, in the case of climate-related financial effects only if it is impracticable to prepare quantitative disclosures).

(b) suggestions on how to address the considerations (paragraphs 20-25 and 27-28) ; and

(c) How is the connectivity of reported information within the annual report used in users' analyses?

Questions for EFRAG FR and SR TEG

30 Do you have any comments on the Chapter 4 content above? Please explain.

31 Do EFRAG FR and SR TEG members have any comments on the proposed questions to constituents in paragraph 29 above, or have any additional questions to ask the constituents? Please explain.