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EFRAG research project on connectivity- Discussion Paper Draft content

PROPOSED DRAFT CHAPTER 5

CONSIDERATIONS FOR ENHANCING THE CONNECTIVITY OF REPORTED INFORMATION AND RELATED ASPECTS

As detailed in Chapter 4, feedback from EFRAG’s outreach¹, along with EFRAG’s review of reporting practices and the findings of several other published thematic reviews of reporting practices, affirmed the importance of the connectivity of the information reported in the annual report while concurrently showing that there is still some way to go before connected reporting becomes a mainstream feature of reporting.

Building on the findings in Chapters 3 and 4 (illustrations and aggregated observations of connectivity in practice), and drawing from the feedback obtained during EFRAG’s outreach, this Chapter primarily provides conceptual considerations for enhancing the connectivity of information across different annual report sections (i.e., financial statements, sustainability statement/disclosures, other parts of the management report, etc.) and related aspects (e.g. further clarifying the borders/differentiating features of the financial statements).

Overview- Considerations for enhancing the connectivity of reported information and related aspects

- 1 In broad terms, the lack of connectivity of information across different annual report sections (i.e., financial statements, sustainability statement/disclosures, other parts of the management report- also referred to as ‘different reports’) could be related to:
 - (a) information that would be reasonably expected to be reported within and connected across different reports during a reporting period, yet this is not the case. For example, if material investments related to sustainability-related risks and opportunities are reported in the sustainability statement/disclosures, but without corresponding information on either the asset capitalisation or expense or impairments in the financial statements.
 - (b) a lack of connectivity of information across different reports during the reporting period due to the distinctive nature of the information within different reports. For example, due to materiality judgements made in the context of the financial statements’ objectives and recognition criteria, certain sustainability-related information (e.g., future period capital commitments) may be reported in the sustainability statement/disclosures but not in the financial statements. Any

¹ This includes feedback obtained during a) the meetings of the EFRAG CAP, the EFRAG FR and SR pillar technical governance bodies, and EFRAG’s advisory working groups (EFRAG IAWG, EFRAG FIWG, EFRAG User Panel, and EFRAG CFSS); b) EFRAG’s outreach interviews and EFRAG’s [April 2025 multi-stakeholder webinar](#). Stakeholders’ feedback was also obtained during EFRAG’s presentations of the 2024 EFRAG Connectivity project’s initial paper, *Connectivity Considerations and Boundaries of Different Annual Report Sections*.

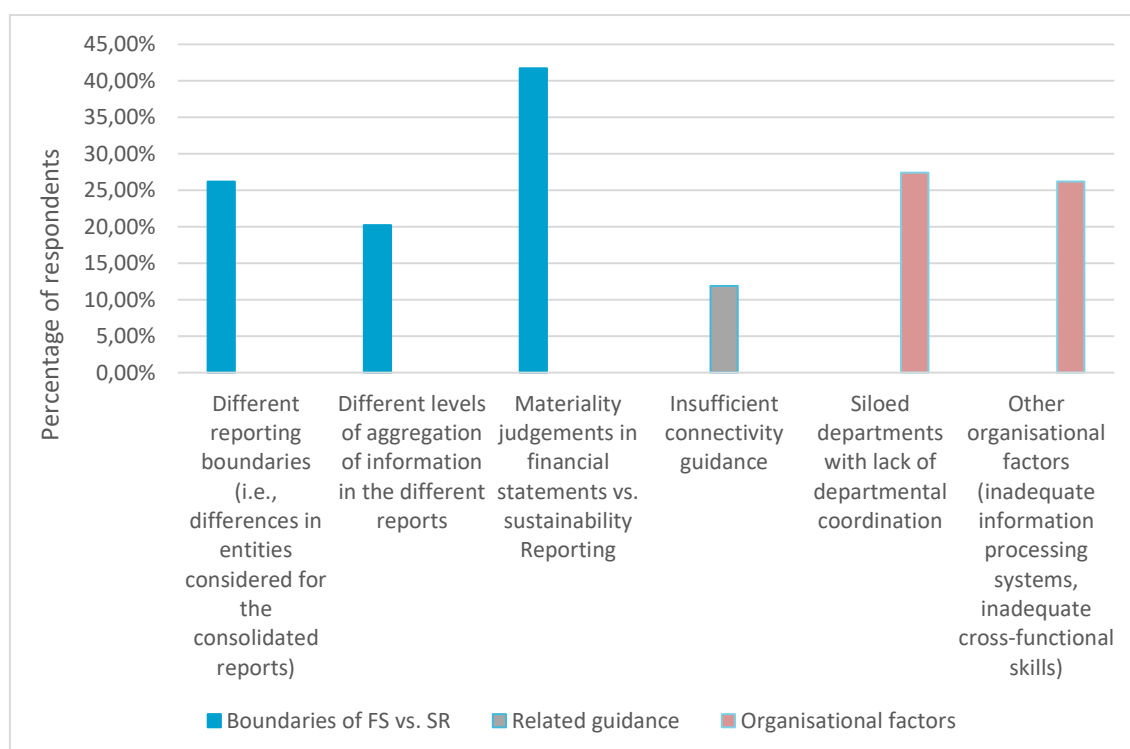
expectations of connectivity during the reporting period under these circumstances would reflect an ‘expectation gap’, which can be best addressed through educational material.

- 2 In providing considerations for enhancing connectivity, this chapter distinguishes between where connectivity of information across different reports would be reasonably expected but is absent (i.e., paragraph 1a) and where connectivity of information across different reports should not be expected due to the distinctive nature of information within the different reports (i.e., paragraph 1b).
- 3 Because the ESRS requirements, including its connectivity requirements and non-mandatory guidance, are under revision, this Chapter does not focus on providing any possible alternatives or suggestions for reviewing sustainability reporting requirements. However, the Chapter provides considerations to stimulate further feedback from stakeholders on aspects of possible enhancement to connectivity and related aspects.

Connectivity-enhancing considerations

- 4 During EFRAG’s outreach to stakeholders, views were sought on where challenges in the connectivity of information across reports may arise. Figure 4.1 below outlines the aspects that were identified and the indicative (not generalisable) level of concern expressed by stakeholders.

Figure 4.1: Stakeholders’ views on sources of connectivity challenges



- 5 As noted in Chapter 4, during EFRAG’s outreach, the required disclosure of anticipated financial effects under ESRS Set 1 and ISSB Standards also surfaced as a point of attention. However, the expectations that were expressed by stakeholders about this disclosure are not analysed any further in this Chapter. As noted in Chapter 2, based on the Revised ESRS ED proposals, the related requirements may change. And broader stakeholder feedback to the ED on this disclosure requirement will be considered, and corresponding decisions thereafter made by the EFRAG SRB.

Related aspect: Further clarifying borders/differentiating features of financial statements

- 6 Across several IASB projects², circumstances have arisen where, in responding to consultative documents, stakeholders have called for further clarification of the borders/differentiating features of financial statements (see **paragraphs 12 to 32** below).
- 7 *Interaction between borders of different reports and connectivity:* Further clarifying the definition of borders/differentiating features of different reports is related to connectivity of reported information, because how the borders/differentiating features of different reports are defined may affect the ease/difficulty of connecting information across different reports. Specifically;
- (a) it will help avoid unnecessary duplication of information across different reports, and, as noted in Chapter 2, this is an enabler of the connectivity of reported information.
 - (b) it can help identify any information gaps³ that need to be addressed within different reports for the benefit of users. In turn, addressing information gaps could result in more connected information across reports.
 - (c) it can lessen the expectation gaps among stakeholders on what ought to be reported and connected across reports. In this regard;

² For instance, the IASB ED on *Climate-related and Other Uncertainties in the Financial Statements*, the 2024 IFRS IC agenda decision on climate-related commitments, the IASB ED on Business Combinations- Disclosure, Goodwill and Impairment (BCDGI), and the IASB research project on intangibles.

³ For instance, a question of possible gaps arose in respect of disclosure of environmental liabilities. The EFRAG SR pillar’s Secretariat reviewed relevant academic literature and conducted a desktop review of the reporting of environmental and decommissioning liabilities by a sample of Oil and Gas companies. Their analysis showed that the reviewed companies did not disclose the triggering event of the decommissioning provisions, the disclosure of the estimated retirement date was missing, and it was difficult to identify the asset for which an asset retirement obligation or decommissioning provision is recognised. Concurrently, the enacted sector-agnostic ESRS do not require this information. This raised the question of whether these disclosures should be considered as part of IAS 37 *Provisions* requirements.

- (i) some stakeholders expect that the financial statements recognition criteria ought to be amended to allow reporting externalities/impacts, including climate-related impacts (e.g. GHG emissions), and uncontrolled resources, including nature-related intangibles/resources⁴ within the financial statements. And there are nascent initiatives⁵, which conceptualise the possible monetisation and inclusion of impacts/externalities and uncontrolled resources within the financial statements. That is, the current borders of the financial statements are perceived to be “too narrow” by some stakeholders.
- (ii) conversely, there has been a concern voiced by some stakeholders about what they perceive to be the “stretched” current borders/differentiating features of the financial statements (e.g., disclosing information in the notes to the accounts because such information is deemed useful to investors even when not related to the defined assets, liabilities, income, expenses, and equity). In effect, these stakeholders expect the disclosure of information in the financial statements/notes to the accounts that is only related to the defined assets, liabilities, income, expenses, and equity (this concern was raised on the proposed disclosure of business combinations post-acquisition performance and expected synergy information in the financial statements- see **paragraphs 27 to 29**). Yet, other stakeholders expect that, in certain circumstances, certain sustainability-related forward-looking information ought to be disclosed in the notes to the accounts (see **paragraphs 33 to 45**).

8 The financial statements, management report/commentary, and sustainability statement/disclosures have distinctive and complementary objectives, and these different reports are complementary parts of the corporate reporting system. Nonetheless, a particular focus on further clarifying borders/differentiating features of financial statements is appropriate because, relative to other annual report sections, there is a higher threshold for including information in the financial statements (i.e. under the recognition criteria for financial statements; a past event is required, only resources controlled by the reporting entity are reported on, and the measurement and existence

⁴ Capitals coalition has a “[Nature on Balance Sheet Initiative](#)” and had a 2020 publication ‘[Improving nature’s visibility in financial accounting](#).’

⁵ Cohen, R and Serafeim, G. 2020, How to Measure a Company’s Real Impact, Harvard Business Review <https://hbr.org/2020/09/how-to-measure-a-companys-real-impact>. Stakeholders have shared examples of initiatives in certain jurisdictions on how to monetise and incorporate CO2 into financial reporting standards (e.g., expenses and carbon liabilities). The 2021 EFRAG PTF-NFRS publication Chapter lists several other experimental initiatives.

uncertainty of the items being reported on is considered). In addition, there is a longer tradition of reporting, reasonable assurance is required, and there is a more established primary audience for financial statements. These factors could perhaps explain the expectations from some stakeholders (outlined in paragraph 7c-i) that more information should be reported in the financial statements than is currently the case under IFRS accounting requirements (i.e. expectation gap related to the reported financial statements information).

- 9 Relatedly, as noted in Chapter 1, an IASB staff agenda paper⁶ signalled that, at a future agenda consultation, the IASB may seek stakeholders' views on whether it should conduct a joint project with the ISSB. Such a project may include: a framework, such as a conceptual framework addressing connected reporting; clarifying borders/differentiating features between different general purpose financial reports; and covering sustainability reporting. This DP can influence this potential IASB-ISSB joint project.

Summary of Chapter 5's focus points

- 10 In sum, based on the feedback from EFRAG's outreach and the discussions held within EFRAG, the following considerations for enhancing the connectivity across reports and related aspects are further analysed in this chapter:
- (a) **Consideration 1: Clarifying the borders/differentiating features of financial statements:** This aspect is further detailed in **paragraphs 12 to 32**.
 - (b) **Consideration 2: Distinguishing the application of financial materiality in financial statements and sustainability reporting.** This aspect is related to clarifying the borders/differentiating features of financial statements and is further analysed in **paragraphs 33 to 45** with a focus on climate-related commitments.
 - (c) **Consideration 3: Assessing implications of differences in level of aggregation or disaggregation:** The analysis in **paragraphs 46 to 53** reviews considerations arising from the differing levels of aggregation or disaggregation.
 - (d) **Consideration 3: Assessing the implications of the differences of organisational reporting boundaries between financial statements and sustainability reporting** (i.e. entities, operations, and assets reported on). The Revised ESRS ED proposals further align the reporting boundary of sustainability reporting to that of the financial statements. Hence, the analysis in **paragraphs 54 to 57** is limited to a

⁶ [ap24-4ac-proposed-approach.pdf](#)

review of the implications for the connectivity of reported information, of any remaining⁷ differences in the respective financial statements' and sustainability statement/disclosures' organisational reporting boundaries.

- (e) **Consideration 5: Enhancing connectivity in process** (including governance within organisations). As noted in Chapters 1 and 2, 'connectivity in process' contributes to the connectivity of reported information. During EFRAG's outreach, stakeholders have underscored the importance of and the steps that could enhance 'connectivity in process', as detailed in **paragraphs 58 to 60**.
- (f) **Consideration 6: Exploring digitisation.** Currently, the conversation about connectivity is largely framed through the lens of PDF reports. The analysis in **paragraphs 61 to 66** provides considerations for digitisation based on structured data provision and AI developments, which could foster connectivity of reported information.

- 11 Besides the above, it is noted that both the June 2024 EFRAG connectivity publication and the February 2025 ANC-France report called for the alignment/connectivity in the auditing of financial statements and the assurance of the sustainability statement. This aspect is not further analysed because audit/assurance is beyond the scope of this Discussion Paper.

Further analysis of considerations for enhancing connectivity and related aspects

Consideration 1: Further clarifying the definition of the borders/differentiating features of financial statements

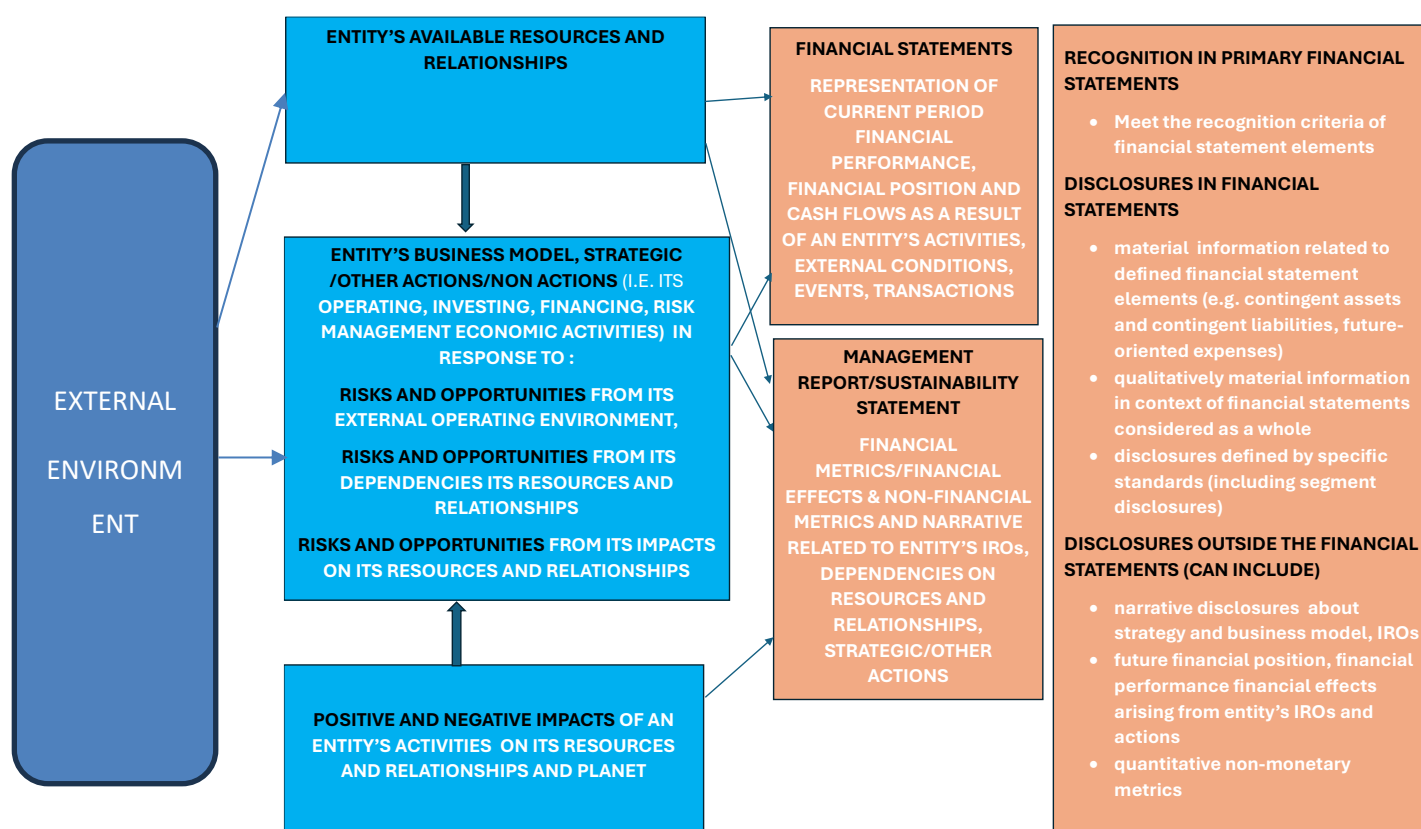
Overview

- 12 As noted earlier, further clarifying the borders/differentiating features of financial statements can help to shape expectations on the reporting and connectivity of information across different reports.
- 13 As a backdrop to the analysis of borders/differentiating features of different reports, the diagram below (Figure 4.2) outlines the interplay between an entity's reported information and its
- (a) available resources and relationships,

⁷ Under Revised ESRS ED proposals, immaterial subsidiaries with material IROs will be in the scope of consolidation of metrics disclosed in sustainability reports based on ESRS.

- (b) impacts,
- (c) strategy, business model, actions in response to the risks and opportunities that arise from its external environment,
- (d) strategy, business model, actions in response to the risks and opportunities that arise from its dependencies on its available resources and relationships, and
- (e) strategy, business model, actions in response to the risks and opportunities that arise from its impacts on its resources and relationships.

Figure 4.2 Factors influencing reporting outcomes



Source: EFRAG⁸ - Reporting outcomes (including financial effects reported within and outside the financial statements) are depicted in beige-coloured boxes.

⁸ Below is a definition of some of the terms applied in Figure 4.2: An **entity's external environment** encompasses: (a) its direct environment—the industries and markets in which the entity interacts with its customers, suppliers, and competitors; and (b) the wider environment including the legal, regulatory and economic environment; the political, technological, social and cultural landscape; and the natural environment (Sourced from 2025 MCPS).

Resources and relationships. These include human, intellectual, financial, natural, manufactured, and social resources and relationships, and they can span across an entity's own operations (e.g. financial, intellectual property, manufacturing), upstream and downstream value chain (e.g. social), and external environment (e.g. natural) (Source: November 2024 ISSB educational material).

Dependencies- How an entity directly or indirectly depends on resources and relationships to generate future cash flows (Source: November 2024 ISSB educational material).

Dimensions of the borders/differentiating features of different reports (AR sections)

14 Different literature⁹ (standard setters', audit firms', and academic literature¹⁰) identifies the following differentiating dimensions of the information within different annual report sections (and with a summary diagram- Figure 4.3 below and the respective requirements in Appendix A):

- (a) *Nature of information*, for instance, non-monetary metrics would primarily be reported outside the financial statements; there is greater emphasis on narrative information in sustainability statement/disclosures relative to financial statements, and strategy, business model, and governance disclosures would typically be disclosed outside the financial statements.
- (b) *Different materiality perspectives* are applied for information in the financial statements and the sustainability statement/disclosures. For financial statements (where materiality is gauged relative to defined elements of financial statements- assets, liabilities, income, expenses, and equity) and sustainability reporting information (where materiality is gauged relative to an entity's/undertaking's IROs) (see Appendix 1, for further analysis of the materiality requirements for the financial statements, sustainability statement/disclosures and rest of management report).
- (c) *Differences in recognition criteria for the reporting of* transactions, events, and conditions. Notably, the occurrence of a 'past event', having control of resources, and meeting a threshold of occurrence/existence and measurement certainty are required for the recognition of information in the primary financial statements or disclosure of contingent liability or contingent asset in the notes to the financial statements. Hence, sustainability-related risks that are expected to result in future cash outflows¹¹ may fail to meet the criteria for recognition as provisions or

⁹ The publications considered include: the 2024 EFRAG Connectivity Project's initial paper, the [2021 PTF-NFRS report](#), the IAASB's Proposed International Standard on Sustainability Assurance ISSA 5000 related definition, and academic literature (Girella, 2018; Bayne, 2022).

¹⁰ Bayne (2022) outlines 10 dimensions that define boundaries of different reports include: the **reporting entity** (extent of financial versus sustainability control/influence); **b) target users** (extent of investor versus wider stakeholder focus); **c) materiality** (extent of financial versus impact materiality); **d) extent of entity-wide versus topic boundary definition**. For instance, the GRI evolution of boundary rules from an entity-wide boundary concept (akin to financial reporting) to a topic-specific concept; **e) impact** (external versus inward impact); **f) outward impact** (extent of direct versus indirect outward impacts); **g) time horizon** (extent of historic versus future focus); **h) performance** (extent of financial versus sustainability focus); **i) value** (extent of entity versus wider stakeholder value focus); and **j) purpose of report/disclosure**.

¹¹ Taking into account the three criteria for recognising provisions under IAS 37 (i.e., present obligation as a result of past events, probable outflow of economic resources and reliable measurement), the 2021 EFRAG PTF-NFRS

disclosure as contingent liabilities. And sustainability-related opportunities¹² without a 'past event' do not qualify to be recognised as assets or disclosed as potential revenue in the financial statements.

- (d) *Organisational reporting boundary* (i.e. entities, operations, and assets reported on) (see Chapter 2 and Paragraphs 54-57).
- (e) *Differences in presentation/level of aggregation between financial statements and the sustainability statement/disclosures* (see paragraphs 46 to 53 for further analysis).
- (f) *Application of accrual principle and preparation of summary/aggregated primary statements*: As outlined in an academic paper (Wagenhofer¹³, 2023), unlike for financial statements, in mandatory sustainability reporting, there is no 'stocks and flows' representation of information, and the accruals principle for the intertemporal allocation of amounts is not applied. There are also no mandated summary statements with aggregated line items (akin to the primary financial statements).
- (g) *Time horizon covered* (e.g. extent of orientation towards forward-looking or retrospective information in a report, and extent of coverage of anticipated financial effects).
- (h) *Extent to which forward-looking information is incorporated*: Both financial statements and sustainability reporting have forward-looking estimates. However, financial statements information is primarily focused on the future consequences of past actions on existing assets and liabilities, whereas sustainability-related information also encompasses future consequences of future actions. That said, financial statements' information can also reflect future consequences of future actions (e.g., goodwill impairment tests that necessitate estimates of the terminal

connectivity publication concluded that the low likelihood of obligations from sustainability-related matters plays a hand in their failure to meet the IAS 37 present obligation criteria. There is also the challenge of establishing that there is an obligation to transfer economic resources (i.e., probable outflow of economic resources) for many sustainability-related circumstances.

The 2021 EFRAG PTF-NFRS publication observed that there could be an increased reporting of sustainability-related risks as liabilities if more legal/regulatory measures were taken and created obligations (e.g., pricing of negative externalities similar to the EU ETS, adoption of mandatory Human Rights Due Diligence on human rights and environment, and prohibition of activities with above-threshold GHG emissions).

¹² Potential assets could be a) the economic value of potential reuse of materials (circular economy); and b) the potential future economic value from sustainability-related research and development activities that are not recognised as intangible assets.

¹³ Alfred Wagenhofer (2023), Sustainability Reporting: A Financial Reporting Perspective, Accounting in Europe.

value of groups of cash-generating units. Another example would be the incorporation of future, committed restructurings in the value-in-use calculation.

Figure 4.3: Comparison of different AR sections (EU corporate reporting)

Financial statements (FS) (Source: Conceptual Framework)	Management report (Source: EU Accounting Directive)	Sustainability statement (Source: EU Accounting Directive and ESRS)
<p>Reflects financial position, financial performance at reporting date (present assets and liabilities)</p> <p>Primary audience of financial capital providers</p> <p>Includes information material to FS users</p> <p>Recognition depends on financial control, separability of items, existence/occurrence and measurement uncertainty considered</p> <p>Reporting entity- entities in scope of consolidation depend on financial control</p>	<p>Reflects entity's performance, position and development; it is traditionally a part of <u>general purpose financial reporting with financial materiality perspective</u></p> <p>Under CSRD, management report can be deemed to be part of <u>general purpose sustainability reporting</u></p> <p>Provides description of principal risks and uncertainties</p> <p>Primary audience is knowledgeable user</p> <p>Implicit that it has same reporting entity as FS</p>	<p>It is a section of the management report</p> <p>Discloses entities' sustainability impacts, risks and opportunities</p> <p>Discloses financial effects of IROs in short, medium and long term</p> <p>Audience of stakeholders including investors and other users with interest in entity's impacts on planet and economy</p> <p>Financially and/or impactfully material information included</p> <p>Same reporting entity as FS, consideration operational control in calculation of environmental metrics</p>
<p>Observations</p> <ul style="list-style-type: none"> - 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) 		

Source: 2024 EFRAG Connectivity Considerations and Boundaries of Different Annual Report Sections

Areas where questions on the borders/differentiating features of financial statements have arisen

- 15 Within EFRAG and amongst stakeholders, discussions on the borders/differentiating features of financial statements have been held in relation to the appropriate placement of information related to a set of identified, specific grey areas (i.e., areas where information could be both in the sustainability statement/disclosures and the financial statements) outlined below. Further clarification by standard setters is needed for the location, information content, and connectivity of information of these grey areas
- (a) sustainability-related intangibles, which are a subset of unrecognised intangibles (i.e. intangible resources that are not recognised as assets in the statement of financial position). The analysis below highlights two of the illustrations of connectivity in Chapter 3 are related to sustainability-related intangibles. That said, some stakeholders have signalled the need for a better depiction of the financial implications of sustainability-related intangibles, and this may call for a rethink of whether to have the disclosure of information on these intangibles in the financial statements (see paragraphs 16 to 25 below);

- (b) business combinations' strategic performance and synergies, where there have been questions of why it is being proposed to have certain forward-looking information in the financial statements (see paragraphs 27 to 29 below);
- (c) triggers of migration over time of items from the management report and/or sustainability statement/disclosures into the financial statements (see paragraphs 29 to 31 below); and
- (d) climate-related commitments. This aspect is separately addressed under consideration 2 (see paragraphs 32 to 44 below). There are other aspects where borders questions arise (information on carbon credits, power purchase agreements) that are not further addressed in this Chapter.

Reporting of sustainability-related intangibles

General placement considerations for intangibles

- 16 **Statement of financial position recognition:** IAS 38 *Intangible Assets* specifies the definition and recognition criteria for recognising an intangible resource as an intangible asset as follows:
- (a) *Definition of an intangible asset:* An intangible resource is an intangible asset if it is identifiable¹⁴, the entity has control over the resource, and there are future economic benefits (IAS 38. 10-17).
 - (b) *Recognition criteria of an intangible asset:* An intangible asset shall be recognised if, and only if: it is probable that the expected future economic benefits that are attributable to the asset will flow to the entity; and the cost of the asset can be measured reliably (IAS 38. 21).
- 17 **Statement of financial performance and goodwill recognition:** If an item within the scope of IAS 38 does not meet the definition of an intangible asset, expenditure to acquire it or generate it internally is recognised as an expense when it is incurred¹⁵. However, if the item

¹⁴ IAS 38.10 states that an asset is identifiable if it either:

(a) is separable, ie is capable of being separated or divided from the entity and sold, transferred, licensed, rented or exchanged, either individually or together with a related contract, identifiable asset or liability, regardless of whether the entity intends to do so; or

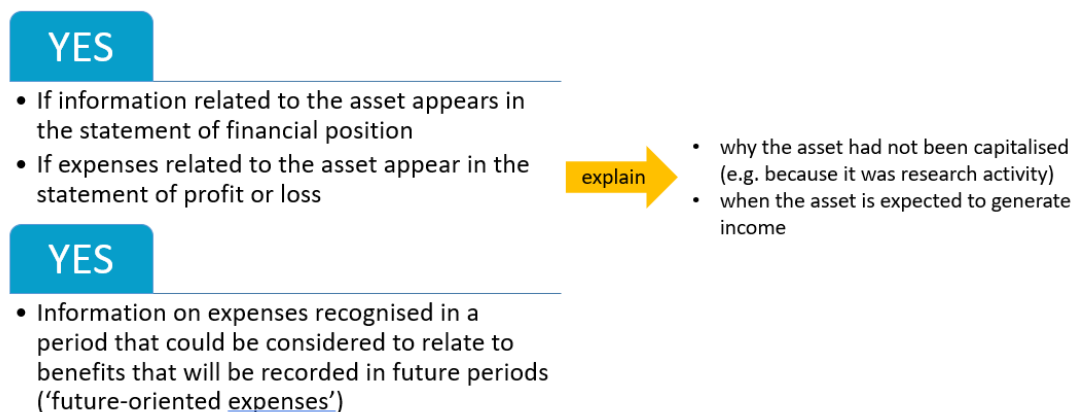
(b) arises from contractual or other legal rights, regardless of whether those rights are transferable or separable from the entity or from other rights and obligations.

¹⁵ IAS 38.69 provides examples of expenditure that is recognised as an expense when it is incurred, and these include: a) expenditure on research (except when it is acquired as part of a business combination); b) expenditure on start-up activities (ie start-up costs), unless this expenditure is included in the cost of an item of property, plant and equipment

is acquired in a business combination, it forms part of the goodwill recognised at the acquisition date (IAS 38.10).

- 18 **Disclosures in financial statements:** IAS 38.118-127 outlines detailed disclosure requirements related to intangible assets. IAS 38. 128-b encourages but does not require a brief description of significant intangible assets controlled by the entity but not recognised as assets because they did not meet the IAS 38 recognition criteria.
- 19 **Location of unrecognised intangibles:** In response to EFRAG’s 2021 EFRAG Discussion Paper¹⁶ *Better Information for Intangibles*, stakeholders provided mixed feedback¹⁷ on what they considered to be the appropriate location for the disclosure of unrecognised intangibles (i.e., resources that are not recognised as intangible assets on the statement of financial position).
- 20 Figures 4.4 and 4.5 below represent the views that were subsequently expressed on the placement of unrecognised intangibles during discussions held by EFRAG’s technical governance bodies and working groups. It is noted that these views have not been previously published as official EFRAG positions.

Figure 4.4 Should intangibles (assets or resources), including those that are sustainability-related, be disclosed in the financial statements?



in accordance with IAS 16; c) expenditure on training activities; d) expenditure on advertising and promotional activities (including mail order catalogues); and e) expenditure on relocating or reorganising part or all of an entity.

¹⁶ EFRAG 2021, [Better information on intangibles - Which is the best way to go?](#)

¹⁷ EFRAG 2023, [Better information on intangibles- Which is the best way to go?- Recommendations and Feedback Statement](#). In response to question 9 on the placement of information, 8 of 22 comment letter respondents suggested unrecognised intangibles should be disclosed outside the financial statements, several comment letter respondents supported having these disclosures in the financial statements, and several respondents favoured having disclosures of both recognised and unrecognised intangibles in one location.

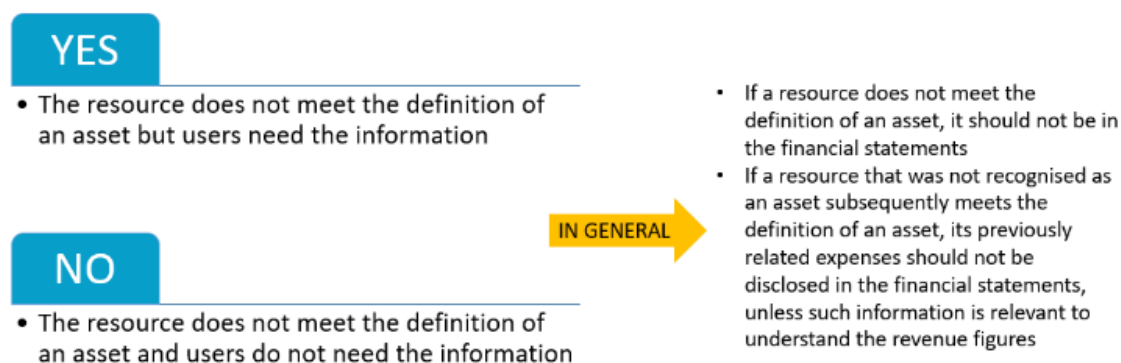
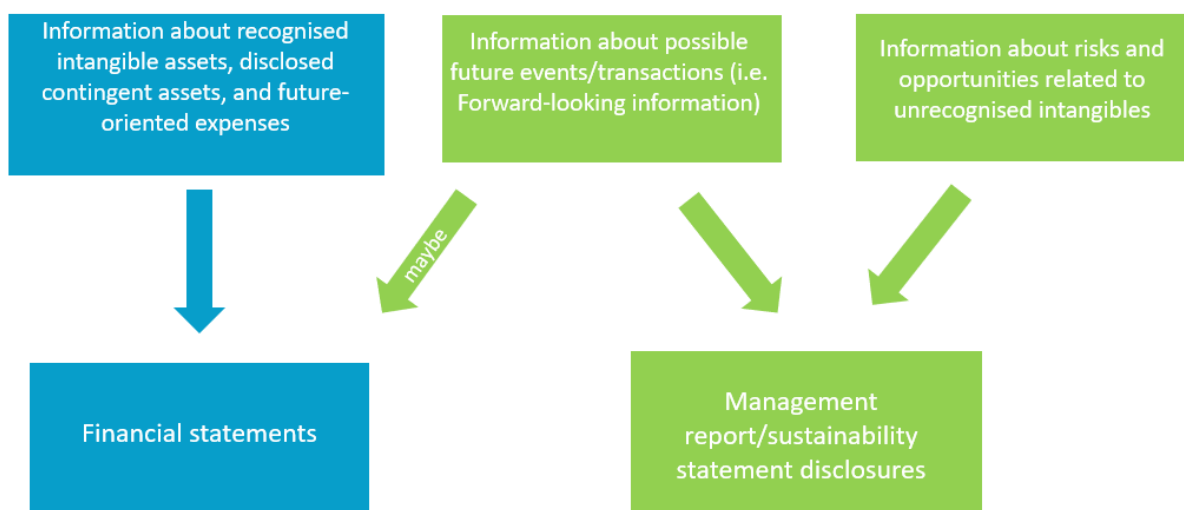


Figure 4.5: Synthesis of placement considerations



21 In effect,

- if a resource does not meet the definition of an asset, it should not be disclosed in the financial statements except when useful for users¹⁸
- information on 'future-oriented expenses' should be disclosed in the financial statements if it relates to benefits of future periods (e.g., this could be for sustainability-related research and development expenditures on carbon capture technologies that are not recognised as assets).

¹⁸ This is consistent with paragraph 3.6-b of the Conceptual Framework for Financial Reporting

Sustainability-related intangibles reporting and connectivity implications

- 22 Sustainability-related intangibles include human capital/resources and relationships (own workforce and value chain workforce), relational and social capital, and intellectual and organisational capital.
- 23 The requirements of different reports in respect of sustainability-related intangibles, which have a bearing on the connectivity of related information across different reports, are analysed below. Information related to these intangibles would primarily be in the management report and/or sustainability statement/disclosures, but there could be information related to these intangibles that is presented and/or disclosed in the financial statements.
- (a) **Sustainability reporting/management report guidance**: Within the EU, Recital (32) of the EU Accounting Directive notes that certain information on intangible resources is intrinsic to sustainability matters, and should therefore be part of sustainability reporting, and it provides examples¹⁹ that illustrate how, in some cases, it is not possible to distinguish information on intangible resources from information on sustainability matters. This point was also made in the 2021 EFRAG Discussion Paper *Better Information for Intangibles- Which way to go?* And the 2021 EFRAG PTF-NFRS report²⁰.
- (b) Article 19 (1) of the EU Accounting Directive²¹ requires entities to disclose in the management report how key intangible resources underpin business models and drive the entity's value creation, and this necessitates a distinction between sustainability-related intangibles and other intangibles. Under sustainability reporting requirements, consonant with recital 32 of the Accounting Directive, the disclosure of sustainability-related intangibles is encompassed within several ESRS topical standards, including ESRS- S1 *Own Workforce*, S2 *Workers in the Value Chain*, S3 *Affected Communities* and S4 *Consumers/End Users*.

¹⁹ For example, information about employees' skills, competences, experience, loyalty to the undertaking and motivation for improving processes, goods and services, is sustainability information regarding social matters that could also be considered as information on intangible resources. Likewise, information about the quality of the relationships between the undertaking and its stakeholders, including customers, suppliers and communities affected by the activities of the undertaking, is sustainability information relevant to social or governance matters that could also be considered as information on intangible resources.

²⁰ [Proposals for a Relevant and Dynamic EU Sustainability Reporting Standard Setting](#)

²¹ Undertakings shall report information on the key intangible resources and explain how the business model of the undertaking fundamentally depends on such resources and how such resources are a source of value creation for the undertaking.

- (c) Internationally, the ISSB has an ongoing research project to possibly develop requirements for the disclosures of human capital as part of the sustainability-related financial disclosures. With respect to the management commentary, the June 2025 IASB MCPS, which is voluntary guidance, includes disclosure requirements for resources and relationships (i.e., sustainability-related, intangibles, and other resources and relationships) as one of the content elements.
- (d) **Financial statements:** The 2021 EFRAG Discussion Paper *Better Information for Intangibles- Which way to go?* and EFRAG's 2021 PTF-NFRS publication on connectivity: *Interconnection between Financial and Non-Financial Information*²² pointed to the limitations of IFRS requirements (IAS 38 and IFRS 3) in respect of reporting human capital, organisational capital and relationship capital. For example, even if a company can identify the incremental staff skills derived from training, which lead to future economic benefits, the company is unlikely to have sufficient control over the attributable expected future economic benefits and therefore, under IAS 38, the company cannot recognise an asset. The same can be concluded for customer relationships²³ unless there has been an exchange transaction. It is also noted that, under IFRS 3 requirements, the value of an acquired assembled workforce is subsumed into the recognised goodwill amount because it is not separately identifiable.
- (e) The above observation does not mean there is no information related to sustainability-related intangibles reported in the financial statements. Notably, a January 2025 ISSB staff paper²⁴ highlights instances in which the application of IFRS accounting standards might result in information directly relating to human capital-

²²https://www.efrag.org/sites/default/files/sites/webpublishing/SiteAssets/EFRAG%20PTF-NFRS_A4_FINAL.pdf

²³ In the absence of legal rights to protect, or other ways to control, the relationships with customers or the loyalty of the customers to the entity, the entity usually has insufficient control over the expected economic benefits from customer relationships and loyalty for such items (e.g., portfolio of customers, market shares, customer relationships and customer loyalty) to meet the definition of intangible assets.

However, if there are exchange transactions for the same or similar non-contractual customer relationships (other than as part of a business combination), it will provide evidence that a) the entity is able to control the expected future economic benefits flowing from these customer relationships, and b) that these customer relationships are separable, and meet the definition of an intangible asset.

²⁴<https://www.ifrs.org/content/dam/ifrs/meetings/2025/january/issb/ap3a-ap4-ifrs-accounting-standards-presentation-disclosure-bees-human-capital.pdf>

related matters being presented or disclosed in the financial statements. For instance,

- (i) IAS 24 *Related Party Disclosures*, where an entity is required to disclose key management personnel compensation in total and by several subcategories, including short-term employee benefits, post-employment and other long-term benefits, termination benefits, and share-based payments (IAS 24.17).
- (ii) IAS 19 *Employee Benefits*, workers health and well-being is linked to employee benefits provided by employers, and IAS 19 has requirements for the disclosure of employee benefit expense, contributions to and expense for defined contribution plans, and characteristics, risks, financial statement amounts of defined benefit plans as well as how these plans may affect the amount, timing, and uncertainty of an entity's future cash flows (IAS 19.25, 53,54, and 135).
- (iii) IAS 37 *Provisions, Contingent Liabilities and Contingent Assets*, for example, this may be related to legal proceedings initiated by employees for wrongful treatment, or severance payments to employees when restructuring.
- (iv) IFRS 2 *Share-based Payment*, where an entity is required to describe each type of share-based payment arrangement and to disclose information that enables users of financial statements to understand the effect of share-based payment transactions on the entity's profit or loss for the period and on its financial position (IFRS 2.45 (a) and IFRS 2.50).
- (v) IFRS 3 *Business Combinations* requires the qualitative description of the factors that make up goodwill, including intangible assets that do not qualify for separate recognition (e.g., an acquired assembled workforce, whose value is not separately identifiable and thus any value attributed to it is subsumed into goodwill (IFRS 3.B37).

24 In sum, whether to disclose information on sustainability-related intangibles in either the financial statements, sustainability statement/disclosures, or the rest of the management report will ultimately depend on the objectives of these different reports. For example, staff training expenses can be informative in respect of human capital (which is not recognised as an asset in the statement of financial position as it is not separately identifiable), and in the sustainability statement/disclosures, for users to assess whether the company is actively training on anti-corruption or other sustainability-related matters.

25 **Implications for connectivity and views on the borders of the financial statements:**

Although the IASB's intangibles project is currently scoped to address financial statements requirements only, unrecognised intangibles may be considered at a later stage. Nonetheless, it has been observed that, for companies that are intangibles-resource-intensive (e.g., pharmaceutical companies), there is largely narrative information in the front part of the annual report, which cannot be readily linked to the single expense line item in the financial statements. Hence, this has led some stakeholders to suggest that information on unrecognised intangibles should be reported within the financial statements. Or, if such information is disclosed outside the financial statements, it should be better linked to the financial statements.

26 Of note, the connectivity illustrations 3 and 5 included in Chapter 3 are related to the connectivity of information on sustainability-related intangibles disclosed in both the sustainability disclosures and financial statements. These illustrations relate to:

- (a) a technology consultancy firm whose share-based payments disclosed in the financial statements are linked to ESG performance factors disclosed in the sustainability disclosures, and
- (b) a forestry company that discloses in the sustainability statement that there is no material legal exposure related to its workers' human rights.

Disclosure of business combinations' strategic performance and expected synergy information

27 This aspect is briefly addressed in this Chapter because the considerations of connectivity and the debate of the location of information outside the financial statements are applicable to other annual report sections besides the sustainability statement/disclosures. In response to the IASB's Exposure Draft (ED) on Business Combinations-Disclosures, Goodwill and Impairment (IASB BCDGI ED), which was published in 2024, several stakeholders (including EFRAG) expressed concerns about the proposal for the disclosure of the strategic post-acquisition performance and expected synergy from business combinations in the financial statements. In summing up the feedback to the ED, a March 2025 IASB staff agenda paper²⁵ noted that stakeholders had concerns, including that such information was

²⁵ [ap18a-conceptual-analysis.pdf](#)

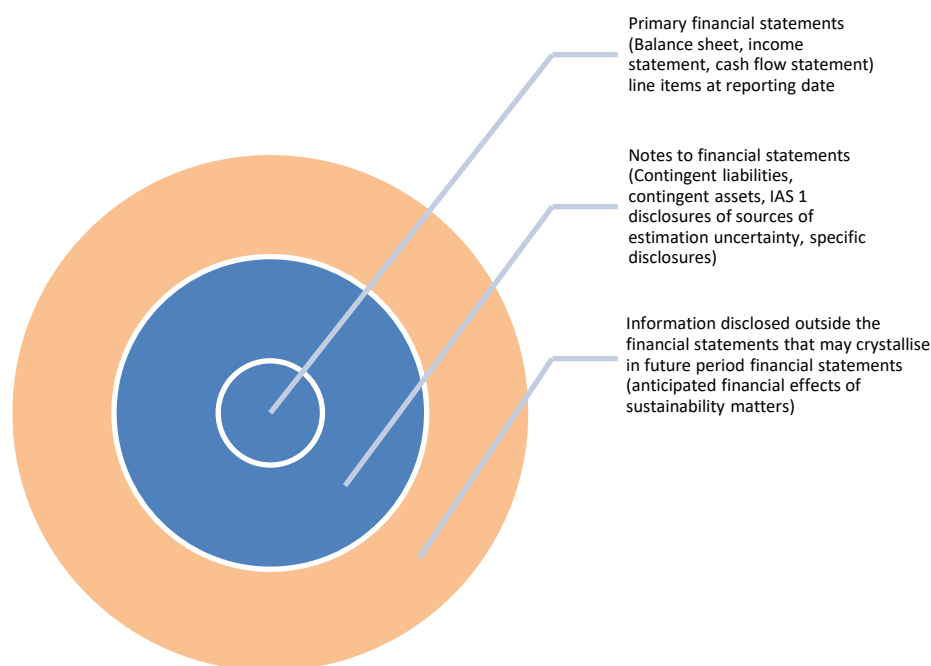
- (a) forward-looking information (by some jurisdictional definitions), and this could result in litigation risk;
 - (b) commercially sensitive;
 - (c) not related to the defined assets, liabilities, income, or expenses; and
 - (d) financial statements cannot provide all the information users need.
- 28 Discussions held at EFRAG during the IASB's redeliberation on the feedback to the ED, it was observed that similar performance information was not required for other acquisitions, and it was questioned why this information was needed for business combinations. A view was expressed that non-financial information did not belong in the financial statements, and in some jurisdictions, some information (e.g., workforce-related information) was prohibited from public disclosure until regulatory requirements were met.
- 29 On the other hand, the aforementioned IASB staff agenda paper indicates that the disclosure of forward-looking information in the financial statements cannot be precluded. The IASB staff note that it is not uncommon²⁶ for IFRS Accounting Standards to require entities to disclose expected or possible future transactions or events based on information available at the reporting date (hedge-accounting related risk disclosures and going concern disclosures).

Possible future period migration of items from other parts of the annual report into the financial statements

- 30 Chapters 2 and 3 highlight the dynamic/intertemporal dimension of connectivity. In this regard, as depicted in Figure 4.5, items disclosed in the annual report outside the financial statements (e.g., the sustainability statement/disclosures and other parts of the management report) may crystallise in the financial statements in future periods (e.g., at a future date, a commitment disclosed in the management report may become either a disclosed contingent liability or recognised provision).

Figure 4.5 Schema of possible financial effects in future reporting periods

²⁶ For example, IFRS 7.21A requires an entity to disclose information about risk exposures for which the entity hedges and applies hedge accounting, which according to IFRS 9.6.3.1 could include forecast transactions



- 31 As a result, the consideration of the borders/differentiating features of financial statements likely has to encompass the consideration of a) items that may crystallise in the financial statements in future periods, and b) indicators of migration of items from other parts of the annual report into the financial statements.
- 32 For instance, this could be in respect of what an academic working paper²⁷ refers to as intangible liabilities, which is a bit of a misnomer, as all liabilities are by definition intangible liabilities (i.e. there are no tangible liabilities). The working paper characterises the so-called ‘intangible liabilities’ as potential, unrecognised liabilities, and they include pending or potential lawsuits; product warranties; infringement of contracts, copyrights, or patents; environmental liabilities (e.g., due to hazardous wastes and pollution); and pending investigations. For instance, firms face or could face lawsuits from: (i) competitors for infringements of patents or copyrights; (ii) communities regarding environmental matters, pollution, and waste management; (iii) regulators for violating laws; and (iv) (a group of) individuals for being injured (financially or personally) because of using the company’s products or services.

²⁷ Boustanifar. H. and Verriest. A., 2023, Intangible Liabilities, Working Paper, EDHEC Business School and KU Leuven https://papers.ssrn.com/sol3/papers.cfm?abstract_id=4543436

Consideration 2: Distinguishing the application of financial materiality in the context of sustainability reporting and financial statements for climate-related commitments

33 Consideration 2 is related to consideration 1 (clarifying the borders/differentiating features of the financial statements). For background purposes, in the Appendix there is a recap of the materiality perspectives under the EU reporting framework and IFRS general purpose financial reports.

Should material climate-related commitments/transition plan-related information be disclosed in the financial statements?

34 As conveyed by the 2025 IASB COUFS set of illustrative examples, [2019 IASB educational article](#) and [\(updated in a 2023 IASB educational article- Effects of climate-related matters in the financial statements\)](#), IFRS Accounting Standards (i.e. both general requirements and specific standards) do not have explicit²⁸ requirements for entities to either report material climate-related and other uncertainties (including other sustainability-related uncertainties) in the financial statements²⁹.

²⁸ This was stated in the 2019 IASB education article by Nick Anderson and the 2023 update.

²⁹ Below is a non-exhaustive list of requirements related to climate-related matters:

- (a) IAS 1: This Standard includes overarching disclosure requirements for information not presented elsewhere in the financial statements but is relevant for their understanding. Entities will therefore need to consider whether to provide additional disclosures to enable investors to understand the impact of climate-related matters on the company. In addition, climate-related matters may give rise to estimation uncertainty and other significant judgements made.
- (b) IAS 2: The selling price of inventories or their completion cost.
- (c) IAS 12: Estimates of future taxable profits and the recognition of deferred tax assets.
- (d) IAS 16/38: Climate-related matters may prompt expenditure to adapt operations (including R&D). They may affect the recognition of costs as assets and estimations pertinent to residual values and useful lives of assets.
- (e) IAS 36: Estimates of recoverable amounts, impairment assessment for assets and goodwill, impairment indicators, and disclosures of key assumptions leading to the recognition of impairment.
- (f) IAS 37: The recognition, measurement and disclosure of liabilities, the nature of provisions or contingent liabilities; and any uncertainties on the timing or amount of outflows of economic benefits.
- (g) IFRS 7: The nature and extent of risks and the concentration of market risk for types of financial instruments.
- (h) IFRS 9: Climate-related contractual terms may affect the classification and measurement of financial instruments and the measurement of expected credit losses (ECL).
- (i) IFRS 13: Fair value measurement of assets and liabilities and related disclosures.
- (j) IFRS 17: Assumptions used to measure insurance contract liabilities and disclosures about significant judgements and risk exposure.

- 35 Moreover, the April 2024 IFRIC agenda decision³⁰ clarified that a public statement on climate-related commitments would only be a constructive obligation if it created a valid public expectation. Thereafter, a provision would only be recognised or a contingent liability disclosed if there is a ‘past event’ and an expected outflow of economic resources. However, this agenda decision did not address other possible related disclosures (i.e., besides contingent liabilities). Hence, the below analysis only focuses on whether forward-looking climate-related commitments should be disclosed in the financial statements. And this is not intended to reignite a discussion about whether a provision should be recognised in the statement of financial position, or contingent liabilities disclosed in the notes.
- 36 Related to the fact pattern considered for April 2024 IFRIC agenda decision, it is noted that, in response to this agenda decision’s consultative documents, stakeholders made suggestions for enhancing disclosures on a) management’s assumptions and b) information about capital expenditure projects required to fulfil climate-related commitments and capital already committed to purchasing assets to fulfil those commitments. Moreover, during EFRAG’s outreach in 2024, users indicated that the disclosure of a time series of likely costs would be useful even if such commitments do not qualify to be recognised as provisions or disclosed as contingent liabilities.
- 37 The 2025 ANC report on climate reporting highlights the type of significant investments that could be related to climate change mitigation. For instance, this could be
- (a) capital commitments related to energy efficiency,
 - (b) renewal of transport fleets with alternative fuels,
 - (c) development of carbon-capture and storage technologies, and
 - (d) investment in renewable energy or nuclear infrastructure.
- 38 The 2025 ANC report and feedback from EFRAG’s outreach highlighted the challenges in determining Capex and Opex. Among other reasons, these terms are not defined within IFRS Accounting Standards and/or the related amounts are not necessarily incorporated into the impairment tests.

View supporting disclosures of forward-looking climate-related commitments in the financial statements

- 39 Stakeholders supporting disclosures of forward-looking climate-related commitments have argued that this should be done based on the IFRS Accounting general disclosure

³⁰ Fact pattern addressed by the April 2024 IFRIC agenda decision: 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.

requirements (Paragraph 31 of IAS 1 [Paragraph 20 of IFRS 18]) and paragraph 3.6-b of the Conceptual Framework for Financial Reporting, which requires consideration of whether information is useful for users.

- 40 Paragraph 31 of IAS 1 [Paragraph 20 of IFRS 18] requires an entity to consider whether to provide additional disclosures when compliance with the specific requirements in IFRS Accounting Standards is insufficient to enable users of financial statements to understand the effect of transactions and other events and conditions on the entity's financial position and financial performance. Relatedly, in its comment letter response to the 2024 IASB COUFS ED, EFRAG acknowledged that paragraph 31 of IAS 1 (paragraph 20 of IFRS 18) is an essential requirement within IFRS accounting literature, as it can be applied to ensure the reporting of material information in the financial statements (including in the context of connectivity) that is not required by specific IFRS accounting requirements as was the case with the IASB ED Example 1³¹ (statement of immaterial exposure³²).
- 41 Stakeholders supporting disclosures of climate-related commitments have argued that if information is material in the context of financial statements, it ought to be disclosed regardless of whether similar information is disclosed outside the financial statements (e.g., management report or sustainability statement/disclosures). Several of these stakeholders, including national standard setters,³³ have voiced a concern that a qualitative materiality assessment, which considers investor expectations on what ought to be

³¹ Fact pattern- 2024 IASB COUFS ED Example 1: The entity is a manufacturer that operates in a capital-intensive industry and is exposed to climate-related transition risks. To manage these risks, the entity has developed a climate-related transition plan. The entity discloses information about the plan in a general purpose financial report outside the financial statements, including detailed information about how it plans to reduce greenhouse gas emissions over the next 10 years. The entity explains that it plans to reduce these emissions by making future investments in more energy-efficient technology and changing its raw materials and manufacturing methods. The entity discloses no other information about climate-related transition risks in its general purpose financial reports.

The entity concludes that its transition plan has no effect on the recognition or measurement of its assets and liabilities and related income and expenses because: (a) the affected manufacturing facilities are nearly fully depreciated; (b) the recoverable amounts of the affected cash-generating units significantly exceed their respective carrying amounts; and (c) the entity has no asset retirement obligations. There are no required disclosures under specific IFRS Standards (IAS 16, IAS 36 and IAS 37). As users would reasonably expect impact on the financial statements, applying IAS 1.31, the entity discloses its transition plan has no effect on its financial position and financial performance and explains why.

³² In applying paragraph 31 of IAS 1 [paragraph 20 of IFRS 18], the entity determines that additional disclosures to enable users of financial statements to understand the effect of the announced regulation on the entity's financial position and financial performance would provide material information. That is, omitting, misstating or obscuring this information could reasonably be expected to influence decisions that primary users of the entity's financial statements make on the basis of those financial statements.

³³ See a) AASB, October 2023, [Auditors' Perspectives: The Impacts of Materiality Practice Statement 2- Making Materiality Judgements](#); this report notes that anecdotal evidence from audit partners, and academic research, reveal the materiality concept to be applied by report preparers and auditors largely in a mechanical fashion, without the sufficient nuance or systemic context required to appropriately make materiality judgements that provide decision-useful information to report users, and b) [UKEB September 2023 report](#)

material information, is not always sufficiently done during the preparation of financial statements.

View against disclosures of climate-related commitments in the financial statements

- 42 Other stakeholders³⁴ have noted that applying paragraph 31 of IAS 1 (paragraph 20 of IFRS 18) to include disclosures on climate-related commitments would be too liberal an interpretation of this general disclosure requirements (e.g., by focusing on what is missing at a line-item level instead of assessing materiality by viewing financial statements holistically) and such an application would stretch the boundaries of the financial statements and likely result in unnecessary duplication of information reported outside the financial statements (i.e. sustainability statement/disclosures or other parts of the management report).
- 43 These stakeholders were of the view that paragraph 31 of IAS 1 (paragraph 20 of IFRS 18) ought to be only invoked in specific circumstances, and it should not be a way of capturing broad topics. Some of them opined that this requirement should only relate to transactions, events and conditions affecting the current financial position and financial performance, and not to possible future financial position and financial performance items.

Concluding thoughts on the disclosure of forward-looking climate-related commitments

- 44 As shown above, there are mixed views on the application of paragraph 31 of IAS 1 (paragraph 20 of IFRS 18). That said, some level of clarification of the application of this paragraph has been provided by the 2025 IASB illustrative examples, where it is stated that this paragraph is only applied after stepping back and considering materiality in the context of the entire financial statements and not on a line-item basis. Nonetheless, some stakeholders have called for related application guidance because a) clarification should not be primarily done through illustrative examples; b) the illustrative example relates to a disclosure that there is no quantitatively material exposure, and there may still be a need for application guidance related to when qualitatively-material incremental information is disclosed. Other stakeholders have called for less emphasis on location and more emphasis on connectivity of related information. That said, the location of information result in different information content as materiality is determined in the context of the objective of different reports.

³⁴ April 2024 IFASS meeting ([see report page 69](#)).

45 Finally, it is noted that, for Chapter 3's illustrations of connectivity, disclosures based on paragraph 31 of IAS 1 (paragraph 20 of IFRS 18) were considered as an anchor point and related examples were sought after. However, from the review of a sample of 72 companies' reports and several other thematic reviews of reporting practices, there were no observed examples of this paragraph being applied. It is nonetheless not possible to infer that this implies the underreporting of material climate-related information after considering qualitative materiality.

Consideration 3: Assessing the implications of differences in the level of aggregation or disaggregation of financial statements and sustainability reporting

Requirements for aggregation or disaggregation in the Financial Statements and Sustainability Disclosures/Statement

46 For both the financial statements and sustainability reporting, as outlined below, there are overarching requirements to aggregate information based on similar characteristics, disaggregate based on dissimilar characteristics, and ensure that the aggregation and disaggregation do not obscure other material/relevant information. Below is a high-level summary of the aggregation and disaggregation requirements under IFRS Accounting Standards, ISSB Standards and ESRS.

- (a) *IFRS Accounting Standards:* As described in paragraph 41 of IFRS 18 *Presentation and Disclosure in Financial Statements*, in the primary financial statements, the financial statement elements are classified³⁵ and aggregated³⁶ into items based on shared characteristics, and items are disaggregated based on characteristics that are not shared. The entity's aggregation and disaggregation of items is to present line items

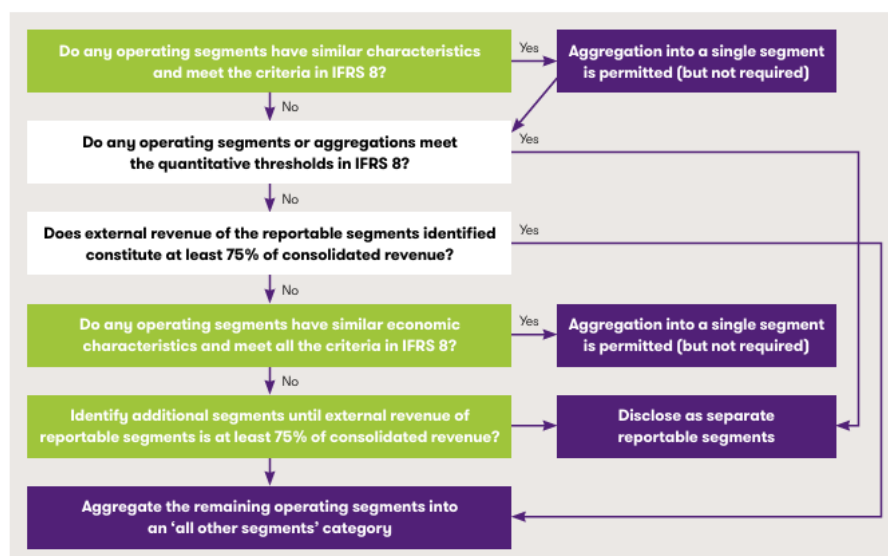
³⁵ Classification is the sorting of assets, liabilities, equity, income or expenses on the basis of shared characteristics for presentation and disclosure purposes. Such characteristics include—but are not limited to—the nature of the item, its role (or function) within the business activities conducted by the entity, and how it is measured. Classifying dissimilar assets, liabilities, equity, income or expenses together can obscure relevant information, reduce understandability and comparability and may not provide a faithful representation of what it purports to represent. (Conceptual Framework for Financial Reporting Paragraphs 7.7-8)

³⁶ Aggregation is the adding together of assets, liabilities, equity, income or expenses that have shared characteristics and are included in the same classification. Aggregation makes information more useful by summarising a large volume of detail. However, aggregation conceals some of that detail. Hence, a balance needs to be found so that relevant information is not obscured either by a large amount of insignificant detail or by excessive aggregation. Different levels of aggregation may be needed in different parts of the financial statements. For example, typically, the statement of financial position and the statement(s) of financial performance provide summarised information and more detailed information is provided in the notes. (Conceptual Framework for Financial Reporting Paragraphs 7.20-22)

in the primary financial statements or disclose items in the notes in a manner that fulfils the respective objectives of the primary financial statements and notes. It is also stated that an entity shall ensure that aggregation and disaggregation in the financial statements do not obscure material information.

- (b) Under IFRS 8 *Operating Segments*, Paragraph 12 indicates that two or more operating segments may be aggregated into a single operating segment if aggregation is consistent with the core principle of this IFRS, the segments have similar economic characteristics, and the segments are similar in each of the following respects: (a) the nature of the products and services; (b) the nature of the production processes; (c) the type or class of customer for their products and services; (d) the methods used to distribute their products or provide their services; and (e) if applicable, the nature of the regulatory environment, for example, banking, insurance or public utilities.’

The following flowchart takes into account the requirements noted in this article as well as ‘*Insights into IFRS 8 – Reportable segments*’ to describe the process involved in aggregating operating segments:



Source-Grant Thornton

- (c) *ISSB Standards*: Paragraphs B29 and B30 of IFRS S1 indicate that information shall be aggregated if items of information have shared characteristics and shall not be aggregated if they do not have shared characteristics. The entity might need to disaggregate information about sustainability-related risks and opportunities, for example, by geographical location or in consideration of the geopolitical environment. For example, to ensure that material information is not obscured, an entity might need to disaggregate information about its use of water to distinguish

between water drawn from abundant sources and water drawn from water-stressed areas. It is also stated that an entity shall not aggregate information if doing so would obscure information that is material.

- (d) *ESRS*: For aggregation or disaggregation under ESRS, Revised ESRS ED (Paragraphs 51 and 52 of draft ESRS 1) would require undertakings to reflect the level at which significant variations of material impacts, risks or opportunities arise, such as by topic, sector, subsidiary, country, location, water basin, site, asset or other appropriate level of aggregation/disaggregation. It is also stated that the undertaking shall ensure that the level of aggregation and disaggregation does not obscure information that is material.

Observations and issues raised during outreach and connectivity illustrations development

General observations

- 47 As noted during the April 2025 EFRAG webinar, relative to the financial statements, sustainability reporting often requires more granular data by project, site or activity to reflect the specific ESG impacts, such as individual projects, facilities or specific activities. Disaggregation by country may also be required, especially when material IROs differ across the geographies.
- 48 During EFRAG's outreach, stakeholders highlighted instances where there were differences in the level of aggregation/disaggregation of related information in the financial statements and sustainability reporting. For instance, a preparer from a banking financial institution indicated that investments in green finance are typically material for the sustainability report but not for the financial statements, particularly if there is a limited impact of such investments on the financial indicators related to the loan portfolio of the related entity (such as net interest income). In addition, it was noted that training expenses may not be material for presentation as a separate line item in the financial statements but may be material for the sustainability statement.
- 49 Moreover, the review of reporting practices showed that assets vulnerable to physical risk may be disclosed by location in the sustainability statement/disclosures, but not be similarly disaggregated in the financial statements. For instance, this can be seen in illustration 15, where in its sustainability statement, a banking institution disaggregates its loan portfolio, distinguishing between the exposures to different climate-related physical risks (acute and chronic risks).

- 50 The above instances are likely a reflection of the application of materiality within the respective contexts of financial statements’ objectives and sustainability reporting’s objectives (i.e. aggregation of information of similar characteristics or disaggregation of information of dissimilar characteristics, and it does not obscure other relevant information). In other words, there is no indication of any shortfall in either the financial statements’ or sustainability reporting’s aggregation or disaggregation requirements, and the observed differing levels of granularity across FS and SR simply reflect what is material for each of these reports.
- 51 *Gross versus net exposure presentation:* Several stakeholders observed that sustainability reporting typically depicts gross exposure before mitigation, while the financial statements typically depict the net exposure, and that this difference in level of aggregation hampers connectivity. In this respect, it is noted that:
- (a) This aspect is primarily related to the depiction of an entity’s risk management and risk exposures. The Revised ESRS ED has proposals for circumstances when it is appropriate to report exposures on a gross versus net basis. Specifically, if a potential negative impact is managed by a past, completed action, the company assesses its materiality after considering the mitigation (on a net basis). If a potential negative impact requires ongoing mitigation or prevention measures, the company must assess its materiality before considering the mitigation (on a gross basis).
 - (b) While the line items in primary financial statements are indeed, in many situations, reported on a net exposure basis, gross exposures can also be disclosed in the notes to the financial statements (e.g. the disclosures of financial instruments that are subject to an enforceable master netting arrangement or similar agreement³⁷ and disclosures of risk management strategy under hedge accounting disclosures³⁸).
 - (c) In other commentary (e.g., EFRAG’s response to the IASB COUFS ED), EFRAG observed that, when related to long-time horizons, some stakeholders find disclosures of potential exposure (e.g. undiscounted amounts) in the notes to the

³⁷ See IFRS 7.13A-C. IFRS 7.13C-a states that “an entity shall disclose...the gross amounts of those recognised financial assets and financial liabilities.”

³⁸ IFRS 7.22A-c- An entity shall explain its risk management strategy for each risk category or risk exposures that it decides to hedge and for which hedge accounting is applied. This explanation should enable users of financial statements to evaluate the extent of risk exposures that the entity manages.

financial statements to be useful³⁹. On this basis, it could be inferred that gross exposure disclosures can be useful.

Possible issue with the level of aggregation or disaggregation

- 52 Material sustainability-related items are rarely disclosed in the segment breakdown. For instance, across the 17 illustrations of connectivity in Chapter 3, of which sustainability related matters were material in both the financial statement and sustainability disclosures/statement, and of which in many instances there were references to sustainability related strategy and business model changes, it is only twice where there was any disaggregation by sustainability-related business unit, revenue or profitability in the financial statements' segment disclosures. Concurrently, it is noted that under ESRS Set 1, ESRS 2 (paragraph AR 14-c), in preparing disclosures related to its business model and value chain, an undertaking shall consider the cost structure and revenue of its business segments in line with IFRS 8 requirements; and under paragraph ESRS 2.40b there is a requirements for a reconciliation of ESRS sectors' revenue to IFRS 8 information⁴⁰.
- 53 The question could arise whether the above observation is indicative of shortcomings in the requirements for segment disclosures (i.e. IFRS 8). In this regard, it is noted that the IASB has a pipeline research project on segment disclosures. Moreover, other national standard setters⁴¹ have highlighted challenges that stakeholders in their jurisdictions have found with the aggregation requirements of segment reporting (i.e. the sole reliance on the management approach and perspective of the Chief Operating Decision Maker to determine reportable segments). It is possible that this could be the root cause of the seeming under-representation of sustainability-related matters in the segment disclosures of the 72 companies analysed as part of EFRAG's connectivity project. That is, sustainability-

³⁹ In its comments on Example 7 in the IASB ED (related to disclosure about decommissioning and restoration provisions, EFRAG noted that some stakeholders have concerns about how entities measure such decommissioning provisions because these are usually incurred very far into the future. That is, these provisions, when discounted to their present value, results in the carrying amount being immaterial and therefore not recognised in the statement of financial position. As there is a risk that the entity may need to settle their obligations on decommissioning and restoration earlier than expected and considering the size of these costs, EFRAG suggests that the IASB consider whether disclosure about the undiscounted amounts of future costs would provide more useful information in this fact pattern. An undiscounted amount can be indicative of the potential risk.

⁴⁰ Set of ESRS 2.40-b a breakdown of total revenue, as included in its financial statements, by significant ESRS sectors. When the undertaking provides segment reporting as required by IFRS 8 *Operating segments* in its financial statements, this sector revenue information shall be, as far as possible, reconciled with IFRS 8 information.

⁴¹ See the Canadian Accounting Standard Setter (AcSB) presentation at the [July 2025 ASAF meeting](#) and the Australian and Malaysian Accounting Standard setters (AASB and MASB) [joint presentation at the March 2025 IFASS meeting](#).

related matters, which have a long-term horizon, may not fall within the ambit of what management monitors regularly for operational purposes.

Consideration 4: Assessing the implications of the differences in the organisational reporting boundaries of financial statements and sustainability reporting

- 54 The respective organisational reporting boundary/ scope of consolidation applied for financial statements and sustainability reporting (i.e., an aspect of basis of preparation) affects the connectivity of reporting information. As noted in Chapter 2, unlike the scope of the financial statements, under ESRS Set 1, the organisational reporting boundary encompasses the value chain, albeit different sustainability matters can have different⁴² organisational reporting boundaries. Moreover, the notions of 'own operations' and 'operational control'⁴³ applied in sustainability reporting do not exist within IFRS accounting requirements.
- 55 At the same time, as detailed in Chapter 2, under the Revised ESRS ED proposals, the scope of consolidation of sustainability reporting will be the same as that of financial statements (which is based on financial control), except for the following:
- (a) The application of operational control for sustainability reporting is still permissible in certain circumstances⁴⁴.
 - (b) As was the case under ESRS Set 1, immaterial unconsolidated subsidiaries for the financial statements can be in the scope of consolidation of sustainability reporting if these subsidiaries have material sustainability-related IROs.
 - (c) There is no equivalent to the equity method of accounting under sustainability reporting.
- 56 It is also noted that the Revised ESRS ED proposals, the GHG and Energy intensity metrics that were in place under ESRS Set 1 are no longer required. Therefore, the issue of the numerator and denominator of these metrics having differing scopes of consolidation is no longer in play.

⁴²For instance, under ESRS, environmental disclosure encompasses information from the value chain, while governance disclosures are limited to information from the reporting entity's own operations.

⁴³ In Appendix II, Table 2 (Definitions in the ESRSs), operational control is defined as "a situation in which the (reporting) entity has the ability to direct the operating activities and relationships of the entity, site, operation or asset". For example, according to ESRS 1 AR 40 operational control exists when the entity (i.e. the parent company or a subsidiary) has the licence – or permission – to operate the assets of unconsolidated joint ventures, associates, non-significant subsidiaries and contractual arrangements.

⁴⁴ As detailed in Chapter 2, the ESRS ED proposes that, under certain circumstances, subject to fair presentation assessment, an undertaking should provide a separate disclosure of the metrics consolidated based on operational control.

- 57 From a connectivity standpoint, a reconciliation of the different scopes of consolidation is helpful. In this regard, as noted in Chapter 4, 13 out of the 15 illustrations included in Chapter 3 indicated the extent to which there were similarities or differences in the scope of consolidation between the sustainability statement/disclosures and the financial statements. So long as there is an explanation of the differences in organisational boundaries (e.g., via a reconciliation), users of the reported information ought to be able to identify what information cannot be connected across the two reporting domains.

Consideration 5: Enhancing connectivity in process

- 58 As noted earlier in the chapter, the information disclosed about governance, including who bears responsibility for managing sustainability risks, can be indicative of the connectivity in process within companies. In this respect, both ESRS and ISSB Standards have requirements for governance disclosures related to sustainability-related matters.
- 59 At the same time, except for the information disclosed about the governance and controls within an organisation, 'connectivity in process' cannot be observed from outside the organisation. In this respect, as highlighted in Chapter 4, 8 out of the 15 companies from which illustrations in the DP were drawn had disclosures about the governance structure that showed the different responsibilities for managing sustainability matters.
- 60 Across the stakeholders' feedback (i.e., preparers, auditors, and users), there was a broad acknowledgement of the need to integrate their financial and sustainability reporting functions. The following points of note were raised during the outreach.
- (a) *Challenges integrating sustainability data into company systems:* Preparers highlighted the challenges of translating sustainability data into quantitative information, and they indicated that they often relied on estimates.
 - (b) *Need for supporting organisational structure and collaboration across sustainability and financial reporting departments:* Stakeholders mentioned the importance of organisational structures that support integrated reporting, with sustainability and financial data managed under a single control system.
 - (c) *Need for robust internal controls:* Stakeholders underscored the importance of robust internal controls across the entire annual report, not just financial statements.
 - (d) *Importance of governance disclosures for users:* Users also emphasised the importance of effective governance in ensuring the long-term prospects, and they gave weight to disclosures about the governance, which highlight individual responsibilities.

Consideration 6: Exploring digitisation

- 61 Technology can be a potential enabler of connectivity between financial and sustainability reporting. Beyond the provision of digital access, it facilitates both structural and analytical links across different forms of disclosure.
- 62 *Structured data provision/XBRL tagging:* At the core of this development is XBRL (eXtensible Business Reporting Language) tagging, which provides a standardised and machine-readable format for financial and sustainability information. This enhances consistency in terminology, enables comparability across data sets, and supports reconciliation between financial statement line items and sustainability disclosures. It also improves usability and automation within reporting processes. With the CSRD mandating sustainability data in digital format, the ESMA European Single Electronic Format (ESEF), and the European Single Access Point (ESAP) under development, a structured data reporting ecosystem that could facilitate connectivity is beginning to take shape.
- 63 According to Houllier et al. (2022), there are five distinct ways in which XBRL can link financial and sustainability reporting:
- (a) Arcs meant for exploration: expressing the existence of a connection where the exact relationship is not defined
 - (b) Standard arcs: capturing a specific technical relationship
 - (c) Non-standard arcs: conveying a technical or semantic relation, creating a new, domain-specific connection
 - (d) Arc labels: specifying the precise nature of a relationship
 - (e) Formulas: defining a technical relation when a close association exists between two concepts

	How many relationships can the relation be applied to?	How specific is the relation it describes?	How much work is required to define and maintain it?	How much work is required from software providers to work with it?
Arcs meant for exploration	Can always be used.	Expresses the existence of a connection, but not much is known about the nature of the relation.	Only requires identification of related concepts.	Standard but not especially meant for navigation.
Other standard arcs	Requires a close relationship between both taxonomy concepts.	Expresses a specific technical relation.	Requires careful consideration of consequences on the validity of documents.	None (standard).
Non-standard arcs	Depends on the meaning behind the relationship.	Expresses a specific technical or semantic relation.	Requires definition of relationship, documentation, and support.	Depends on the relationship and its specification, generally non-negligible.
Arc labels	Can always be used, but there is not always relevant information to add in a title.	Since it documents a specific relationship, it should express the exact nature of the relationship.	Potentially large amount of work if many connections are documented.	Little (standard but seldom used).
Formulas	Requires a close relationship between both taxonomy concepts.	Expresses a specific technical relation.	Requires careful consideration of consequences on the validity of documents, even more so with complex formulas.	None (standard).

- 64 The interoperability between financial and sustainability reporting taxonomies further strengthens connectivity. The classification of data elements within sustainability reporting, when linked to corresponding financial data, provides users with clearer insights into the financial impacts of sustainability issues. Complementary digital tools, such as visualisation, hyperlinks, and structured taxonomies, also play a role in supporting navigation and improving the accessibility and usability of connected data.
- 65 *Role of Artificial Intelligence (AI)*: AI adds an additional layer of analytical value by enabling the processing of both structured and unstructured information. AI can identify patterns, extract insights, and support activities such as risk assessment and valuation when integrating financial and sustainability disclosures. However, AI lacks the precision of XBRL tagging, particularly in relation to contextual interpretation and the analysis of tabular data. For this reason, AI and XBRL are best understood as complementary: digital tagging provides reliable and structured data points, while AI enhances the analytical and interpretative processes built upon them.
- 66 In sum, the future of connectivity in corporate reporting will rely upon the combined use of digital tagging, interoperable taxonomies, and AI-enabled analysis. Together, these technologies create a more transparent, accessible, and comparable reporting environment, ultimately strengthening the decision-making capabilities of regulators, investors, and other stakeholders.

Questions for EFRAG FRB and SRB members, and suggested questions to constituents on Chapter 5

1 Do EFRAG FRB and SRB members have any comments on Chapter 5's content?

2 For Chapter 5, the following questions for constituents are suggested:

(a) Consideration 1: Clarifying the boundaries of financial statements (Analysed in paragraphs 12 to 32)

(i) *In Chapter 1, it is noted that clearly defined boundaries of different annual report sections are an enabler of connectivity. Along these lines, in paragraph 7, it is observed that there is a need to clarify the boundaries of financial statements because:*

- *this has been a recurrent point of attention across different financial reporting topics/IASB projects (climate-related reporting, synergies from business combinations, and unrecognised intangibles),*
- *some stakeholders are concerned about stretching the boundaries of financial statements, and*
- *there is an expectation gap at play for many other stakeholders in terms of what can be reported in the financial statements.*

Do you agree or disagree with the suggested clarification or enhanced definition of the boundaries of the financial statements? Please explain

(ii) *Paragraphs 20 and 21 outline suggestions for principles of placement in the context of unrecognised intangibles that were made during discussions held by EFRAG's technical governance bodies. Do you agree or disagree with these suggested principles for the placement of unrecognised intangibles, particularly in the context of sustainability-related intangibles? Please explain*

(iii) *In paragraph 31, it is suggested that identifying indicators of the migration of items from other parts of the annual report into the financial statements could be a helpful aspect of understanding the boundaries of the financial statements. Do you agree or disagree with this view? If you agree, do you have any suggestions on what could be considered indicators/triggers of items migrating from other sections of the annual report into the financial statements?*

(b) Consideration 2: Application of financial materiality in financial statements and sustainability reporting (Analysed in paragraphs 33 to 45)-

3	(i) Do you agree with view 1 (supporting the disclosure of forward-looking climate-related commitments based on IFRS accounting general disclosure requirements – paragraph 31 (20) of IAS1 (IFRS 18) or view 2 (against the disclosure of these commitments)? Please explain
	(ii) Based on the analysis of the issue and/or your practical experience, do you agree or disagree with the stakeholders who have called for the development of application guidance for paragraph 31 (20) of IAS1 (IFRS 18)? Please explain
	(c) <u>Consideration 3: Differences in level of aggregation or disaggregation</u> (Analysed in paragraphs 46 to 53)-
	(i) The analysis in the DP suggests that the observed differences in the level of aggregation or disaggregation of the financial statements and the sustainability statement/disclosures are mainly a result of differences in what is material in the context of each of these reports, and it should not be seen as a problem. Do you agree or disagree with this view? Please explain
	(ii) The analysis suggests that the observed underrepresentation of sustainability-related revenues and profitability-related metrics in segment disclosures could be a result of the IFRS 8 aggregation being done based on the management approach. Do you agree or disagree with this view? Please explain
	(d) Do you agree or disagree with the observations and suggestions made for the following considerations?
	(i) <u>Consideration 4: Implications for connectivity of the differences of organisational reporting boundaries</u> between financial statements and sustainability reporting (analysed in paragraphs 54 to 57)
	(ii) <u>Consideration 5: Enhancing connectivity in process</u> (including governance within organisations) (analysed in paragraphs 58 to 60)
	(iii) <u>Consideration 6: Digitisation of reporting</u> (analysed in paragraphs 61 to 66)
	Do EFRAG FRB and SRB members agree, disagree, or have any suggested refinements to the above proposed questions to constituents? Do EFRAG FRB and SRB members have any suggested additional questions to ask the constituents? Please explain.