

Project Task Force
Non-financial reporting standards

Outreach meeting
European standard- setting (ESS)



European Financial Reporting Advisory Group



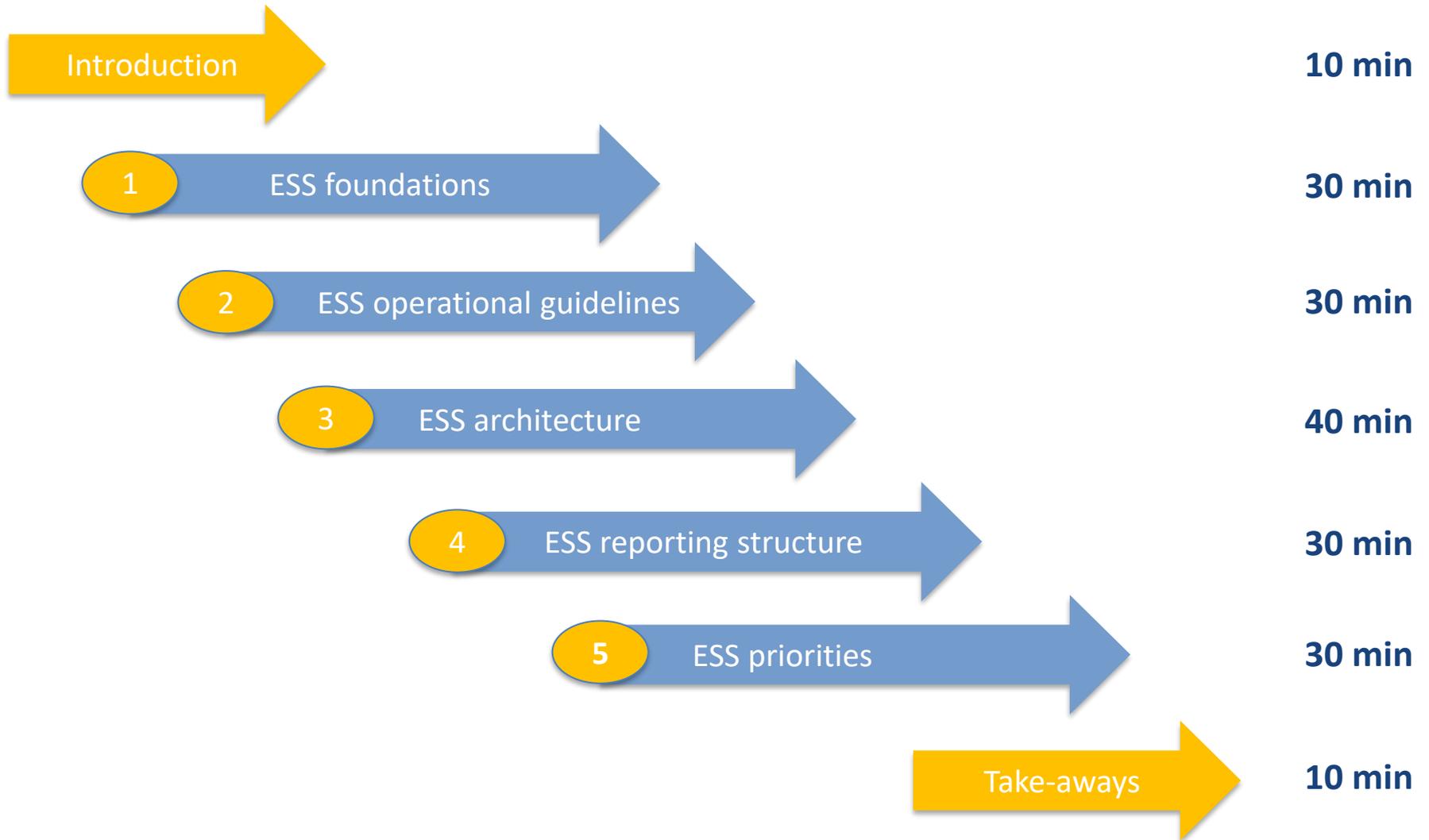
Disclaimer

This document is a tentative summarised presentation on ongoing work-in-progress from the Project Task force on non-financial reporting standards of the European Corporate Reporting Lab at EFRAG.

The views reflected in this outreach document provide an indication of the approach followed and of the possible orientations that the Task Force may adopt, but it does not prejudge the final Proposals that will be made to the European Commission by the Task Force in its Final Report.

It is intended to gather views from European stakeholders on key preliminary views emerging from the Task Force current ongoing work.

Agenda



Background

- In June 2020, the European Commission (EC) issued a request for technical advice mandating EFRAG to undertake preparatory work for the elaboration of possible EU non-financial reporting standards in the context of the wider revision of the Non-Financial Reporting Directive.
- This preparatory work is being carried out by a multi-stakeholder Project Task Force (PTF-NFRS) that was appointed by the Steering Group of the European Reporting Lab @EFRAG (European Lab), within which the project operates.
- Following the official appointment of its members and Chair on September 4, the Task Force developed a three-phase approach:
 - ✓ Phase I – Assessment until the end of October 2020 (please refer to the Progress Report published on EFRAG website on 6 November 2020)
 - ✓ Phase II – Recommendations until the beginning of January 2021
 - ✓ Phase III – Outreach and conclusion in January 2021, in which context the outreach meetings take place

Background

- The mandate given by the EC describes in details the main tasks expected by the Task Force in order to **develop recommendations about the possible scope, content and structure of future non-financial reporting standards.**
- The EC insisted on the importance of the interaction between future EU non-financial reporting standards with the key private sector standards and frameworks used in the market. Executive VP Dombrovskis highlighted in his letter to the EFRAG Corporate Reporting Lab: ***‘the technical advice must analyse and build on existing reporting standards and frameworks to the greatest possible extent’***.
- Hence, a thorough assessment of existing initiatives has been conducted during phase I. The Task Force is now considering the possible ways for the ESS to build on and cooperate with the leading initiatives to promote international harmonisation and coherence in corporate reporting and foster a global playing-field for international companies. (See ESS Priorities)

More information about the PTF-NFRS can be found on EFRAG website [here](#).

Background

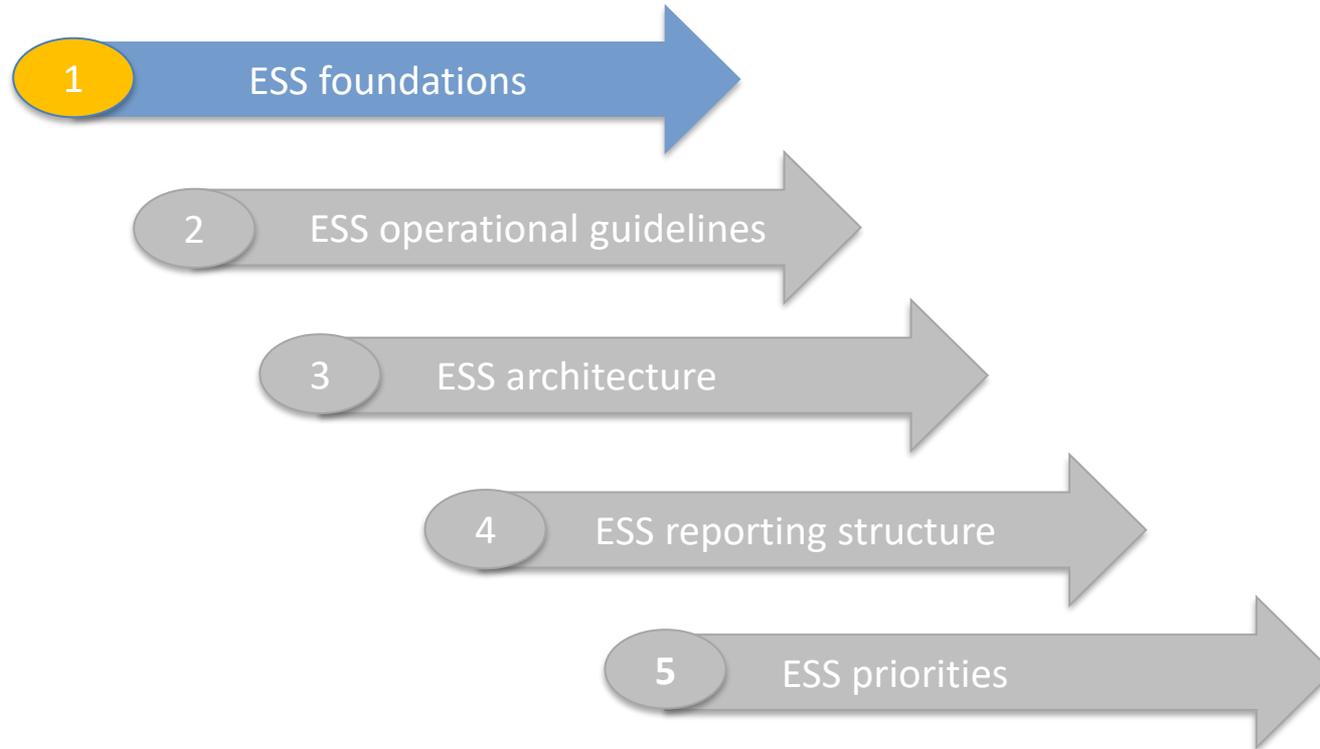
- The objective of the seven online outreach events, planned between 13 and 22 January 2021, is to collect a wide and representative range of views regarding **the priorities and approach for the possible sustainability European Standard-Setter** should there be one. The purpose of the outreach is not to discuss whether there should be an ESS, which is an EU decision and not in the remit of the Task Force.
- This Outreach Document is intended to give a preliminary view of the Task Force possible orientations.
- We hope that this document will allow constructive discussions during the webinars. We look forward to receiving your feedback and thank you very much for your time and consideration in this tight schedule.

EU sustainability reporting: 3 processes in parallel



→ Therefore, interaction as a basis (under final coordination by Level 1)

Agenda



Overarching Principle #1

A principles-based sustainability reporting system.

Overarching Principle #2

An inclusive range of sustainability reporting stakeholders.

Building block #1

Supporting the EU sustainability reporting momentum.

Building block #2

Addressing the specific challenges of financial institutions.

Building block #3

Including SMEs in the EU sustainability reporting landscape in a proportionate manner.

Building block #4

Fostering sector-specific sustainability reporting relevance.

Building block #5

Acknowledging the importance of intangibles in sustainability reporting.

The **standard-setting foundations** frame the mission and role of the ESS within the EU sustainability reporting landscape. As such, they are then considered and cascaded down into the standards architecture.

Overarching Principle #1

A principles-based sustainability reporting system.

- A principles-based sustainability reporting system (e.g., IFRS) is to be read as opposed to a rules-based system (e.g., US GAAP).
- Due to the EU legal system and culture the former is to be promoted: any implementation of the standards takes place under the umbrella of principles, with clear definitions to be followed and details on how to translate the principles into the required disclosures.

Overarching Principle #2

An inclusive range of sustainability reporting stakeholders.

- Reporting standards can focus on the information needs of a variety of users (or stakeholders): investors, lenders, employees, business partners, public authorities, civil society, etc. that should be well defined.
- As businesses are generally considered key players of society as a whole in the EU, the ESS should design sustainability reporting standards that foster accountability and dialogue vis-à-vis a broad and inclusive range of stakeholders.

Building block #1

Supporting the EU sustainability reporting momentum.

- Building on the EU sustainability reporting momentum created by the current NFRD and other related initiatives (European Green Deal), and in order to support and amplify it, the ESS should (i) make sure that it takes into account the best reporting achievements and identified enhancement priorities, and (ii) plan, then execute the following steps in a medium/long term perspective.
- The ESS should elaborate standards facilitating the flows of data between preparers and users of the disclosures (vertical alignment), and should also consider the interactions with reporting obligations stemming from other ESG/sustainability policy initiatives (horizontal alignment) to foster consistency.

Building block #2

Addressing the specific challenges of financial institutions.

- The EU Sustainable Finance Strategy places a strong emphasis on the role of financial institutions (banks, insurance undertakings, asset managers) to stimulate and accelerate sustainability transitions.
- FIs most significant impacts are indirect impacts stemming from the products they create, distribute and manage.
- The ESS should recognise financial institutions as specific preparers and users of sustainability reporting and ensure the availability and access of data necessary to meet their own disclosure requirements.

Building block #3

Including SMEs in the EU sustainability reporting landscape in a proportionate manner.

- SMEs represent a very significant part of the economy and the value chain and therefore have a critical role to play in supporting the EU sustainability goals. They will also be key recipients of sustainable investment flows, for which they still have to provide relevant sustainability information.
- The ESS should adopt a proportionate standard-setting approach tailored for EU SMEs that will integrate their size, risk profile and governance structure variety.

Building block #4

Fostering sector-specific sustainability reporting relevance.

- Sector-agnostic sustainability reporting is pivotal since it is the only level that provides comparability across sectors, i.e. for the economy as a whole, enabling transitions.
- However, risks and impacts may significantly vary from one economic sector to another and sector-specific information allows intra-sector comparability.
- The ESS should adopt a standard-setting approach to sector-specific sustainability reporting as a complement to sector-agnostic sustainability reporting. This level would be better understood if presented in a clear and distinct manner.
- The ESS should choose an EU compatible classification of sectors already used for other purposes and design balanced sector-specific sustainability disclosures building upon
 - (i) existing sector legal requirements
 - (ii) covering risks and impacts not covered, or not covered enough by sector-agnostic sustainability reporting.
- All sectors should be covered over time with an initial emphasis on higher-risk sectors.

Building block #5

Acknowledging the importance of intangibles in sustainability reporting.

- Financial reporting recognises intangibles in financial statements only when acquired (e.g., goodwill), as a counterpart of financial outflows at the date of acquisition. While the increase or decrease of intangibles explain the best part of increases or decreases in market values, financial reporting does not recognise, and does not envisage to recognise, (most) internally generated intangibles.
- Better understanding the impact of intangibles on financial value creation is therefore an important component of sustainability reporting. Their impact on social/environmental value creation is generally considered through topical disclosures.
- The ESS should introduce in its standard-setting processes the “intangible dimension” and develop a specific standard-setting approach on intangibles ensuring this dimension is properly reflected in disclosures.

Outreach questions related to ESS foundations

General

- 1) Would you agree that these Two Overarching Principles and Five Building-Blocks could constitute solid foundations for the possible EU standard-setting?
- 2) Would you see other key elements to consider?

Outreach questions related to ESS foundations

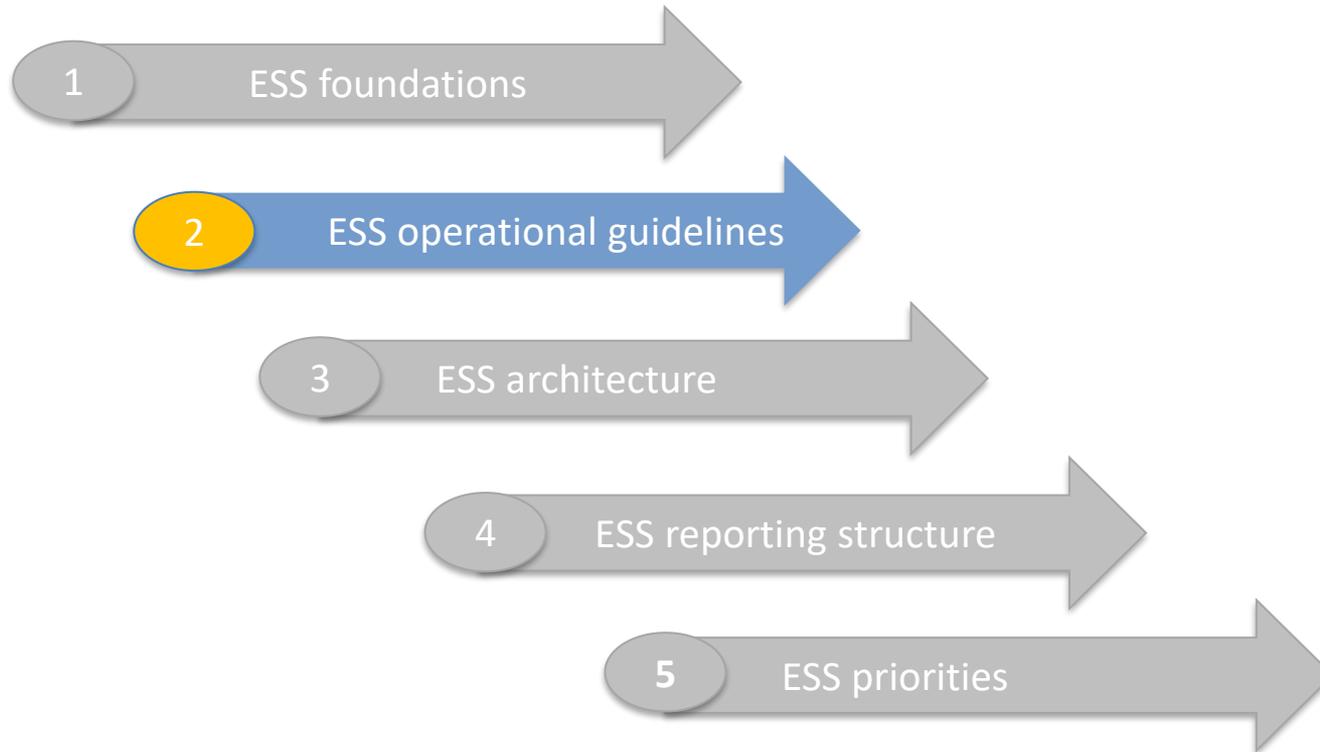
Financial institutions

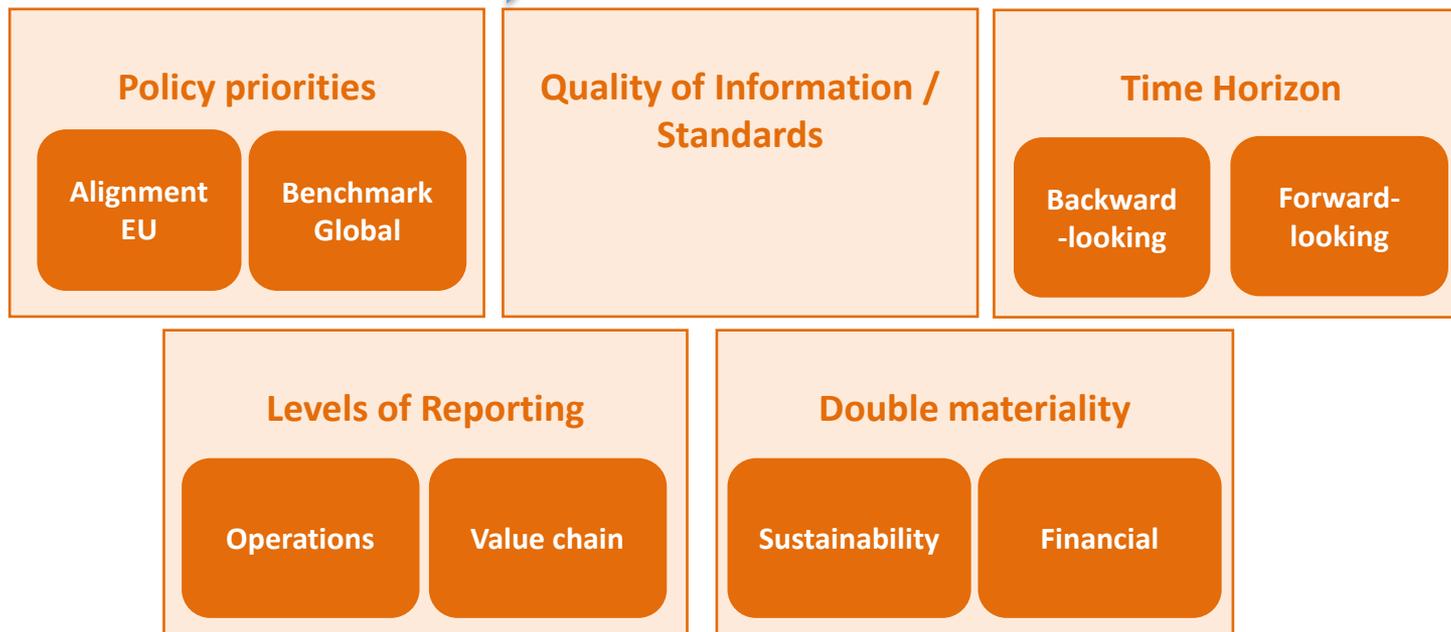
- 3) Apart from making appropriate data available to FIs, do you perceive there is a data availability timing issue?
- 4) Would you highlight other challenges?

SMEs

- 5) What are in your view the key characteristics of SMEs to consider to establish a proportionate reporting content?

Outreach sequencing





- The **standard-setting guidelines** are a set of **tools** to be developed by the ESS prior to any standard-setting in order to guide its work when setting the standards themselves. They cover 5 themes that need to be systematically considered in the standard-setting process. Some guidelines may have to be translated into standards when they have to be cascaded down to reporting entity level.
- As a general principle, all guidelines should **draw on existing European and international initiatives** for setting the appropriate processes and concepts.

Policy priorities

Alignment EU

Benchmark
Global

- EU has set itself clear sustainability roadmaps and goals. The ESS should adopt guidelines ensuring that future standards are designed to take into account EU sustainability policies reporting implications.
- Global policy priorities represent a significant reference for sustainable development and need to be considered during the sustainability standard-setting process through a benchmark of the elaborated standards against their key features.

Quality of Information / Standards

- Operating guidelines are needed to develop quality principles (characteristics) that could be set in Level 1, both at general sustainability reporting level and at disclosure level (for data points, targets,...).
- They should cover in particular how to embed faithful representation, relevance, comparability, understandability, reliability into the standard-setting process.
- They should also operationalise the intrinsic value of each relevant type of information: qualitative, quantitative non-monetary and quantitative monetary.
- In line with an overall support for stronger assurance, guidelines would need to focus on the criteria needed to facilitate auditability of sustainability information in relation with appropriate auditing standards.

Time Horizon

Backward
-looking

Forward-
looking

- Sustainability reporting encompasses retrospective and forward-looking information (implying setting targets, dedicating resources, establishing roadmaps, simulating outcomes, possibly under different scenarios...)
- Further guidelines are needed to support the elaboration of standards related to forward-looking sustainability information per category of information and per time horizon.

Levels of Reporting

Operations

Value chain

- Sustainability disclosures should primarily address the perimeter of operations under the control of the reporting entity (own operations) to foster coherence with financial information (consolidated approach).
- Sustainability disclosures should also address other levels of reporting with specific challenges:
 - Own operations segmented to reach more granular information (geography-specific, activity-specific by segment, asset specific),
 - Value chain when deemed material and as a key lever for business model transformation.
- Guidelines should consider: (i) control/influence/responsibility implied, (ii) impacts 'severity' and (iii) data availability and collection.

Double materiality

Sustainability

Financial

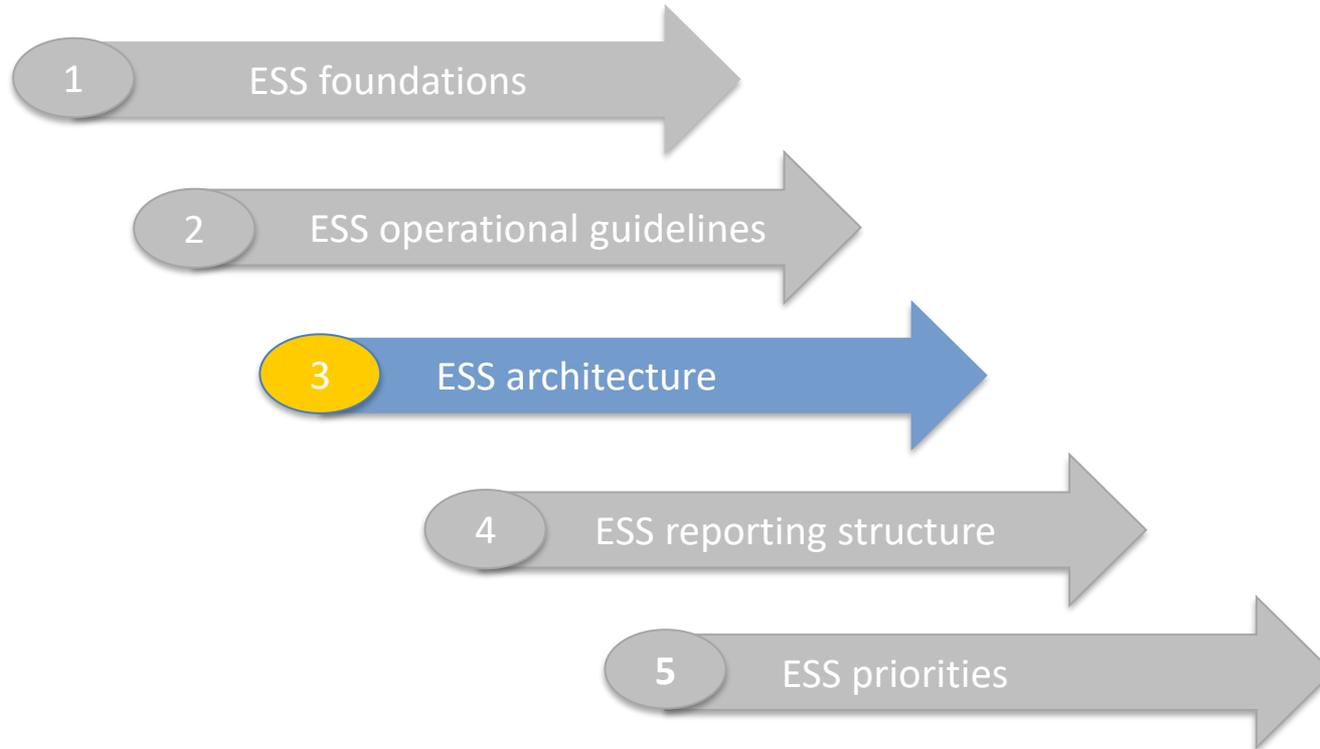
- EU legislative level establishes a double materiality approach for sustainability reporting: sustainability materiality and financial materiality. Each perspective must be considered in its own right. The ESS should operationalise the concept and clarify a ‘sum of both’ dimension (as opposed to an ‘overlap’ dimension).
- Materiality assessments should be made at each level of the sustainability reporting architecture: at sector-agnostic and sector-specific levels by the standard-setter and at entity-specific level by the governance/management (based on a standardised approach).
- The ESS should adopt a standard to disclose how reporting entities report on their own materiality assessment process. The standard should address the approach to be followed by the entity when a mandatory requirement may lead to an insignificant disclosure under its specific circumstances.

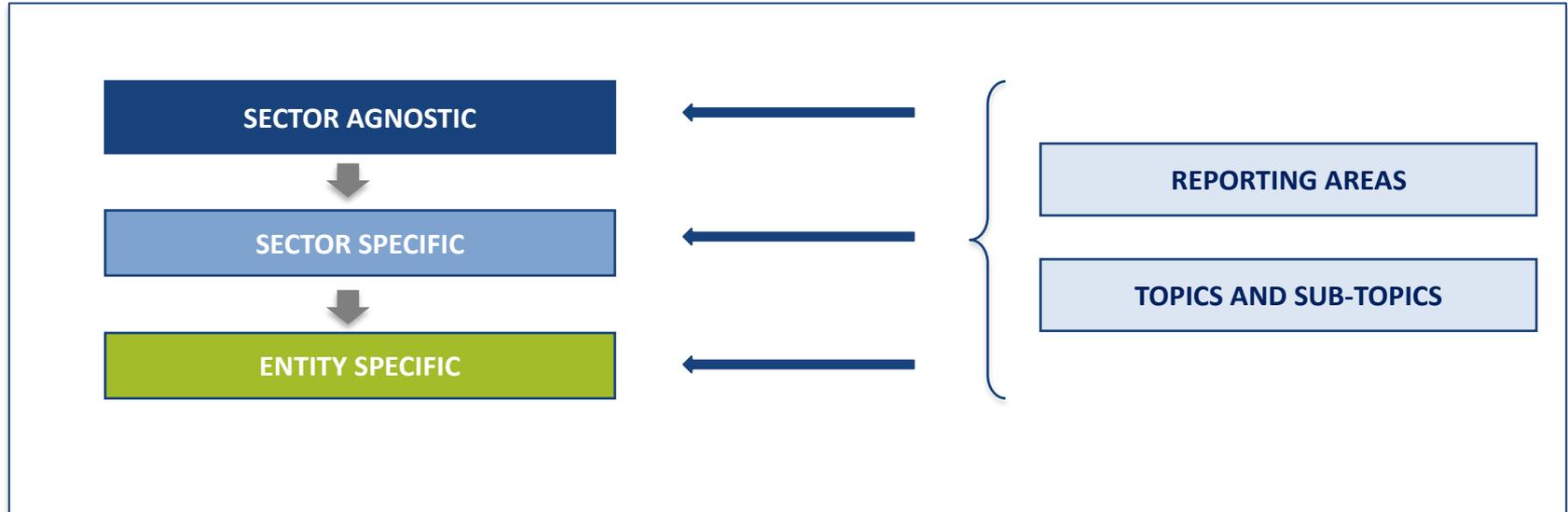
Outreach questions related to ESS guidelines

- 6) Would you agree that these guidelines are the appropriate tools supporting the elaboration of the sustainability reporting standards?

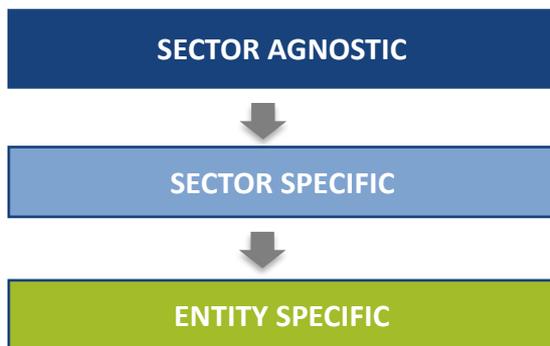
- 7) Would you see other key elements to consider?

Outreach sequencing





The standard-setting (and reporting) **architecture** should combine **three layers** (sector-agnostic, sector-specific, entity-specific) and **two dimensions** (reporting areas and topics) in order to define the right level of sustainability information.



The Sustainability Standards Architecture combine three layers:

- The **sector-agnostic** layer encompasses disclosures and data points that will be mandatory requirements to be followed by all reporting entities in the scope of the NFRD. This would also include the design of the sustainability reporting structure and format within corporate reporting, together with the related Reporting Taxonomy (referred to as the classification of sustainability information in a way that will allow from day one digital taxonomy).
- The **sector-specific** layer encompasses disclosures and datapoints that will be mandatory requirements to be followed by all reporting entities of each sector. This would address risks and impacts not covered, or not enough covered, by sector-agnostic sustainability information, as a complement to sector-agnostic sustainability reporting.
- The **entity-specific** layer encompasses disclosures and data points appearing material following an entity double materiality assessment process and that are not covered, or not enough covered, by the requirements of the above layers. The full materiality assessment process at entity level will be conducted following a standard inspired by the standard-setting guidelines.

REPORTING AREAS

- A sustainability reporting area is associated with a specific information objective or expected content that should be disclosed. For example, there are currently 5 reporting areas within the NFRD: Business Model, Policies including due diligence processes, Outcome, Principal risks and their management, KPIs) and 4 for climate under the TCFD approach (Governance, Strategy, Risk Management, Metrics and Targets).
- Sustainability reporting areas can be applied at two different levels: entity-level, topic-level.
- Business decision-making is generally articulated as follows: (a) Strategy definition and related challenges, (b) Implementation measures (action plan to deliver the strategy), (c) Performance measurement (monitoring of action plan).

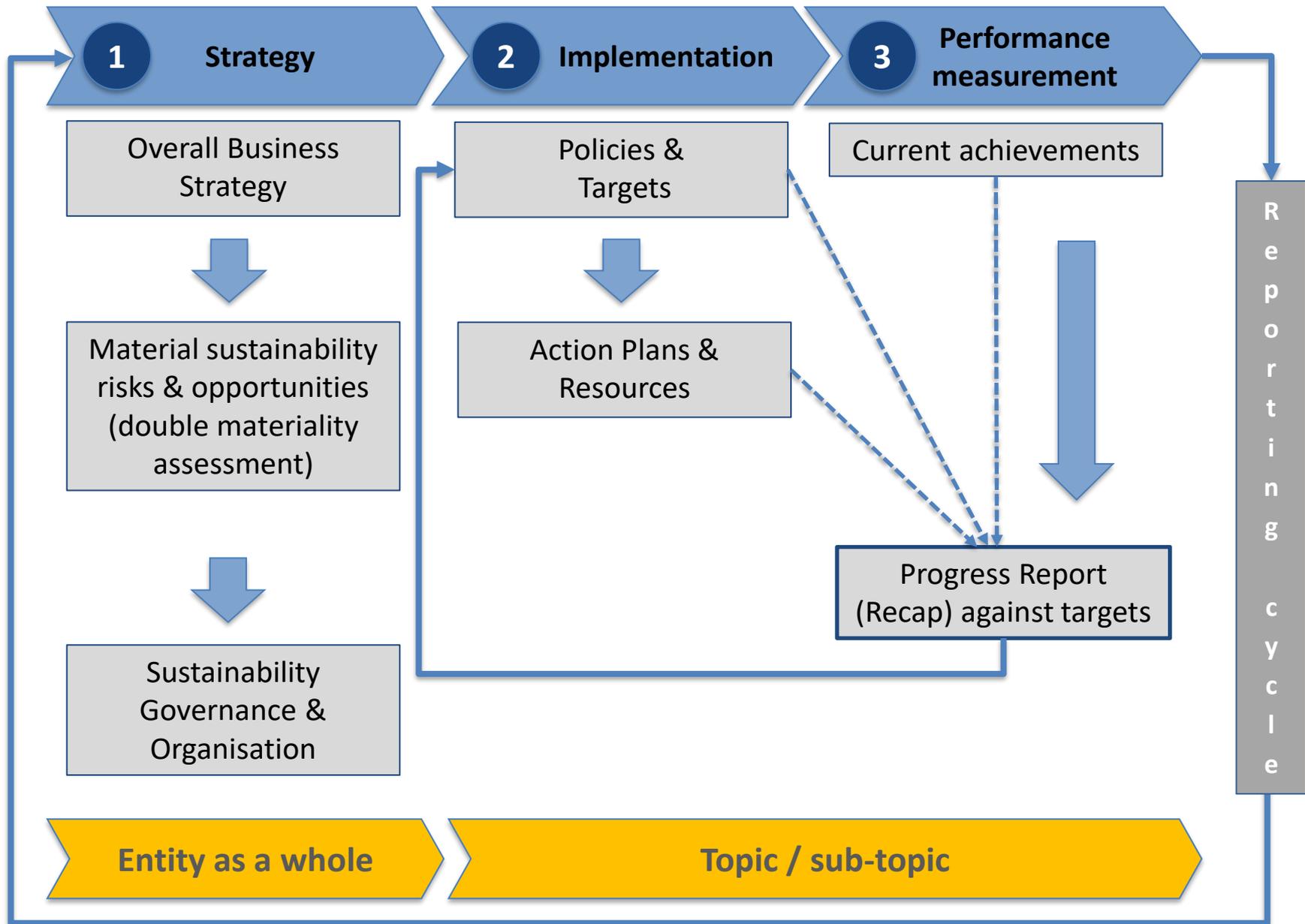


- Aligning reporting areas (focused on users' expectations) and decision-making (focused on the preparer's approach) should help reflect in a comprehensive manner how the reporting entity addresses sustainability matters as a whole.

REPORTING AREAS

(currently under consideration by the Task Force)

- As reflected in the following slide (presented **for illustrative purposes** only) there is a need to cascade down further for each of the reporting/decision-making areas. The Task Force will finalise its position in the course of January.
- Under Strategy
 - ✓ Overall strategy (including business models) needs to be presented first,
 - ✓ Then sustainability risks and opportunities (challenges) related to the overall strategy need to be identified from a double materiality assessment perspective,
 - ✓ And finally a specific emphasis needs to be put on the governance of sustainability related matters (as a subset of the general organisation of governance).
- Under Implementation
 - ✓ Policies and targets needs to be presented first,
 - ✓ Then action plan and dedicated resources.
- Under Performance measurement
 - ✓ Current achievements needs to be presented first,
 - ✓ Then a progress report against targets could be considered.
- Reporting areas could be associated with the relevant reporting cycle (for instance annual reporting).



TOPICS AND SUB-TOPICS

(currently under consideration by the Task Force)

- Topics are themes on which reporting entities should report. For instance, the current NFRD is articulated around environmental matters, social and employee matters, respect for human rights and anti-corruption and bribery matters.
- The ESG classification of topics is widely used by reporting entities, though varying when coming to the sub-topics to be included in each topic. A reference to a multi-capital approach is often made.
- The Environmental part needs structuring but has already reached a certain level of maturity.
- The positioning of relationships and value chain information remains an open question and highlights the need for structuring and clarifying topics and sub-topics.
- The following changes are currently considered:
 - a) Building on the existing ESG classification, while clarifying the more granular sub-topics around possible different articulations (by stakeholders for Social topics for instance),
 - b) Renaming the categories for the purpose of clarity,
 - c) Creating an additional topic dedicated to Relationships.
- For **illustrative purposes only**, two options are presented in the two following slides. The Task Force will finalise its position in the course of January.

Option 1

Environmental

Climate

Water & Marine Resources

Biodiversity & Ecosystems

Circular economy

Pollutions

illustrative

Social

Workforce

Value Chain workers

Affected communities

Consumers / end users

[Public Authorities]?

illustrative

General (incl. Governance)

Governance

Business Ethics

Organisation

Brand/Communication

Innovation

illustrative

Possible compatibility with multi-capital approach

Natural Capital

Human Capital

Intellectual Capital

Social & Relationships
Capital

Option 2

Environment

Climate
Water & Marine Resources
Biodiversity & Ecosystems
Circular economy
Pollutions

illustrative

People

Labour relations
Health & Safety
Other Human Rights
Human Resources

illustrative

Organisation (incl. Governance)

Governance
Business Ethics
Organisation
Brand/Communication
Innovation

illustrative

Relationships

Supply chain
Customers
Public Authorities
Human Rights
Communities

illustrative

Possible compatibility with multi-capital approach

Natural Capital

Human Capital

Intellectual Capital

Social & Relationships
Capital

Outreach questions related to ESS architecture

Architecture

- 8) Would you agree with the proposed standard-setting architecture in three reporting layers (sector-agnostic, sector-specific, entity-specific) and two dimensions (reporting areas and topics)?

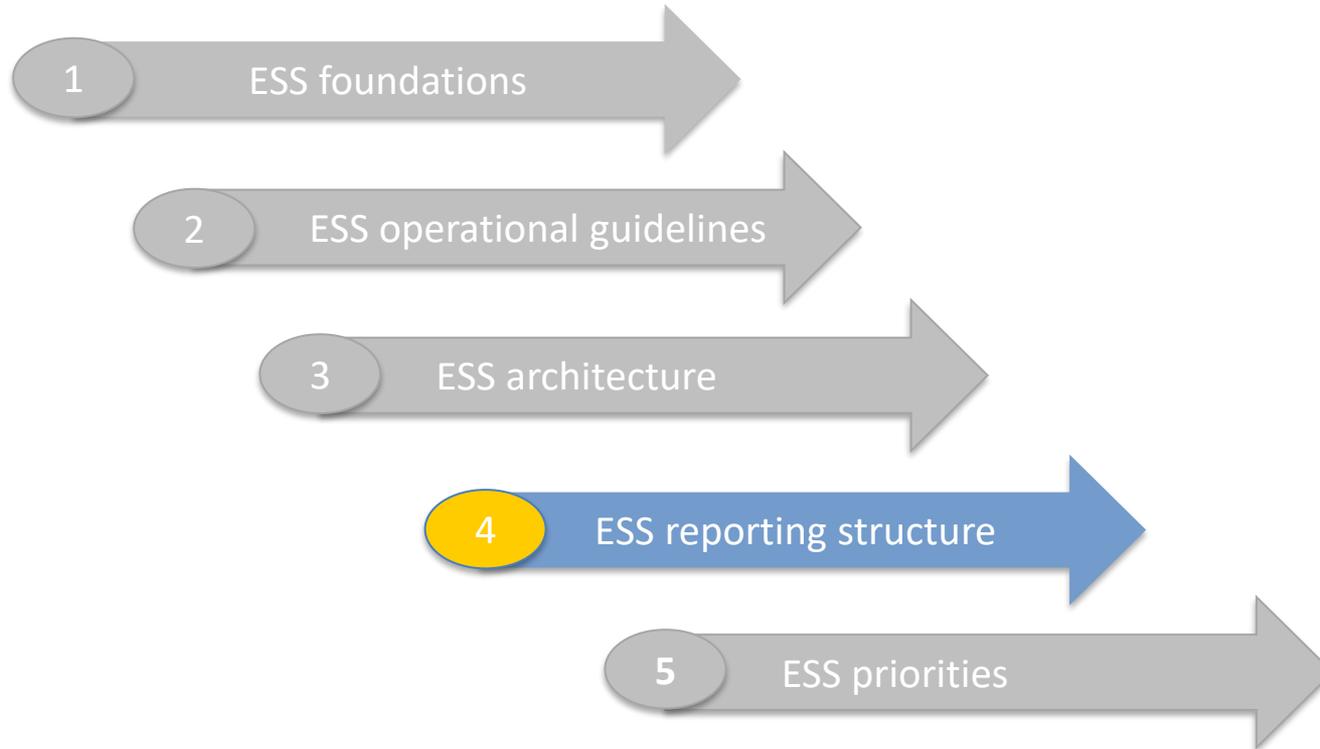
Reporting areas

- 9) Would you agree with the general principle of associating reporting areas with management decision-making?
- 10) Would you agree with the three main reporting areas?

Topics and sub-topics

- 11) What is your view on the two options?
- 12) Any other option?
- 13) Would be in favour of relating topics and sub-topics to a multi-capital approach?

Outreach sequencing



Sustainability Reporting

MANAGEMENT REPORT
(SUSTAINABILITY STATEMENTS)

REPORTING TAXONOMY

Interconnection

Interconnection

Financial Reporting

FINANCIAL STATEMENTS

RELATED TAXONOMY

Beyond content, it is key to define a **standard reporting structure**. Such a structure should reflect the reporting (and standard-setting) architecture and should enable the adoption of a digital taxonomy from the beginning.

**MANAGEMENT REPORT
(SUSTAINABILITY
STATEMENTS)**

- Under the current NFRD, sustainability information is presented in a number of different ways: management or separate report, information scattered in various locations hindering the status of sustainability reporting and the comparability of information.
- The general flexibility of management reports could accommodate two sections: one dedicated to sustainability statements (qualitative and quantitative information) and the other to the overarching presentation (financial and sustainability) of the reporting entity's affairs (governance and management vision, interpretation, judgements, etc...). One option is therefore to dedicate a clearly identified section of the management report to sustainability reporting (the Sustainability Statements, including both qualitative and quantitative standardised information).
- The reporting structure needs to be specifically addressed by the standard-setter, in order to establish a comprehensive and stable reporting structure organising a rational classification of sustainability disclosures per topic and per layer (sector-agnostic, sector-specific, entity-specific).

REPORTING TAXONOMY

- A reporting structure based upon a clear and stable classification of disclosures is a sound basis for establishing a digital taxonomy of sustainable data. Reflecting the decisions made at EU level in terms of single access point, the standard-setting processes should organise the granular segmentation of disclosures allowing for their inclusion into the digital taxonomy.
- The related taxonomy should allow for different levels of reading, from the most granular level to the executive summary level. Entity-specific extensions should be allowed. When extensions become common practices they should be considered to be included in the standard-setting process.



Interconnection



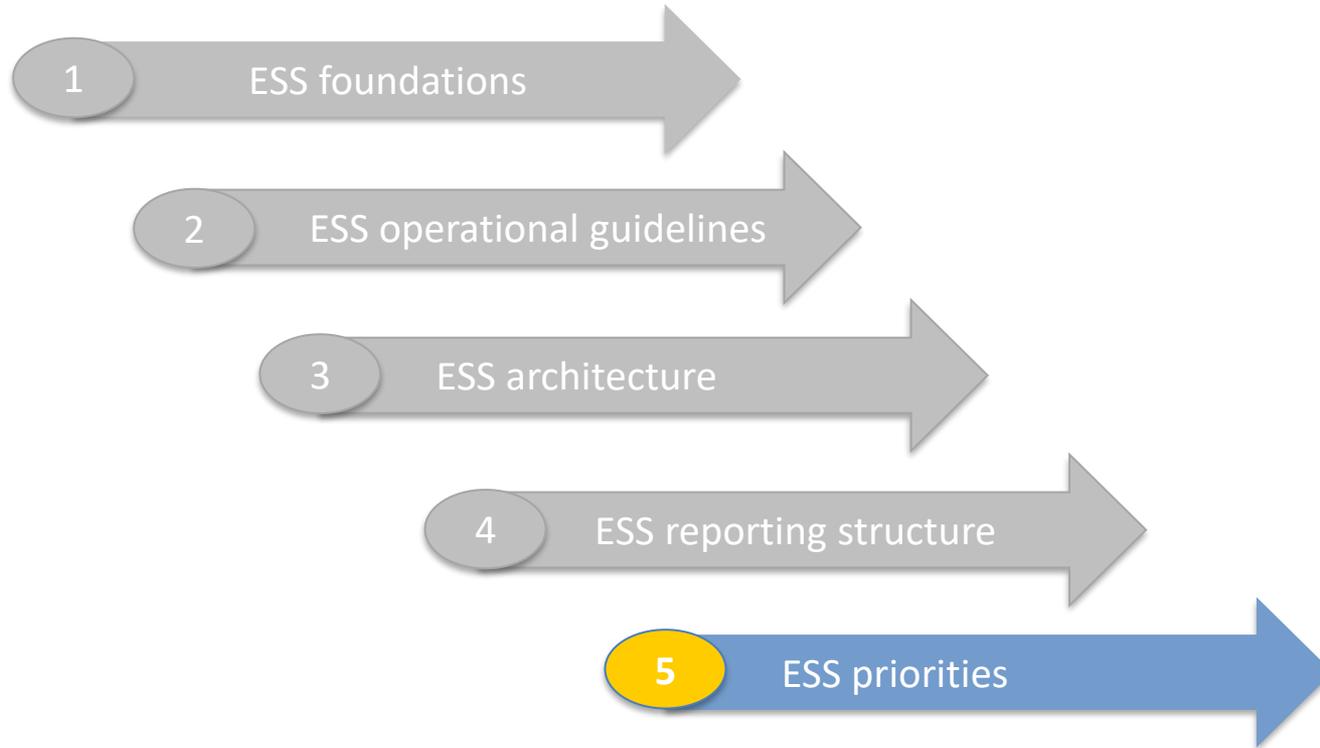
Interconnection

- A consistent and all-inclusive Corporate Reporting should be based on two pillars on an equal footing: Financial Reporting and Sustainability Reporting. Therefore, interconnection between the two pillars is key.
- Connectivity implies connecting sustainability disclosures to any related financial information. Therefore, it requires when preparing sustainability disclosures to identify the relevant anchor points and their counterparts in financial information to allow reconciliations or cross-references to financial reporting.
- There should be a distinction between:
 - direct connectivity: a sustainability disclosure can be linked to or is derived from information in the financial statements or in the detailed accounts (if not deemed necessary for financial reporting purposes: e.g., training costs, taxonomy KPIs...)
 - indirect connectivity: a sustainability disclosure needs to be put in relation with other financial information (e.g., budgeted expenses, scenario analysis...)
- Financial reporting also needs to be coherent with sustainability disclosures (e.g., assumptions for impairment testing), therefore the ESS should offer anchor points for financial information in order to ensure continuity and coherence in corporate reporting.
- The ESS should provide the framework (methodologies, processes and anchor points) for proper interconnection.

Outreach questions on the ESS reporting structure

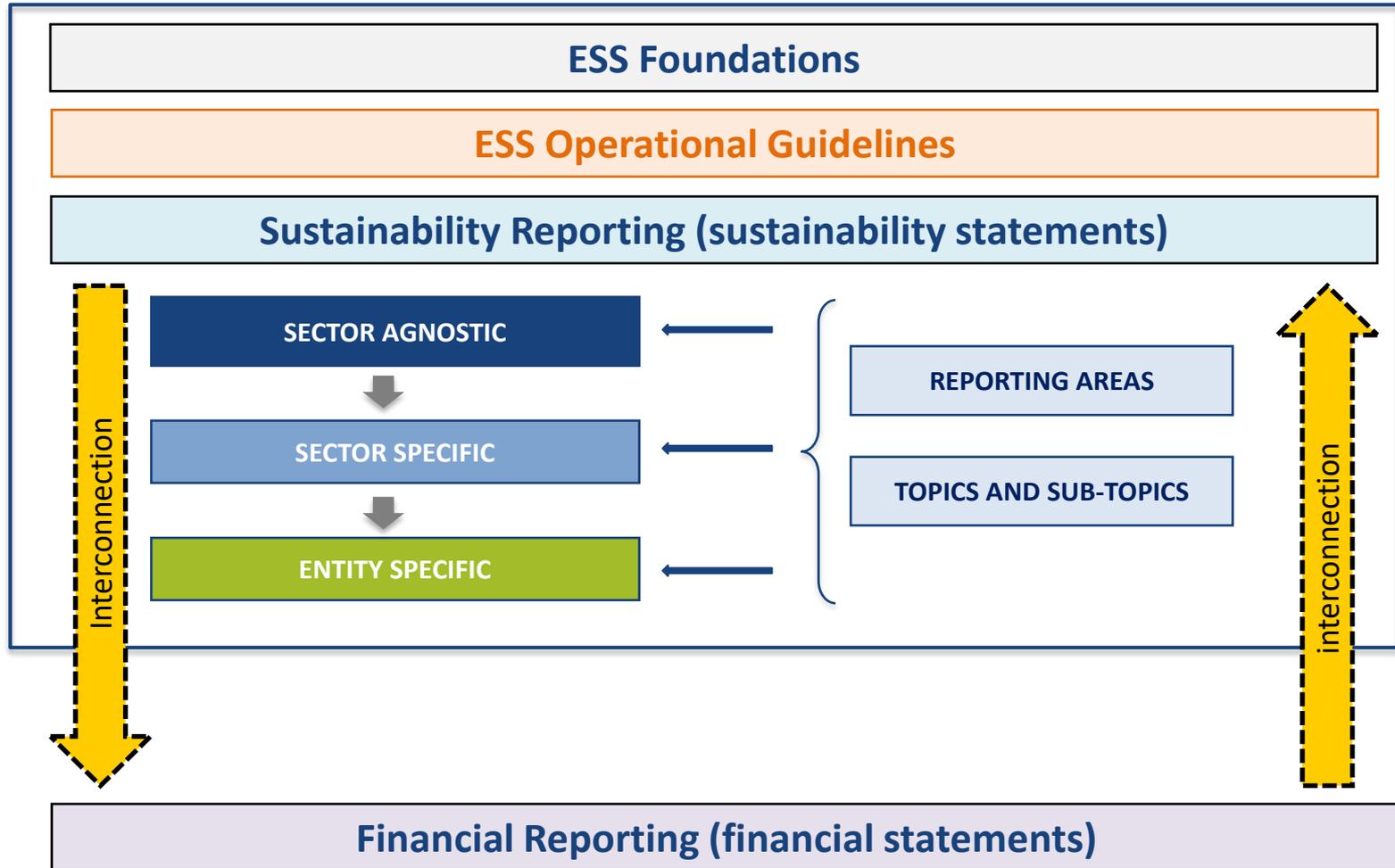
- 14) Would you agree with the proposed reporting structure?
- 15) In particular, would you support including sustainability statements in a dedicated section of the management report?
- 16) Would you support the idea of adopting reporting taxonomy from day one to be applied to each issued standard?
- 17) Would you agree on the key importance to operationalise interconnection with financial statements?

Outreach sequencing



Target general architecture

Summary of the above



- There is general agreement that the EU sustainability momentum calls for a major step in sustainability reporting. As a consequence, the Task Force considers that (i) priorities should be taken into account and (ii) the next step should aim at delivering urgently a coherent first set of disclosures.
- Along the EU momentum, there is a large number of initiatives in relation to sustainability standard-setting, with current notable convergence efforts. The Task Force welcomes these efforts and considers of prime importance to cooperate with the leading international initiatives to ensure coherence and reciprocal input between EU and other international initiatives, in order in particular to foster a global playing-field for international companies.

Outreach questions on the ESS priorities

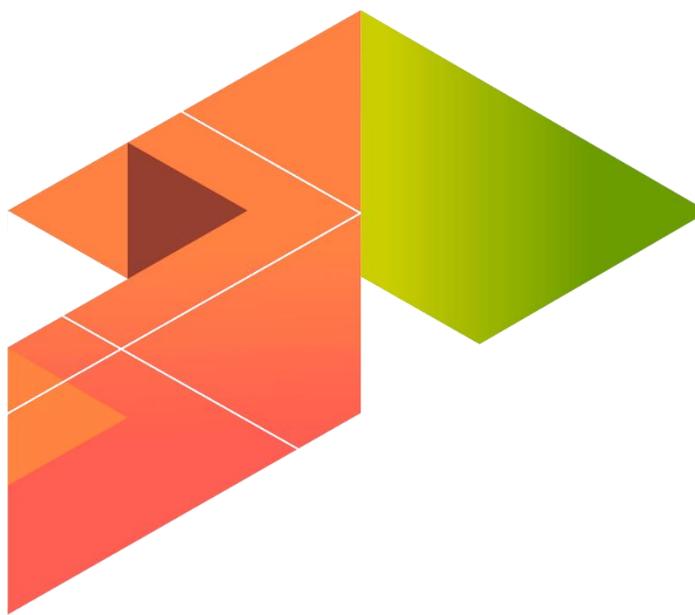
The Task Force is currently considering possible roadmap options for elaborating standards corresponding to the target reporting architecture and reporting structure. The Task Force will finalise its position in the course of January.

- 18) In this context, the Task Force would be happy to receive input from the outreach meetings on what could be a **coherent first set of disclosures** and the **related standard-setting priorities**.
- 19) The Task Force would also be happy to receive input on possible **standard-setting interactions between the EU and other international initiatives**.



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THANK YOU



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