Association pour la participation des entreprises françaises à l'harmonisation comptable internationale

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EFRAG Secretariat

35 Square de Meeûs

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Belgium

Re: EFRAG Discussion Paper – Connectivity of Financial and Sustainability Reporting

As associations that represent issuers that are heavily engaged in both financial reporting and sustainability, Acteo, l'Afep and Medef are particularly concerned by the notion of connectivity.

Although it is frequently mentioned by investors, regulators and standard setters, this notion still remains inadequately defined and is insufficiently operational. This vagueness contributes to a lack of understanding between stakeholders and can lead to implicit expectations which are sometimes unrealistic and often unsatisfied.

In this context, we welcome ERFRAG's initiative, which aims to propose a common definition of "connectivity" and to explore the most appropriate means of implementing it.

Having said that, we do find the DP very extensive in length and complex to understand, rather confusing in places, and ultimately lacking in concrete proposals and clear ideas for making significant progress in this area. The DP juxtaposes concepts, examples and standard-setting pathways, without always explaining how these relate to each other and whether they should be obligatory or not, thus limiting clarity and operational usefulness for preparers. As a consequence, the levers for improvement which should be adopted as a priority by entities remain difficult to identify.

Moreover, we wonder what the status of these proposals will be and what the next steps should be. As we have indicated above, the notion of connectivity is very widely used and, as a result, any document which aims to provide a framework for it, particularly when that document is signed by EFRAG, could very swiftly become a reference of standardisation which would impose itself on issuers independently of its formal status or its non-mandatory nature.

In our view, connectivity can be defined and implemented in the context of the various frameworks that currently exist, without its being transformed into a new element of standard-setting.

Moreover, the large entities involved in the first wave of implementation, who will remain within the scope of the CSR Directive, have employed a great deal of resources in implementing the existing ESR standards. They will now have to adjust to the new standards that the European Commission is going to put in place, and would therefore wish to be provided with a certain period of stability in order to be able to integrate the new rules. Without contesting the importance of connectivity, they consider that it is important not to advance with precipitation.

If you require any further information on this subject, please do not hesitate to contact us.
Yours sincerely,

ACTEO	L'AFEP	MEDEF
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1. Proposed definition of connectivity and its benefits

> *"The attribute of high-quality information that supports the provision of a holistic and coherent set of information within and across different annual report sections"*

We agree with the fundamental idea that connectivity is not an attribute solely of financial statements or of sustainability reports, but that it must be a qualitative attribute of the annual report in its entirety. It should not be just one statement that carries all the elements of connectivity. Connectivity is the notion of creating links between the different parts of the annual report in order to have assurance about their overall coherence and completeness, without imposing the requirement for completeness on one individual element.
Accepting this definition, we also agree with the benefits of connectivity listed in the DP, and with the statement that connectivity improves the informational content and the reliability of the annual report, and, as a result, the communication of the entity.

2. Underpinning concepts

- **Current Literature**

Although the sustainability standards (ESRS and ISSB alike) are more explicit on the notion of connectivity, because they are more recent, it seems to us that it is unfair to consider that the body of IFRS is silent on the subject and thus needs to be added to.

Current IFRS relies on underlying principles (such as faithful representation, relevance, internal consistency, materiality, etc.) which, when properly utilised, contribute greatly to the connectivity of the annual report.

We think therefore that the problem is not so much the absence of principles but the lack of clarification of the respective roles of the financial statements and the other components of the annual report. What is missing is a clear explanation of what can be said and what cannot be said, and what is in the scope of the financial statements as opposed to what belongs in the other areas of the annual report. In this respect, the arguments provided in the DP relating to the respective objectives and scope of the different parts of the annual report are very useful.

- **Attributes**

Although we agree that the financial statements must be complete and sufficient in themselves, we think it is important to reiterate that this does not imply that they must deal with every aspect of the entity. Each element of the annual report has a different, well-defined role, with connectivity being necessary to ensure that the different components are linked and mutually coherent. We agree also with the assessment in the DP that the financial statements correspond to different levels of audit and legal responsibility from the rest; this must be taken into account.

We are particularly sensitive to the argument that the aim should be to achieve a certain level of coherence in the internal control processes of the entity in order to guarantee connectivity. It seems to us that this organisational connectivity is in the process of becoming increasingly widespread within entities, particularly since the implementation of the taxonomy requirements and the first reports under CSRD.

- **Different types of connectivity**

The DP lists five types of connectivity:

- Provision of explanations (narrative/integration)
- Coherence (overview, explanation of variances)
- Consistency of data, assumptions and measures
- Direct and indirect connectivity (references and reconciliations)
- Inter-period connectivity (forecast and actual financial effects)

We think that connectivity must above all be seen as a qualitative principle relying essentially on:

- The overall coherence of information provided,
- The consistency of data, assumptions and measures used.

In our view, the other forms of connectivity cited in the DP (direct or indirect connectivity, inter-period connectivity) are more operational mechanisms which facilitate the implementation of this principle rather than individual categories or types of connectivity.

We think that it is very important to make the distinction between the principle and the attributes of the different tools and mechanisms that allow for the application of the principle.

- **The anchor point**

This notion is judged to be useful and relevant since these anchor points enable one to identify the structural elements linking the financial statements, the sustainability reports and the other sections of the annual report.

Provided that they can be selected by the preparer on the basis of their criteria of relevance, the anchor points seem to us to be useful, as long as they remain:

- Tools for understanding and creating consistency;
- Explanatory landmarks for the user; and
- Not additional, implicit requirements which create new recognition or measurement obligations.

At this point, the DP would be improved by a clearer explanation of the expected use of such anchor points and their relationship with existing principles. Without such clarification, there is a risk that the anchor points would be seen to be a new implicit, mandatory requirement of the standard-setter, an obligatory checklist rather than tools aimed at helping preparers by improving the connectivity within the annual report.

3. The boundaries between the elements

In our view, this is the essential centre of the debate about connectivity and more widely the principal source of the divergence in interpretation of the concept, as well as the source of the sometimes excessive expectations of users, which are inevitably disappointed. We agree with the finding in the DP that the divergent expectations about the role of the financial statements have led to the necessity of clarifying the rules so that one can avoid creating expectations that cannot be satisfied.

Indeed, the DP has identified several different expectations about the role of the financial statements, ranging from an extension of the recognition requirements through intermediate positions, which rely on the notes to the financials, to more restrictive approaches. However, it seems to us that the definition of these three levels of expectation is not sufficiently fine to reflect the full set of approaches which could be adopted.

We think that a fourth approach is worthy of explicit mention, that is, an approach which would in effect represent the status quo in terms of the application of current rules:

- No change in the recognition criteria for the capture of external transactions;
- Disclosure in the notes but only when the relevant criteria of IFRS are met; and
- The disclosure of certain forward-looking elements already catered for in IFRS when their use is justified by the requirement to support certain book values (such as, for example, depreciation tests or provisions).

In addition, we think that the structural divergences between the different elements of the annual report are well recognised. They must not only be preserved but also be the subject of a significantly increased educational effort aimed at the whole body of stakeholders. In our view, this is first and foremost a responsibility of the standard-setters in both financial and sustainability reporting aera, rather than one that can rest on preparers through their disclosures alone. We would urge them to invest significantly more in helping users of every background understand what they can, and cannot, expect from each component of the annual report.

In respect of the specific matter of materiality, it is insufficient to merely contrast simple financial materiality and double materiality; one must also bring into the discussion divergence in timing and in gross or net exposure.

In respect of exposure, we think it is useful to point to a likely source of expectation gap: in some cases, a reader may encounter risks presented on a gross basis in a sustainability report and may expect a corresponding financial effect to follow. The reader must then be put in a position to analyse the mitigating action plans in order to arrive at an assessment of the net (residual) financial materiality, which is the only exposure capable of being reflected in the financial statements.

On the question of timing, which is in fact touched on in the DP under the label of inter-temporal relationships, we share the analysis which maintains that certain information which is today excluded from the financial statements could, in due course, change its nature and gain in reliability, thus becoming eligible for recognition in the primary financial statements or disclosure in the notes. Although we understand the educational value of presenting examples of indicators or triggering events to enable users to grasp the link between sustainability reporting, management and the future financial statements, we are not in favour of imposing the obligation to publish or use these indicators on a systematic basis. Thes elements relate particularly to the realms of entity management and risk management, and should be regarded solely as good practice or management orientation and in no circumstances turn into constraints.

4. Other areas of reflection

- **The quantification of expected outcomes**

These elements seem today to be at the heart of the expectations of users but equally are at the centre of the preoccupations and uncertainties of issuers. The findings listed in the DP relating to the difficulties experienced seem relevant, in our view: terminology which is sometimes ambiguous; the absence of benchmarks and stable methods; the high level of uncertainty; potentially commercially-sensitive information; the risk of over-interpretation; and the significant matters of reliability and auditability.

- **Information by Operating Segment**

We do not share the findings relating to the perceived failings of IFRS 8 and do not think that this standard should be amended to respond to the needs of connectivity. In accordance with the DP, we consider that the objectives of sustainability reporting do not necessarily coincide with the financial operating segments or the drivers of performance. To align the whole would be a fundamental change in the structure of IFRS 8 and its management view. On the contrary, we think that the financial statements respond to their own, valid objectives and do not have the vocation of providing the whole of the information necessary for a thorough analysis of the risks and opportunities of sustainability. This latter objective is addressed by the sustainability reporting statements, and this underlines the importance of a clear articulation of the relationship between the various documents.

In conclusion, if connectivity can be seen today to be a lever for the improvement in the quality of reporting, it is also the source of strong expectations, which are sometimes poorly calibrated as a result of misunderstandings. In this respect, the DP provides some useful insights, particularly in the area of the diversity of means of connectivity and the relative variations in the interpretation of the respective roles of the financial statements and the sustainability reports. It is also useful in that it provides a definition of the notion of connectivity.

The DP highlights the actual issues at stake, in particular in the matters of the clarification of the boundaries, the management of expectations and the clarity of reading of the annual report as a whole. The tools that are proposed by the DP – illustrative examples, anchor points or connectivity mechanisms – must above all be intended to facilitate the understanding of the notion of connectivity by the whole body of stakeholders and to serve as educational landmarks. They must not become new requirements. From our point of view, these objectives must lead EFRAG to revise the DP in order that the educational objective stand out more clearly. It would also be very welcome if EFRAG were to devote some effort to render the document more concise so that preparers and users alike might more easily grasp its implications.

As a principle, we think that connectivity can and must be put in place progressively and in a proportionate way within the existing regulatory frameworks, without calling into question the fundamentals of the existing body of accounting standards. The implementation of the notion of connectivity must not lead to an implicit extension of the role of the financial statements, nor to the creation of additional obligations for issuers, particularly in the matter of premature quantification of transactions or risks.