



AWARDS FOR BEST BELGIAN SUSTAINABILITY REPORTS 2021

EDITION 2022

Interconnectivity between financial and sustainability reporting

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Workshop 10 January 2023



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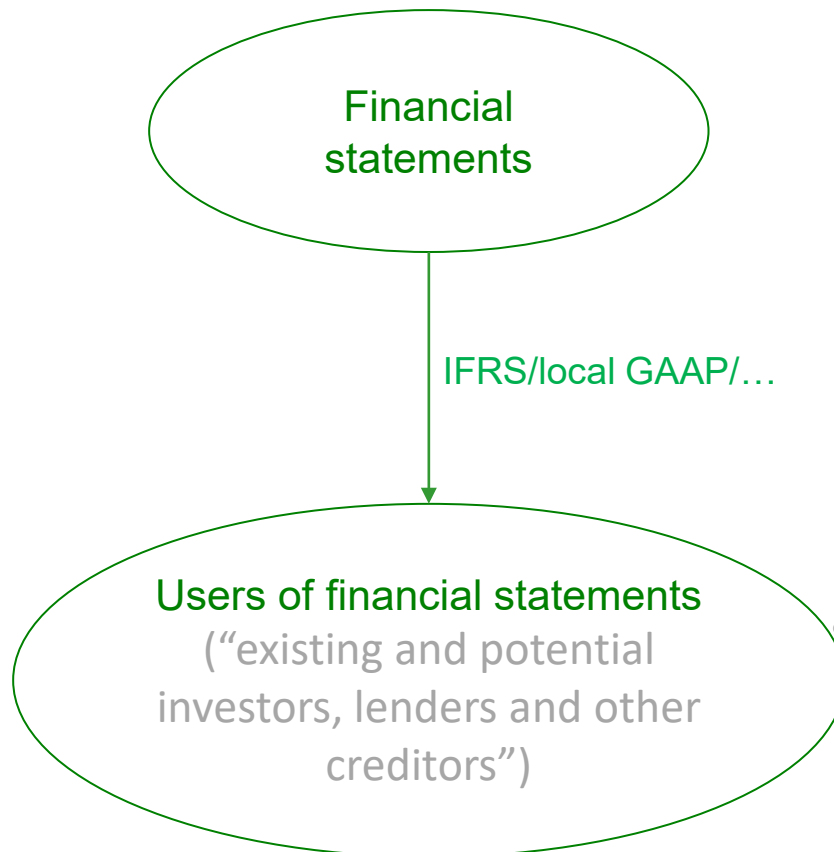


Purpose

- **Proposition:**
 - We will have to make sure that there is connectivity between the financials on the one side and the sustainability topics on the other side
- **The questions are thus:**
 - What can “interconnectivity between financial and sustainability reporting” mean?
 - How should this interconnectivity impact financial reporting as we know it?
 - What should financial reporting say about sustainability topics and how to measure the financial impact of sustainability issues?
 - Where and how would they add value for the users of financial statements?
 - How will this translate in the upcoming reporting standards?

Financial reporting

- This is what *financial statements analysis* **is not**:



This does not conflict with the objective of financial reporting as formulated in the IFRS' Conceptual Framework for Financial Reporting.

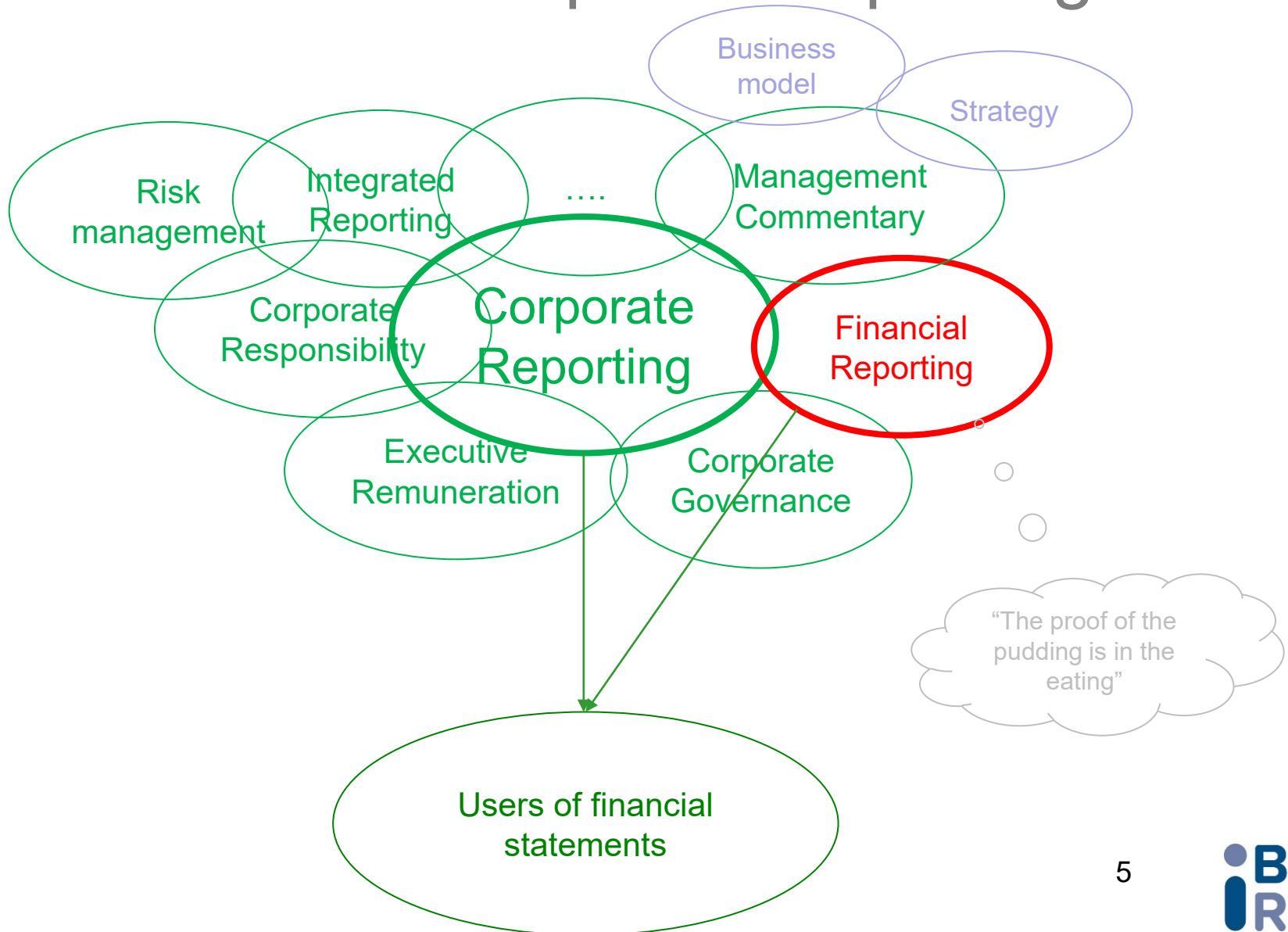
Society in general?
#DoubleMateriality

Financial reporting

- This is what *financial statements analysis* is:

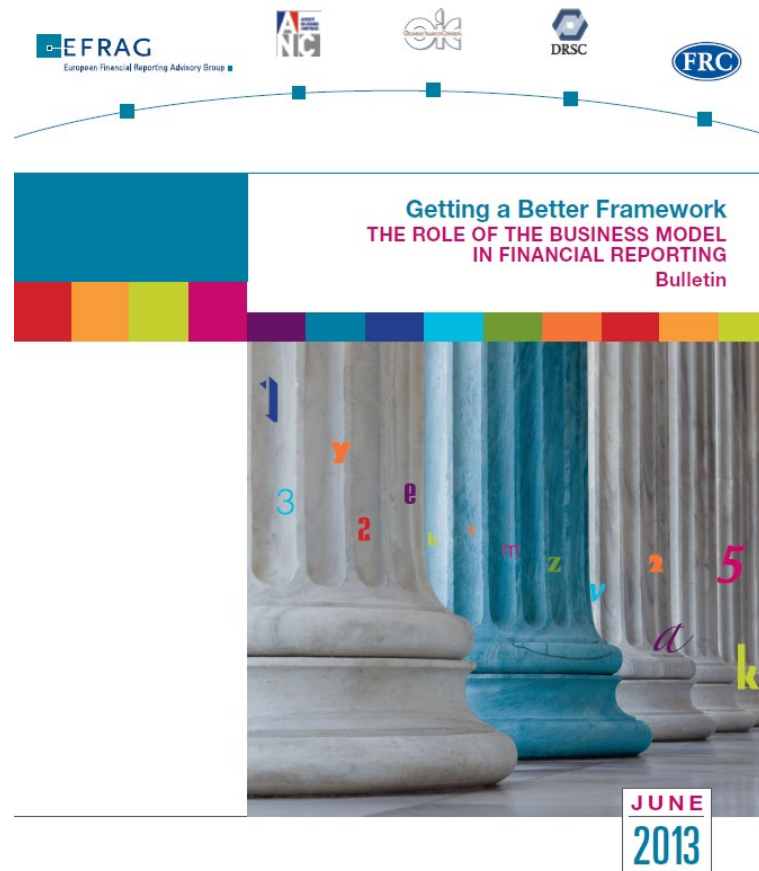


Corporate reporting



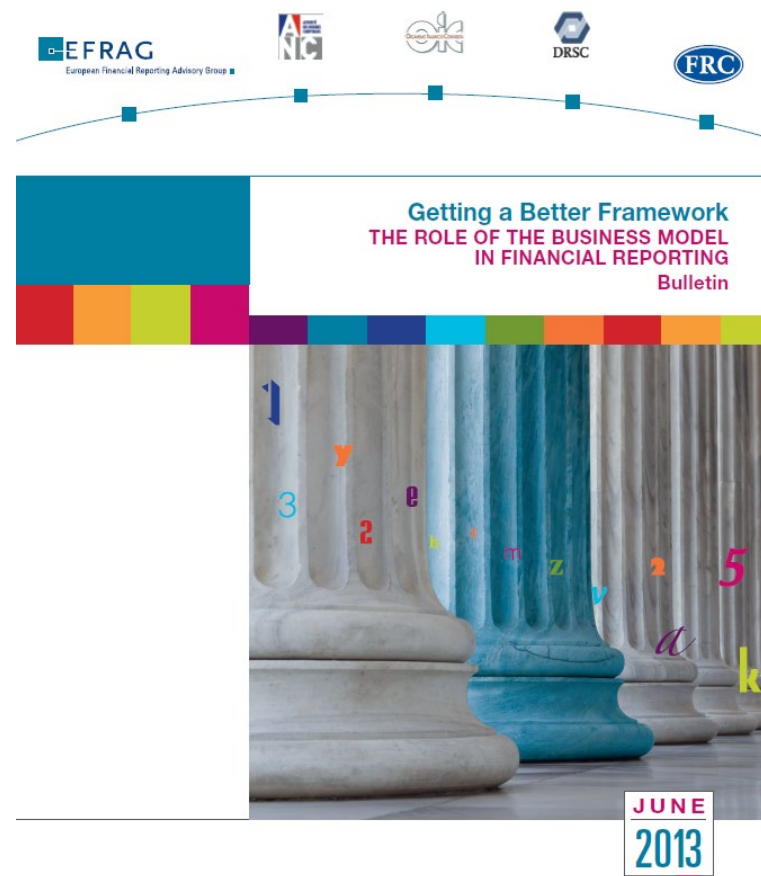
Corporate reporting

- Example: **business model**
 - Undefined term in the IFRS literature
 - “academic literature evidences that the term is increasingly referred to in corporate reporting to describe an entity’s activities, its asset configuration [...], and its customers, products and services”
 - Sometimes the term ‘business model’ focuses on the value creation process of the entity, i.e. how the entity generates cash flows
 - “What is the company doing, where and for whom, and how is the company doing that?”



Corporate reporting

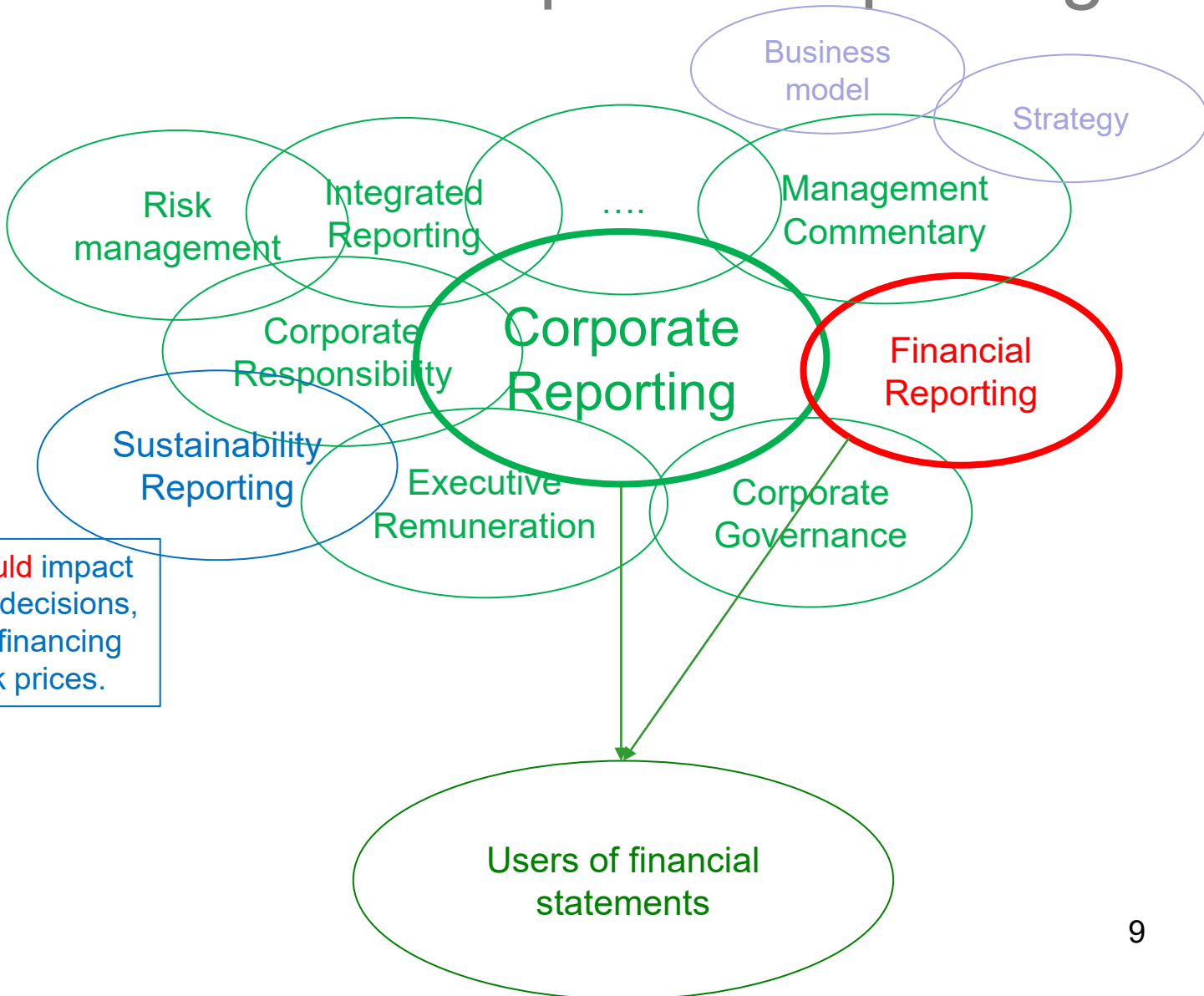
- Example: retail sector
 - Large or small retail areas?
 - City centres or not?
 - Average surface?
 - Product range?
 - Pricing policy?
 - Countries, regions...?
 - ...
- Other: pharmaceuticals, shipping companies, tourism/hotel business, chemicals...



Corporate reporting

- Example: strategy
 - E.g., Internal or external growth - Vertical or horizontal expansion - How does the company anticipate new products and markets, new technology... that are or will be impacting the company's development (~ future operating cash flows)
 - Conceptual Framework 1.3: “Investors’, lenders’ and other creditors’ expectations about **returns** depend on their assessment of the amount, timing and uncertainty of (the prospects for) **future** net cash inflows to the entity and on their assessment of management’s **stewardship** of the entity’s economic resources.”
 - **Future**: but then the user needs to understand the (chosen?) direction of travel
 - **Stewardship** adds an extra “corporate” layer
 - Financial information should enable users to assess management’s stewardship of the entity’s economic resources

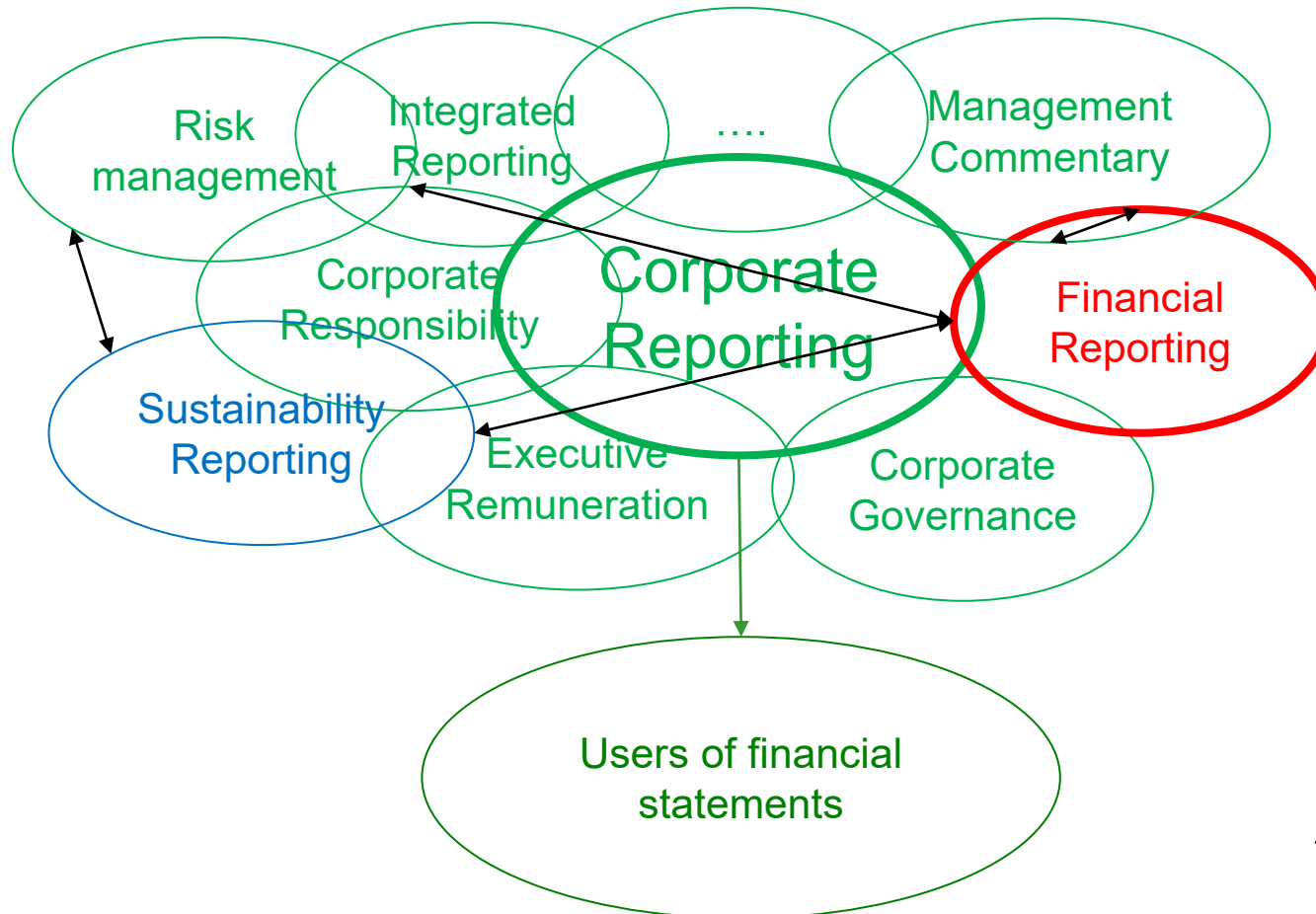
Corporate reporting



Will or should impact investment decisions, access to financing and stock prices.

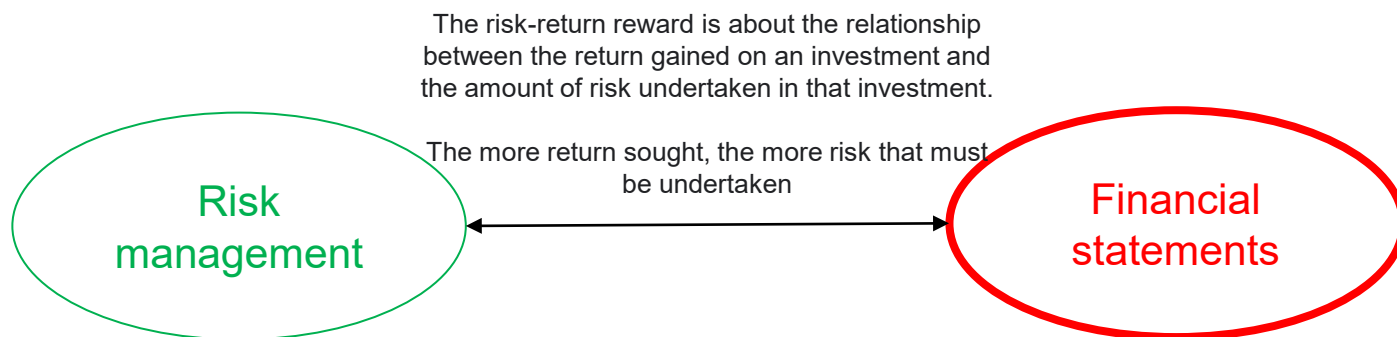
Connectivity

- The different building blocks of corporate reporting need to be *connected* !!! ???



Connectivity

- Financial statements and **risk management**



Risk management

126	1. Risk management process
127	2. Solvay's main risks
128	2.1. Security
129	2.2. Environmental impact and controversies
130	2.3. Compliance and business integrity
131	2.4. Operations safety
134	2.5. Climate change
135	2.6. Regulatory framework for chemicals sustainability
135	2.7. Emerging risk
135	3. Other risks
138	4. Litigation

3.3. Financial risk

RISK HORIZON: SHORT TO MEDIUM TERM

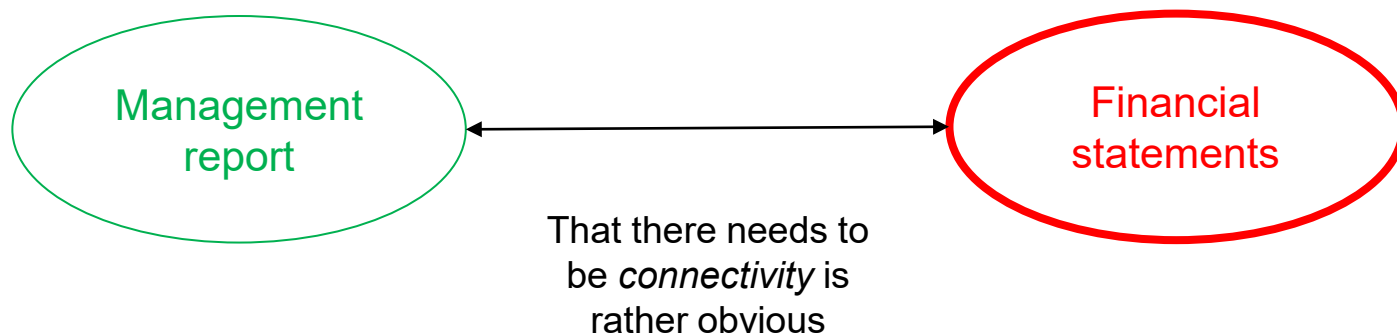
3.3.1. Risk description

We face various different types of financial risk. These include:

- Liquidity risk (see note F32 to the consolidated financial statements, Financial instruments and financial risk management);
- Foreign exchange risk (see note F32 to the consolidated financial statements, Financial instruments and financial risk management).
- Interest-rate risk (see note F32 to the consolidated financial statements, Financial instruments and financial risk management).
- Counterparty risk (see note F32 to the consolidated financial statements, Financial instruments and financial risk management).
- Pension obligation risk (see note F31.A. Provisions for employee benefits).
- Tax litigation risk (see note F31.B. Provisions other for employee benefits).

Connectivity

- Financial statements and **management report**



Connectivity

- Because the **management report** should:
 - Provide management's view of the entity's financial performance and financial position (including forward looking information)
 - Supplement and complement the information presented in the financial statements
 - Be clear and straightforward and be presented with a focus on the most important information, **be consistent with its related financial statements** avoiding duplicating disclosures and avoiding generic and immaterial disclosures

Connectivity

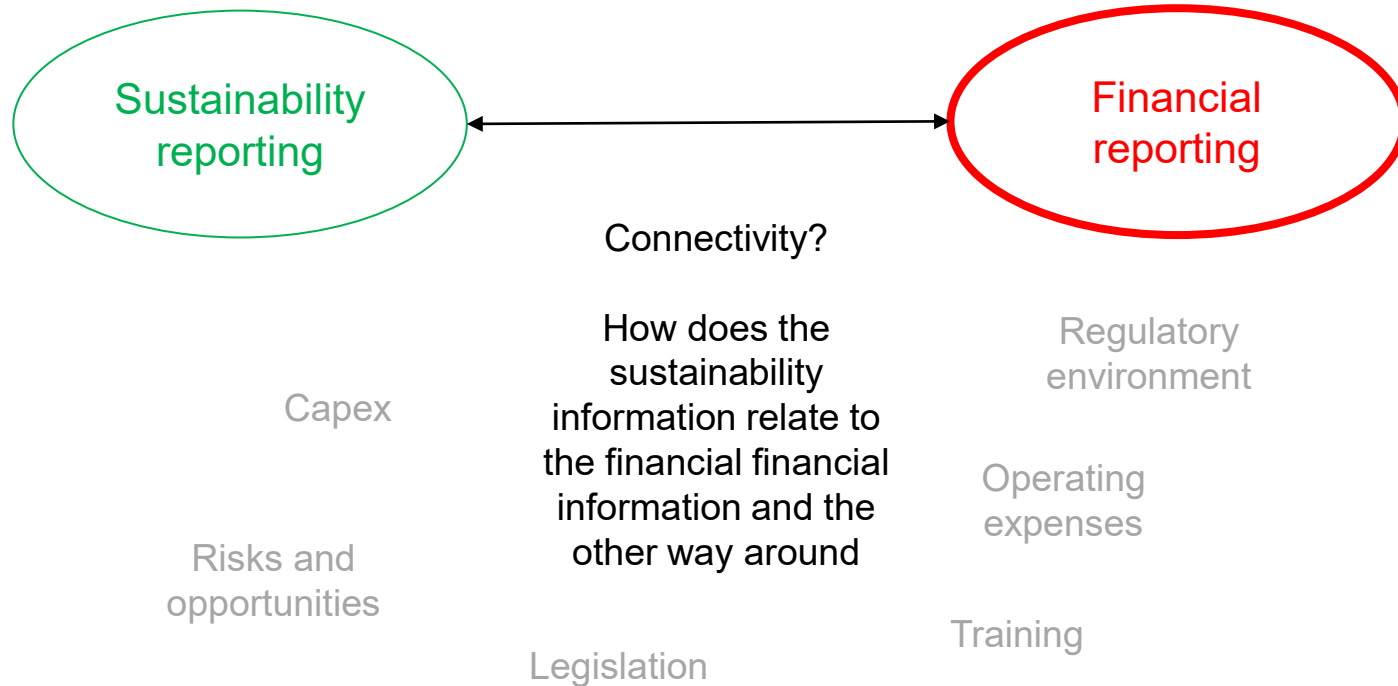
- The **EU Accounting Directive** discusses the *management report* and defines its objectives and content and requires in particular:
 - A fair and balanced review of the development and performance of the business and of its position and a description of the principal risks and uncertainties that it faces, consistent with the size and complexity of the business
 - That the analysis should include **both financial and non-financial key performance indicators** relevant to business, including at least information relating to environmental and employee matters
 - That the management report should include, where appropriate, references to, and additional explanations of, amounts reported in the annual financial statements

Connectivity

- As it is impossible to include all financially relevant information in the financial statements, the IASB developed the *Management Commentary Practice Statement* (2010 - currently being revised).
- The *Management Commentary Practice Statement* is the manual for writing the management report that:
 - Sets out a rigorous, principle-based approach for explaining a company's purpose, business model, strategy and performance, incorporating the long-term drivers of its success.
 - Is not a mandatory part of the IFRS Standards
 - Requires the need to consider both the risks and opportunities facing a company
 - Expects management to report on **environmental and societal issues** to the extent necessary for the users of financial statements to form their own assessment of the company's longer-term prospects and management's stewardship of the business

Connectivity

- Financial and sustainability reporting

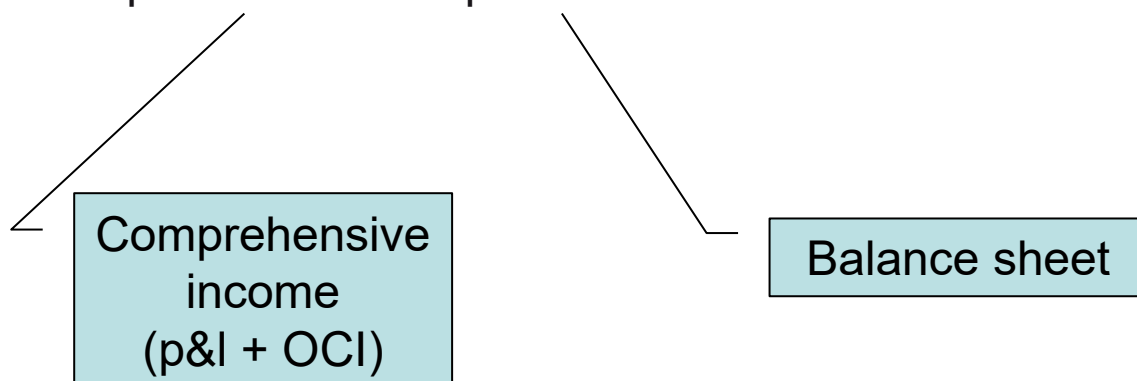


Connectivity

- Benefits that *connectivity* can provide:
 - The non-financial information should supplement and complement the financial information and should be consistent with the financial information
 - Connectivity between financial information and the non-financial information will make the corporate information more useful, relevant and coherent
 - Connectivity will avoid overlaps and repetitions of the same information in different reports

Connectivity

- *Sustainability* is already an issue in financial reporting
- The EU Accounting Directive says that:
 - The information [in the management report] should not be restricted to the financial aspects of the undertaking's business, and there should be **an analysis of environmental and social aspects of the business** necessary for an understanding of the undertaking's development, performance or position



Connectivity

- *Sustainability* is already an issue in financial reporting

November 2019

In Brief

More recent material on this topic is available.
Please refer to educational material:
[Effects of climate-related matters on financial statements](#)
(published 20 November 2020)

IFRS® Standards and climate-related disclosures



Nick Anderson

Climate-change is a topic on which investors and other stakeholders increasingly ask the International Accounting Standards Board (Board), why this is not mentioned explicitly in IFRS Standards.

In this update, Nick Anderson, a member of the Board, provides an overview intended to help investors understand what already exists in the current requirements and guidance on the application of materiality, and how it relates to climate and other emerging risks. While climate-change risks and other emerging risks are not covered explicitly by IFRS Standards, the Standards do address issues that relate to them.

This article has been inspired by work from the Australian Accounting Standards Board (AASB) and Audit and Assurance Board (AUASB).

November 2020

Effects of climate-related matters on financial statements

Connectivity

- Examples:
 - IAS 1 requires disclosure in the notes of information that is not presented elsewhere in the financial statements but is relevant to an understanding of them. Information will be relevant if it could reasonably be expected to influence decisions made by investors.
 - **Sustainability information** could be relevant to understand the financial position and the financial performance of an entity
 - ESG information can already have an impact when applying e.g.,
 - IAS 36 *Impairment of Assets*
 - IFRS 13 *Fair Value Measurement*
 - IFRS 9 *Financial Instruments* / IFRS 7 *Financial Instruments: Disclosures*
 - IAS 37 *Provisions, Contingent Liabilities and Contingent Assets*

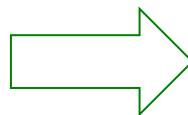
Connectivity

- *Management Commentary Practice Statement*

December 2010

IFRS Practice Statement

Management Commentary
A framework for presentation



May 2021

IFRS[®] Practice Statement
Exposure Draft ED/2021/6

Management Commentary

Comments to be received by 23 November 2021

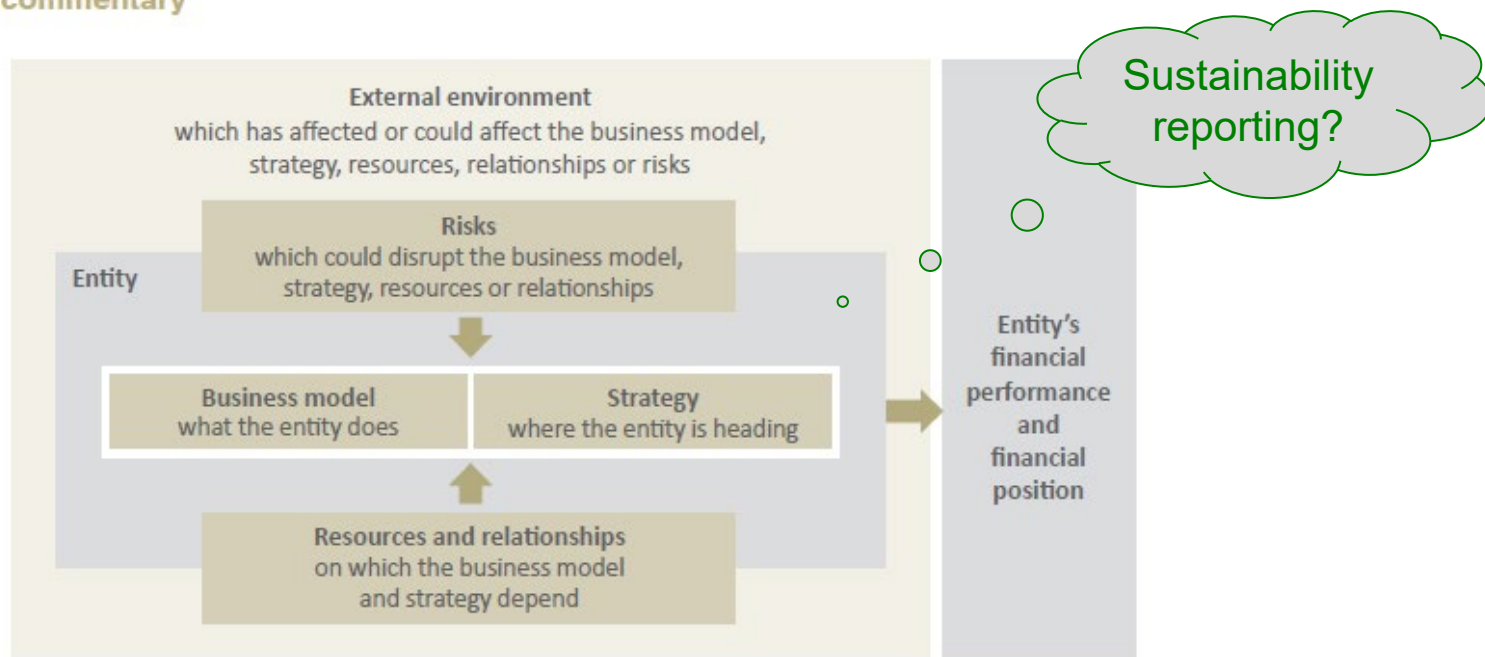
Connectivity

- Why did the IASB decide to revise the *Management Commentary Practice Statement* ?
 - “Because the current practice statement provided insufficient information about the entity’s intangible resources and relationships **and about environmental, social and governance (ESG) matters** affecting the entity. Intangible resources and relationships and environmental and social matters increasingly affect many entities’ ability to create value and generate cash flows, and information about their effects increasingly interests investors and creditors.”

Connectivity

- The ED illustrates the relationships between **six areas of content**:

Figure 1—Relationships between the six areas of content in management commentary



Source IASB's ED/2021/6 Management Commentary (May 2021)

Connectivity

- In Dec-22, the **ISSB** decided to seek feedback in the request for information on its Agenda Consultation regarding **a potential joint project with the IASB** on connectivity in reporting, building on the IASB's Management Commentary project and the Integrated Reporting Framework.
- In Dec-22, the IASB noted that:
 - a. Staff had started analysing similarities and differences between the Integrated Reporting Framework and the Exposure Draft *Management Commentary*
 - b. The ISSB was discussing whether to include in a request for information on its Consultation on Agenda Priorities a joint project with the IASB on connectivity in reporting, building on the IASB's Management Commentary project and the Integrated Reporting Framework; and
 - c. The staff was monitoring developments in the ISSB's Consultation on Agenda Priorities and will present to the IASB at a future meeting alternatives for the way forward on the Management Commentary project.

Connectivity

- EFRAG’s final comment letter on the ED *Management Commentary* (3 December 2021) already referred to the idea that it would be a good idea to consider sustainability reporting and management commentary together:
 - **“Interaction with the IFRS Foundation Trustees’ project on sustainability reporting**
 - EFRAG suggests to the IASB to reconsider the finalisation of the management commentary project in the context of the work that the ISSB is about to start. The role of the Practice Statement in fostering connectivity of financial reporting and sustainability information could be enhanced if the IASB and ISSB manage the project jointly.”

Source EFRAG’s Final Comment Letter dd. 3 December 2021 on the IASB’s ED/2021/6 *Management Commentary* (May 2021)

Connectivity

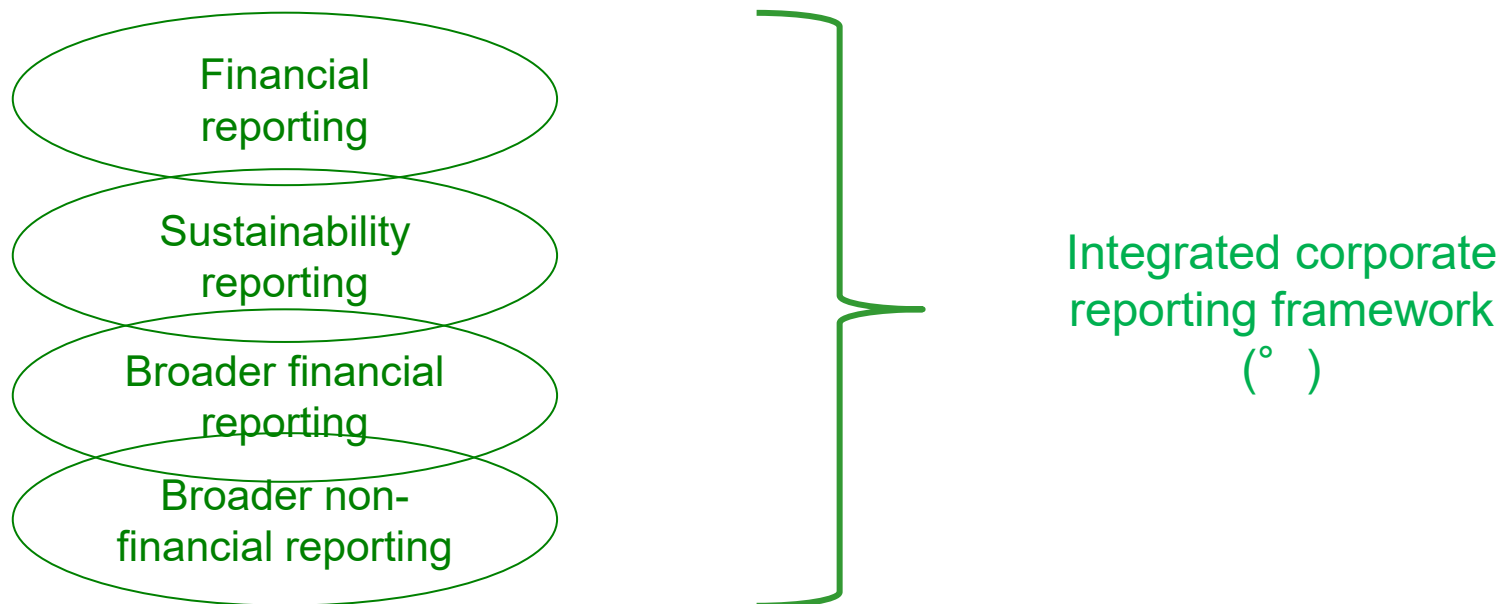
- The *Corporate Sustainability Reporting Directive* says that:
 - The reporting standards should promote a more integrated view of all the information published by undertakings in the management report to provide users of that information with a better understanding of the development, performance, position and impact of the undertaking. [...]. Those standards should also contain guidance for undertakings on the process carried out to identify the sustainability information that should be included in the management report, *since an undertaking should only be required to disclose the information relevant to understand its impacts on sustainability matters, and the information relevant to understand how sustainability matters affect its development, performance and position.*

Connectivity

- *How to connect sustainability and financial reporting?*
 - **IASB**: by revising the *Practice Statement Management Commentary* considering both the “separate” financial reporting (IASB) and sustainability reporting (ISSB) frameworks, i.e. making it a joint project
 - “In assessing the feedback to the Third agenda consultation, the IASB acknowledged that the connectivity between the IASB and the ISSB will be an overarching theme for the IASB in the coming years.”
 - **CSRD**: work in progress
 - “The reporting standards should promote **a more integrated view...**”
 - Several stakeholders have commented on how ESG factors should impact financial statements

Connectivity

- Looking into the future



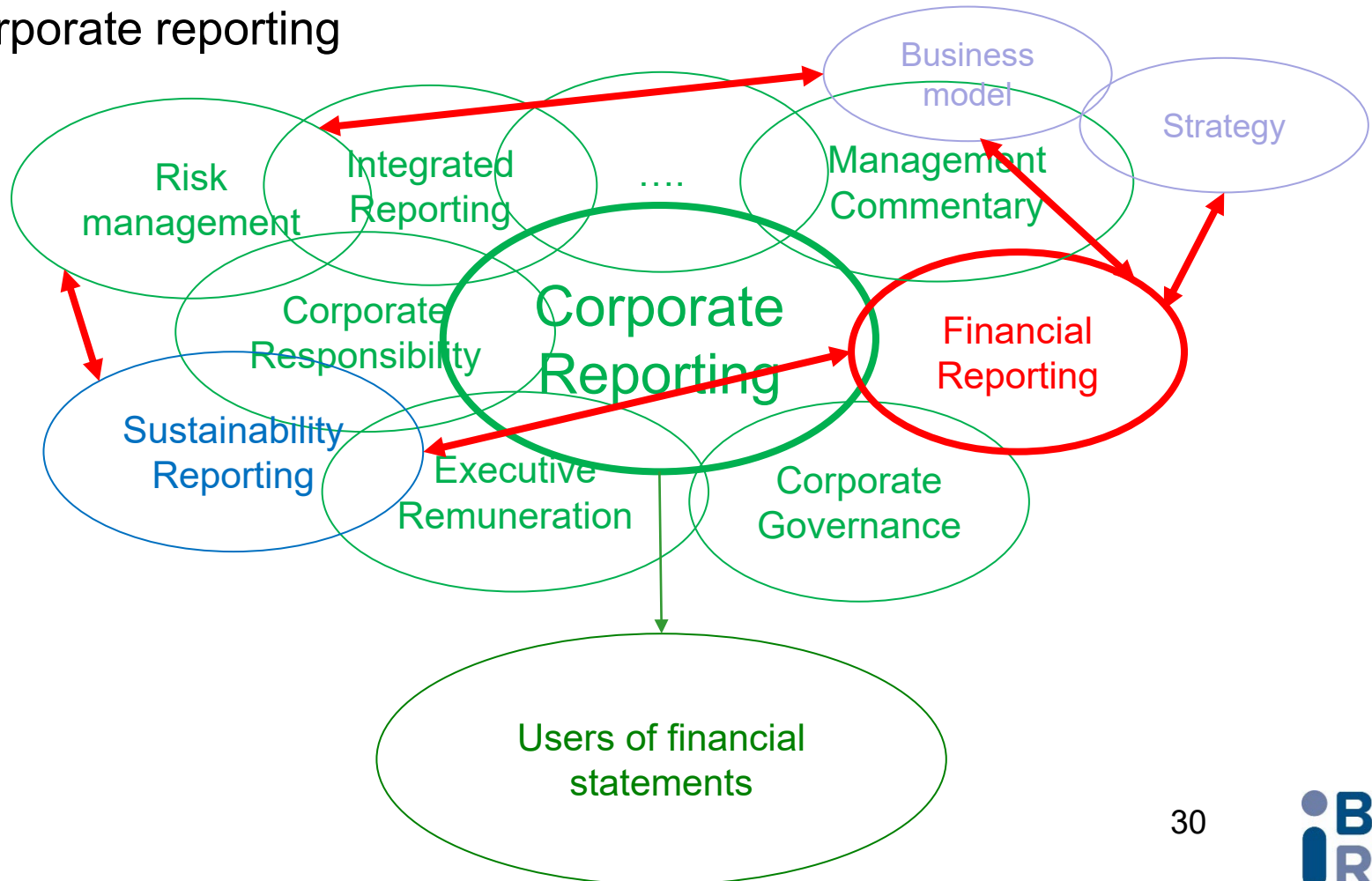
(°) an idea also developed by i.a. *Accountancy Europe* in a paper called *Interconnected Standard Setting for Corporate Reporting* (January 2020)

Connectivity

- “Integrated corporate reporting framework”
- If financial analysis is about assessing free cash flows than
 - Sustainability reporting is (also) closely linked to **risk management**
 - Possible impact of sustainability issues on products and services, investments and divestments... and how the company deals with that
 - Risks regarding “what is the entity’s impact on the environment” and how could this jeopardise the future development
 - But is also to some extent **opportunities management**
 - How can the business model benefit from ESG developments?

Connectivity

- We need “connectivity” between the different building blocks of corporate reporting



Users and sustainability reporting

- The Dutch **AFM** carried out an exploratory study “**Exploration on the use of non-financial** information by institutional investors and analysts” in February 2020
- Some conclusions:
 - “the AFM notes that use of NFI by investors and analysts is still limited,”
 - “Investors and analysts make only limited mention on non-financial aspects during public contacts such as earnings calls and shareholder meetings”

Users and sustainability reporting

- Poll question 1

Users and sustainability reporting

- That said, several investors have introduced **ESG Investing**, an investment policy that ensures that the invested money goes to companies making the world a better place
- ESG investing often relies on independent **ESG ratings** or **ESG scores** that assess a company's environmental performance, social impact, and governance policies

Users and sustainability reporting

- Other papers and research reports suggest/suggested that investors are/were increasingly making use of ESG information
- But also said that:
 - The information should be **comparable**
 - The information should be better **integrated** with the financial information
 - **KPI's** were viewed as essential
 - Non-financial (ESG) disclosures should be **independently verified**
 - **Shareholders** should be able to approve company non-financial disclosure at general meeting of shareholders

Users and sustainability reporting

- Poll question 2

Users and sustainability reporting

- This confirms more or less:
 - Sustainability reporting is still a confusing combination of many things
 - Multiplicity of frameworks and standards does not help
 - We need further streamlining, a consistent platform/framework...
 - #Coherence #Comparability
 - It may take some time to build up credibility
 - See also how financial reporting has developed over the past two decades...
- Admittedly, some stakeholders are also questioning ESG Investing and sustainability (reporting) as a whole...

Users and sustainability reporting

- **EFRAG** is also looking at this:
 - ... as sustainability reporting is expected to develop significantly in the coming years, both in terms of content and **in terms of quality**
 - These developments will create challenges
 - In terms of the location of information (which information to be provided where); and
 - in terms of **connectivity**: enabling an understanding of how sustainability information relates to financial statements and the other way around

Users and sustainability reporting

- Admittedly, a lot of investors are already taking sustainability risks and opportunities into account
 - Developing **ESG Investing** to ensure their money goes to companies making the world a better place
 - Integrating ESG within the investment process believing that sustainability is a key component of long-term value creation
 - Based on their own models, strategic insights... factoring in ESG issues in the investment process
 - With dedicated ESG teams
 - Engaging with other experts active in the field of sustainability to push together e.g., for better risk disclosures

Users and sustainability reporting

- **ESG Investing**

- Excluding sectors based on certain qualitative criteria, controversial activities...
- Focussing on key areas e.g., decarbonization, energy transition, water and waste projects...
- Factoring in e.g., management quality
- Adjustments to WACC when determining fair value
 - Good ESG score ... WACC is reduced
 - Bad ESG score ... WACC is increased
- How to factor in the ESG *uncertainties*?
 - Free cash flows, scenario analysis...

} Very judgemental

Users and sustainability reporting

- Poll question 3

Users and sustainability reporting

- **Summarising**

- The different building blocks of corporate reporting need to be (or are?) connected
- Sustainability reporting is (or will be) considered
 - In the IASB's Management Commentary (being revised)
 - In the CSRD
 - But should perhaps become part of an overarching integrated corporate reporting framework
- Sustainability reporting is still work in progress but is expected to develop significantly in the coming years
 - #Conceptually #Comparability #Coherence #Understandability #...
 - Stakeholders are diving into this (or are diving into this) to establish the needed connectivity



AWARDS FOR BEST BELGIAN
**SUSTAINABILITY
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Thank you for your attention



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