Beyond the GAAP

Mazars' monthly newsletter on financial and sustainability reporting

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Editorial

As we approach the half-yearly closing of accounts, Beyond the GAAP presents a snapshot of the new standards and interpretations applicable from 1 January 2022 (both mandatory and optional). In addition to this overview, we bring you a summary of the ESMA recommendations published on 13 May. The European Securities and Markets Authority has identified the key issues to address in the interim financial statements in the context of Russia's invasion of Ukraine. ESMA has also published specific recommendations on the forthcoming implementation of IFRS 17 – *Insurance Contracts.*

As promised, Beyond the GAAP will also take a closer look this month at the draft sustainability standards published by both the ISSB (one on general disclosure requirements, the other on climate-related disclosure requirements) and EFRAG (13 draft standards, including two cross-cutting standards and 11 topical standards on ESG issues). We present a comparative analysis of the main proposals in the draft standards.

IFRS Highlights

Redeliberations continue on Primary Financial Statements project

At its May 2022 meeting, the IASB (International Accounting Standards Board) continued its redeliberations on the proposals in the December 2019 General Presentation and Disclosures exposure draft, in the wake of comments received from stakeholders.

Management performance measures

In May, the IASB's redeliberations focused heavily on management performance measures or MPMs (cf. Beyond the GAAP no. 164, March 2022, for more details of the Board's previous decisions on this topic). MPMs are measures that an entity uses in communications outside IFRS financial statements and the IASB is hoping to establish a framework for these measures, according to which certain disclosures would be required in the notes.

The redeliberations to date have confirmed the proposal in the exposure draft to introduce a list of the minimum required disclosures on all the MPMs used by the entity, to be presented in a single note to the financial statements, in order to promote transparency in financial reporting on these measures. These required disclosures will include a reconciliation between each MPM and the most directly comparable subtotal or total in the income statement.

However, further redeliberations were required on the controversial proposal in the exposure draft to require the disclosure of the income tax and non-controlling interest effects of each item disclosed in the reconciliation.

At its May meeting, the IASB tentatively decided to confirm this proposal, but to revise the method for calculating the income tax effect. The exposure draft proposed that an entity should determine the income tax effect on the basis of a reasonable pro rata allocation of the entity's current and deferred tax in the country or countries concerned, or use another method if that would result in a more appropriate allocation in the circumstances. The IASB finally decided to permit entities to calculate the income tax effect as either:

- the tax effects of the underlying transaction(s) at the statutory tax rate(s) applicable to the transaction(s) in the relevant jurisdictions(s); or
- the tax effects as described above, with any other income tax effects related to the underlying transaction(s) to be allocated based on a reasonable pro rata allocation of current and deferred tax, or on another method that achieves a more appropriate allocation.

The addition of the first approach aims to simplify the calculation by allowing the entity to focus on the direct tax effects of the item being reconciled. However, the IASB also requested the staff to continue investigating alternative calculation methods that could improve the cost/benefit ratio for entities.

Unusual income and expenses

Redeliberations on this topic began last December (cf. Beyond the GAAP no.161, December 2021).

In May, the IASB decided to label unusual income and expenses as "income and expenses with limited recurrence", and to define them as follows: "*Income and expenses have limited recurrence when it is reasonable to expect that income or expenses that are similar in type and amount will cease, and once ceased will not arise again, before the end of the assessment period.*"

As a reminder, the definition proposed in the exposure draft (before the December 2021 redeliberations) was as follows: *"Income and expenses with limited predictive value. Income and expenses have limited predictive value when it is reasonable to expect that income or expenses that are similar in type and amount will not arise for several future annual reporting periods."*

Thus, there have been two significant changes from the exposure draft definition:

- the definition of income and expenses "with limited recurrence" now specifically refers to income and expenses recognised in the past, rather than taking an entirely forward-looking approach;
- the predictions for the future will relate to the "assessment period". The IASB has yet to decide on how to define this period, e.g. by linking it to the period used for budgets and forecasts, or by specifying a minimum and/or maximum number of years.

In May, the IASB also began redeliberations on the disclosures to be presented on income and expenses with limited recurrence in a separate note to the financial statements. Discussions will continue once the staff has carried out further analysis with regard to the new definition of income and expenses with limited recurrence.

Sixth compilation of IFRS IC agenda decisions published

On 5 May, the IFRS Foundation published the sixth compilation of IFRS Interpretations Committee (IFRS IC) agenda decisions, published between November 2021 and April 2022. This document is available here.

The agenda decisions included in this compilation relate to IFRS 9 – *Financial Instruments*, IAS 20 – *Accounting for Government Grants and Disclosure of Government Assistance*, IFRS 16 – *Leases* and IAS 7 – *Statement of Cash Flows*, and cover the following specific topics:

- the TLTRO III financing programme for European banks (for more details on this agenda decision, which relates to IFRS 9 and IAS 20, cf. Beyond the GAAP no. 164, March 2022);

- economic benefits from use of a wind farm (for more details on this agenda decision, which relates to IFRS 16, cf. Beyond the GAAP no. 161, December 2021);
- demand deposits with restrictions on use arising from a contract with a third party (for more details on this agenda decision, which relates to IAS 7, cf. Beyond the GAAP no. 165, April 2022).

IFRS IC agenda decision on whether a software reseller is an agent or principal under IFRS 15

In April 2022, the IFRS Interpretations Committee (IFRS IC) reached a final decision, ratified by the IASB in May and available here, on whether a software reseller is an agent or principal under IFRS 15.

In the request submitted to the Committee, a reseller advises an end-customer on the type of software and number of licences but does not provide any other services (the licences are standard licences). If the customer chooses to buy the licences, the reseller places the order with the software manufacturer and the customer enters into a contract directly with the manufacturer. The software manufacturer provides the customer with the software licences – issued in the customer's name – via a software portal and an activation key. If the reseller advises the customer to buy a type or number of licences that do not meet the customer's needs, the customer may refuse to accept the licences. In this case, the reseller may neither return them to the manufacturer nor sell them to another customer.

In its agenda decision, the Committee did not reach a conclusion on whether the reseller is acting as an agent or as a principal under IFRS 15 – *Revenue from Contracts with Customers*. This would require the use of judgement based on the specific facts and circumstances of the case, including the terms and conditions of the contracts. The Committee thus simply drew attention to the relevant sections of the standard and explained how they apply, setting out its reasoning step by step. It also reminded preparers of the requirement to provide disclosures in the notes on material accounting policies in accordance with IAS 1, and on significant judgements made in determining revenue in accordance with IFRS 15.

New IASB appointments

On 26 May, the Trustees of the IFRS Foundation announced the appointment of Linda Mezon-Hutter and Robert Uhl as members of the IASB.

They will fill the two positions reserved for the Americas and will serve a five-year term from September 2022, succeeding Tom Scott and Mary Tokar.

Linda Mezon-Hutter has been a member, vice-chair and chair of the Canadian Accounting Standards Board (AcSB) and has also held a position on the IASB's Accounting Standards Advisory Forum.

Robert Uhl has been a member of the IFRS Interpretations Committee (IFRS IC) and the Emerging Issues Task Force of the US Financial Accounting Standards Board (FASB).

Nick Anderson, Jianqiao Lu and Ann Tarca have been reappointed for a second three-year term.

For more details on these appointments, see here.

European Highlights

ESMA publishes 26th extract from IFRS enforcement decisions database

Readers will be aware that ESMA (the European Securities and Markets Authority) publishes extracts from its database of IFRS enforcement decisions at frequent although irregular intervals. The 26th extract from the confidential database, which records decisions taken by enforcers in the European Economic Area (EEA), was published on 17 May and is available here.

ESMA's dual aim for these semi-regular publications is to:

- strengthen supervisory convergence between the 38 national enforcers and supervisory authorities in the EEA that participate in the European Enforcers Coordination Sessions; and
- provide issuers and users of financial statements with relevant information on the appropriate application of IFRSs from the perspective of the EECS.

However, ESMA emphasises that the published decisions:

- are not interpretations of IFRSs, which remain the prerogative of the IFRS IC;
- are based on the IFRS requirements valid at the date of publication of the financial statements, and may be superseded by subsequent changes to the IFRS framework.

The 11 decisions published in this latest extract relate to the annual financial statements for 2018, 2019 and 2020, and cover the following topics:

- consideration of credit enhancements in the measurement of expected credit losses (IFRS 9);
- measurement of net realisable value of inventory (IAS 2);
- costs to make the sale in calculating the net realisable value of inventories (IAS 2);
- recognition of revenue over time (IFRS 15);
- significant financing component (IFRS 15);
- presentation of litigation proceeds as revenue (IFRS 15);
- impairment test of cash-generating unit (CGU) comprising right-of-use assets (IFRS 16/IAS 36);
- COVID-19 impairment indicators (IAS 36);
- identifying cash-generating units (IAS 36);
- operating segments (IFRS 8);
- change in the composition of cash and cash equivalents (IAS 7/IAS 8).

Among the published decisions, of particular note is the decision relating to the impairment test of a cash-generating unit comprising right-of-use assets under IFRS 16, which concluded that:

- the recoverable amount of a CGU with an associated right-of-use asset cannot be calculated based on cash flow projections that include lease payments that are already reflected in the lease liability; and
- the discount rate must reflect the impact of IFRS 16 on the capital structure.

The publication of this decision is likely to mean the end of impairment testing using methods in which (i) the CGU includes the right-of-use asset but the lease liability is deducted and (ii) the value in use is calculated based on cash flow projections

that include lease payments that are already reflected in the lease liability, and the discount rate does not reflect the impact of IFRS 16 on the capital structure.

All the decisions published by ESMA as extracts from the EECS enforcement decisions database are available in a single master document. This document, last updated in July 2021, is available here.

ESMA publishes recommendations on first-time application of IFRS 17 – *Insurance Contracts*

IFRS 17 – *Insurance Contracts* was adopted by the European Union at the start of this year and will be applicable for the first time from 1 January 2023.

The new standard specifies the disclosures required on first-time application (an explanation of the impacts on the financial statements for 2023 and the prior periods presented). These disclosures will be presented for the first time in the 2023 interim financial statements. However, IAS 8 requires entities to present disclosures on the forthcoming implementation of the new standard and its expected impacts, prior to first-time application.

Against this background, ESMA published recommendations on 13 May (available here) covering the disclosures to be provided progressively by insurers in the run-up to first-time application of IFRS 17.

ESMA published similar recommendations in 2016 (available here) ahead of first-time application of IFRS 9; these remain relevant, as many insurers have deferred first-time application of IFRS 9 to 2023, using the temporary exemption permitted by IFRS 4.

As regards the forthcoming implementation of IFRS 17, ESMA:

- recommends that issuers should disclose qualitative and quantitative information on the impacts of application of the new standard, from the 2022 interim financial statements onwards;
- points out that information on the opening balance sheet and the comparative financial statements should be available by the publication date of the 2022 financial statements (at the start of 2023), as the standard will already be in force by that time;
- states that where information, even if only partial, has already been provided to the company's management and supervisory bodies, this information is "reasonably available" and should be disclosed. If it is not disclosed, the entity should explain why not;
- provides a list of recommended disclosures, including the methodology used to determine discount rates, the level of aggregation of contracts, use of the optional exemption provided in the EU version, and the provision or otherwise of comparative information for IFRS 9;
- notes that the impact disclosures should, as far as practicable, cover the key changes from the previous standard (IFRS 4), particularly as regards opening equity, the contractual service margin (CSM) and alternative performance measures (APMs).

Standards and Interpretations applicable at 30 June 2022

Now that interim final reports are being finalised for 30 June 2022, Beyond the GAAP presents an overview of the IASB's most recent publications. For each text, we clarify whether it is mandatory for this closing of accounts, or whether early application is permitted, based on the EU endorsement status report (position as at 2 May 2022, available on EFRAG's website here).

As a reminder, the following principles govern the first application of the IASB's standards and interpretations:

1. The IASB's draft standards cannot be applied as they do not form part of the published standards;
2. The IFRS IC's draft interpretations may be applied if the two following conditions are met:
    - the draft does not conflict with currently applicable IFRSs;
    - the draft does not modify an existing interpretation which is currently mandatory.
3. Standards published by the IASB but not yet endorsed by the European Union at 30 June may be applied if the European endorsement process is completed before the date when the interim financial statements are authorised for issue by the relevant authority (i.e. usually the board of directors);
4. IFRS IC's Interpretations published by the IASB but not yet endorsed by the European Union at the date when the interim financial statements are authorised for issue may be applied unless they are in conflict with standards or interpretations currently applicable in Europe.

Remember that in accordance with IAS 8 the notes of an entity applying IFRSs must include the list of standards and interpretations published by the IASB but not yet effective that have not been early applied by the entity. In addition to this list, the entity must provide an estimate of the impact of the application of those standards and interpretations.

Regarding minor amendments and interpretations, it seems relevant to limit such list to only those amendments and/or interpretations which are likely to apply to the entity's activities.

It should also be noted that under IAS 34 – *Interim Financial Reporting*, the changes in accounting policies required by new standards must also be disclosed in the interim financial reporting published in the course of the year.

Standard	Subject	Effective date according to the IASB	Date of publication in the Official Journal	Application status at 30 June 2022
IFRS 14	**Regulatory Deferral Accounts** (issued on 30 January 2014)	1/01/2016 Early application permitted	No endorsement (The EC has decided not to launch the endorsement process of this interim standard and to wait for the final standard)	Not permitted
Amendments to IFRS 10 and IAS 28	**Sale or Contribution of Assets between an Investor and its Associate or Joint Venture** (issued on 11 September 2014) **and effective date** (issued on 17 December 2015)	Postponed Early application permitted	Deferred	Permitted [1]
IFRS 17 and amendments	**IFRS 17 Insurance Contracts** (issued on 18 May 2017); including **Amendments** (issued on 25 June 2020)	1/01/2023 Early application permitted	23 November 2021 (UE introduces an option to exempt intergenerationally-mutualised and cash flow matched contracts from the annual cohort requirement)	Permitted
Amendments to IFRS 17	**Initial Application of IFRS 17 and IFRS 9 – Comparative Information** (issued on 9 December 2021	An entity that elects to apply the amendments shall apply them when it first applies IFRS 17	Awaiting endorsement by the EU (date not yet announced)	Permitted[2]
Amendments to IAS 16	**Property, Plant and Equipment: Proceeds before Intended Use** (issued on 14 May 2020)	1/01/2022 Early application permitted	2 July 2021	Mandatory
Amendments to IAS 1	**Classification of Liabilities as Current or Non-current** (Issued on 23 January 2020) - **Deferral of Effective Date** (Issued on 15 July 2020)	1/01/2023 Early application permitted	Awaiting endorsement by the EU (date not yet announced)	Not permitted
Amendments to IAS 1	**Presentation of Financial Statements and IFRS Practice Statement 2: Disclosure of Accounting policies** (issued on 12 February 2021)	1/01/2023 Early application permitted	Awaiting endorsement by the EU (date not yet announced)	Permitted

[1] If the entity had not developed an accounting policy.
[2] If the European endorsement process is completed before the date when the financial statements are authorised for issue and subject to early application of IFRS 17

Standard	Subject	Effective date according to the IASB	Date of publication in the Official Journal	Application status at 30 June 2022
Amendments to IFRS 3	**Reference to the Conceptual Framework** (issued on 14 May 2020)	1/01/2022 Early application permitted (if the entity applies at the same time all other updates to the Conceptual Framework of March 2018)	2 July 2021	Mandatory
Amendments to IAS 37	**Onerous Contracts - Cost of Fulfilling a Contract** (issued on 14 May 2020)	1/01/2022 Early application permitted	2 July 2021	Mandatory
Annual Improvements to IFRSs 2018–2020 Cycle	**Annual improvements to various Standards** (issued on 14 May 2020)	1/01/2022 Early application permitted	2 July 2021	Mandatory
Amendments to IAS 8	**Definition of Accounting Estimates** (issued on 12 February 2021)	1/01/2023 Early application permitted	3 March 2022	Permitted
Amendments to IAS 12	**Deferred Tax related to Assets and Liabilities arising from a Single Transaction** (issued on 7 May 2021)	1/01/2023 Early application permitted	Awaiting endorsement by the EU (date not yet announced)	Permitted [3] (except transitional provisions)

[3] A voluntary change in accounting policy is authorised provided such change is applied retrospectively in accordance with IAS 8 (i.e. the transitional provisions under IAS 12 amendments cannot be applied).

ESMA highlights key issues for 2022 interim reporting raised by Russia's invasion of Ukraine

On 13 May, ESMA published a statement (available here) highlighting key issues raised by Russia's invasion of Ukraine, which require particular attention when preparing interim financial reporting at 30 June (including both the IFRS financial statements and the management report). These recommendations may also be relevant to annual financial statements, for entities whose reporting period does not coincide with the calendar year.

The importance of 2022 interim financial reporting in an uncertain and rapidly-changing environment

ESMA emphasises the need for financial reporting that is as transparent as possible regarding the impacts of Russia's invasion of Ukraine, whether direct or indirect (e.g. the increase in the price of some commodities), as well as the impacts of sanctions imposed on Russia and Belarus.

ESMA recommends that issuers provide specific and detailed disclosures, tailored to their particular situation. Disclosures must help users to understand the current and, where possible, expected significant impacts of the conflict on an issuer's financial position, performance and cash flows.

ESMA recommends that issuers with significant exposure to the impacts of the conflict and the associated sanctions should generally present all the necessary disclosures in a single note to the financial statements, or provide a key to all the different notes that relate to Russia's invasion of Ukraine.

ESMA also emphasises the need to provide information on the identification of the principal risks and uncertainties to which issuers are exposed, whether directly or indirectly.

If an issuer has significant risk exposure, but the invasion has not actually had a material impact on its financial statements, ESMA recommends that the issuer should explain why this is the case.

Furthermore, ESMA emphasises that it is important to keep the market informed as soon as possible on any relevant material information relating to the conflict that affects an entity's fundamentals, prospects or financial situation.

The European market regulator also highlights the essential role played by audit committees in particular in ensuring that interim financial reporting is of high quality.

Additional information should be presented in interim financial statements and management reports

ESMA makes a general call for consistency between disclosures in the interim financial statements and in the interim management report.

Additional information to be presented in interim financial statements

ESMA reminds issuers that under IAS 34, the level of information provided should be proportionate to the objective of providing an update on the latest complete set of annual financial statements published. As the conflict has been in progress since 24 February 2022, it constitutes a significant event for the first semester, and ESMA thus expects that a substantial update will be required for entities with significant operations in Russia, Ukraine and/or Belarus, or that have significant exposures to indirect impacts of the conflict.

ESMA also notes that, in addition to the disclosures required by IAS 34 for condensed interim financial statements, entities may need to provide additional information that is normally only required under IFRSs in a complete set of annual financial statements, in order to provide relevant information on the impacts of the war in Ukraine in the 2022 interim financial statements. ESMA gives as an example the disclosures on financial risks required by IFRS 7 (credit, liquidity, currency and commodity risks) and the associated sensitivity analyses.

As a result of the uncertainty resulting from the war in Ukraine, many entities will need to make use of significant judgements and assumptions when preparing their 2022 interim financial statements. They will need to update the assessments carried out at 31 December 2021 on significant judgements, assumptions about the future and other major sources of uncertainty. The interim financial statements should include disclosures on the nature and amount of these changes.

Additional information to be presented in the interim management report

As regards the disclosures to be presented in the half-yearly management report, ESMA also recommends that issuers should provide detailed, entity-specific information. This should include disclosures on the following:

- a commentary on the direct and indirect impacts of the war in Ukraine and the associated sanctions on the entity's strategic orientation and targets, financial position and performance, and cash flows;
- details of measures taken to mitigate the effects of the crisis (particularly any specific support measures that it has applied for/received, and its risk hedging strategy);

ESMA also reminds issuers to update their disclosures on related party transactions with companies and/or individuals subject to sanctions, when relevant. This also applies to the interim financial statements.

How to approach key issues in the context of Russia's invasion of Ukraine

Ability to continue as a going concern

In the current context, ESMA points out that the going concern assumption shall be assessed at group level (even if there are doubts about a subsidiary). An issuer shall take account of all available information, including any restrictions on the group's ability to readily access cash and cash equivalents (which should be disclosed if relevant).

Impairment testing of non-financial assets

The decisions taken by some companies to abandon, sell, suspend or cancel operations or investments in Ukraine, Russia and Belarus are, *a priori*, indicators of impairment under IAS 36. Thus, ESMA notes that such decisions must be taken into account when assessing whether an entity needs to recognise impairment.

It also acknowledges that impairment testing is particularly tricky in the current context, and the assessment of cash flow projections may involve consideration of multiple scenarios. ESMA emphasises that, in such a case, the weighting of these various scenarios should be calibrated on the basis of reasonable, supportable and realistic estimates and assumptions, to avoid the risk of excessively optimistic or pessimistic biases.

In addition, discount rates may need to be updated to reflect increases in interest and

inflation rates, unless future cash flows have already been updated to reflect these changes.

Finally, disclosures on impairment testing should also include updated information on sensitivity analyses, which may require an expanded range of reasonably possible changes in key assumptions.

Assessment of control, joint control or significant influence

Given the change in facts and circumstances resulting from Russia's invasion of Ukraine and the associated sanctions, some issuers may need to reassess whether they still have control, joint control or significant influence over their subsidiary, joint arrangement or associate. This assessment should be carried out with care on a case-by-case basis, to assess whether the changes in facts and circumstances may call into question the previous assessment. However, ESMA notes that the decision to abandon operations in Ukraine, Russia or Belarus, or restrictions on access to information or on the use of financial resources, may not necessarily lead to the loss of control, joint control or significant influence.

Implementation of IFRS 5

ESMA reminds issuers that non-current assets (or disposal groups held for sale) may only be classified as held for sale under IFRS 5 if they are available for sale immediately, in their present condition, and the sale is highly probable. It should also be noted that the standard requires a specific accounting treatment for operations that are to be abandoned or terminated (no impact on the balance sheet, but recognised in profit or loss and the cash flow statement, provided that the operation in question represents a separate major line of business or geographical area of operations).

Other disclosure requirements

Entities must also consider whether other disclosures are relevant in light of the identified impacts of the conflict. These might include the recognition of deferred tax assets in accordance with IAS 12, remeasurement of foreign currency transactions or translation of foreign currency financial statements in accordance with IAS 21, and the measurement of provisions (including provisions for onerous contracts) in accordance with IAS 37.

ISSB and EFRAG draft standards on sustainability disclosures: a comparative analysis

In recent months, work on the standardisation of sustainability reporting has accelerated, requiring stakeholders to invest significant resources in understanding the proposals and their potential impacts.

Given the high stakes involved in this work, Beyond the GAAP presents a preliminary comparative analysis of the main proposals of the International Sustainability Standards Board (ISSB) and the European Financial Reporting Advisory Group (EFRAG) to help stakeholders form an opinion on the recently published draft standards, which are open for comment until 29 July and 8 August 2022 respectively.

At first glance, it can be observed that these drafts both follow the usual structure familiar to stakeholders who are accustomed to IFRSs issued by the IASB (notably with appendixes that form an integral part of the draft standard, along with basis for conclusions). The main reporting principles of the ISSB and EFRAG are also very similar to those known and applied in the publication of IFRS financial statements.

While the two standard-setters, ISSB and EFRAG, have exchanged views on their respective work in recent months in order to minimise divergences between the two frameworks (to the extent that they currently exist on either side), some of the fundamentals are different, which in practice is likely to create some disparities in sustainability disclosures. This being so, given the fundamentals adopted by EFRAG and the granularity of the information required, entities required to comply with the future European standards should be able to meet the requirements of the ISSB's framework.

Different ambitions and agendas

ISSB's “building blocks” approach to developing a comprehensive global benchmark

31 March saw the international publication of the ISSB's first two exposure drafts:

- IFRS S1 *General Requirements for Disclosure of Sustainability-related Financial Information* (available here) describes how to disclose sustainability information in general terms, following the IFRS framework applied by the ISSB, including what to do in the absence of previously published standards on particular topics. IFRS S1 is thus the counterpart to IAS 1 – *Presentation of Financial Statements* and IAS 8 – *Accounting Policies, Changes in Accounting Estimates and Errors.* In practice, IFRS S1 sets out general principles for sustainability reporting based on the four pillars identified by the Task Force on Climate-related Financial Disclosures (TCFD) – governance, strategy, risk management, and metrics and targets – as the key aspects of how an entity operates with respect to sustainability;
- IFRS S2 *Climate-related Disclosures* (available here) clarifies the disclosures to provide in the area of climate risk. This draft incorporates the TCFD recommendations and sectoral reporting requirements derived from the standards set by the Sustainability Accounting Standards Board (SASB). The ISSB's current approach is thus sectoral, requiring an entity to publish different – but sometimes also

redundant – metrics for each of the sectors in which it operates.

The ISSB expects to publish both standards in their final form by the end of the year, depending on the comments received. The IFRS sustainability reporting framework will then be gradually supplemented by other "IFRS S", as the ISSB aims to develop standards that serve as a comprehensive global baseline for sustainability reporting.

For the time being, the ISSB is taking a "building blocks" approach aimed at compatibility with other standards already applied voluntarily by companies or imposed by certain jurisdictions. This step-by-step construction of an internationally recognised sustainability reporting framework is based on:

- the consolidation of the Value Reporting Foundation (VRF) into the IFRS Foundation. The VRF itself represents the relatively recent consolidation of the Sustainability Accounting Standards Board (SASB) and the International Integrated Reporting Council (IIRC): on 25 May, the IFRS Foundation announced the next steps in this process, with the forthcoming release of the VRF's Integrated Reporting Framework directly by the IFRS Foundation. The consolidation of the VRF is expected to be completed by 30 June. As a first step, the IFRS Foundation will encourage the voluntary application of this integrated reporting framework in its current form. In a second phase, the ISSB and IASB will work with the Integrated Reporting Council, which will emerge from the VRF, to determine how to reflect this framework and its principles in both Boards' standard-setting projects and the resulting disclosure requirements;
- convergence with the Global Reporting Initiative (GRI), agreed in March, which should eventually, and where possible, align terminology, standard structure and metrics, thus helping to reduce the cost of sustainability reporting to entities.

The "success" of IFRS S will be dependent on the widespread use of these standards for sustainability reporting, as has been the case with the IASB's IAS and IFRS accounting standards for financial statements. This was emphasised by the ISSB in a statement on 18 May to mobilise stakeholders around its work.

EFRAG standards to support the European green deal

For its part, EFRAG launched its public consultation at the end of April and has been working urgently for several months (initially in project mode) to meet the agenda imposed by Europe's green deal, in part led by the Corporate Sustainability Reporting Directive (CSRD). The basis for conclusions of the draft standards have just been published (available here with all the draft standards).

The final text of the CSRD should be ready by the end of June. It will set out the main principles for sustainability reporting by European entities and will require the application of standards prepared by EFRAG to ensure comparability of the information they disclose.

Given Europe's commitment to sustainability reporting, the first set of standards prepared by EFRAG and endorsed by delegated act in Europe is expected to include 14 European Sustainability Reporting Standards (ESRSs). Thirteen drafts were published at the end of April (for more details, see Beyond the GAAP no.165, April 2022). The

draft ESRS SEC 1 on segment classification will be published later.

Ultimately, the European sustainability reporting framework will include not only standards applicable to all entities regardless of their business sector (the subject of the first set currently under public consultation), but also sector-specific standards and a dedicated standard for small and medium-sized enterprises (subject to the final provisions of the CSRD). In other words, at this stage, the disclosures required under the first ESRSs will be sector-agnostic but will need to be supplemented by entity-specific disclosures if necessary (the latter are likely to decrease as the ESRS framework is expanded to include sector-specific standards).

To meet the reporting obligations of the draft CSRD, the draft standards currently include no fewer than 136 disclosure requirements or DRs, each DR requiring the disclosure of several items of information. Each DR is in principle mandatory, as long as it is material for the entity, given its particular circumstances. The result of the materiality analysis (see below) will confirm whether an entity should actually provide a given disclosure, based on its ability to rebut the presumption of materiality of any particular information covered by a disclosure requirement.

Although organised differently, the four TCFD pillars are reflected in the architecture of the ESRSs, which are structured around three headings:

- strategy, covering how sustainability is integrated into the overall strategy, how the governance of sustainability is organised and the process and outcome of the double materiality analysis. This heading addresses the TCFD's strategy and governance pillars, and that part of the risk management pillar relating to the identification of risks and opportunities (through the materiality analysis in accordance with ESRSs);
- operational implementation, covering policies and procedures, action plans, targets and resources. The first of these correspond to the rest of the TCFD's risk management pillar, the second to its strategy pillar, while target-setting reflects a part of the metrics and targets pillar; and
- performance measurement, which covers past and future performance and the future trajectory until the targets are achieved – corresponding to the remaining part of the metrics and targets pillar.

Therefore, risk management is becoming very much integrated with strategy and the way in which impacts, risks and opportunities are taken into account in adjusting strategy and the business model.

In more detail, for the European standards that “mirror” ISSB standards, we can observe that:

- ESRS 1 *General Provisions* does not contain any disclosure requirements but explains how the other standards are organised and, in particular, the relationship between ESRS 2, another cross-cutting standard, and the topical standards. ESRS 1 also explains how the three layers of disclosures (sector-agnostic, sector-specific and entity-specific) are aggregated. In addition, key concepts, such as double materiality and the value chain, are presented and explained;
- ESRS 2 sets out the disclosure requirements for general information, such as the key features of the entity's value chain. The standard also includes

the strategic and business model disclosures, disclosures on sustainability governance, and disclosures on the materiality analysis performed to identify the material impacts, risks and opportunities to which the entity is exposed, all of which are intended to be supplemented with the disclosures required by the topical standards. Overall, the requirements in terms of general reporting principles and specific aspects of governance, strategy, risk and opportunity management and targets are broadly similar across the two sustainability reporting frameworks. Nevertheless, ESRS 2 tends to be more detailed and more prescriptive than IFRS S1, since the European approach is generally more rule-based whereas the ISSB approach is more principle-based;

- ESRS E1 *Climate change* is the standard corresponding to IFRS S2. While the two standards are broadly similar in many respects, the draft European standard has some distinctive features. The first of these concerns the centrality of alignment with the Paris Agreement (limiting the temperature increase to 1.5°C) when defining the climate transition plan and setting the corresponding targets, whereas the ISSB's draft merely asks whether and to what extent the transition plan takes the Paris Agreement into account. The second distinctive feature is the inclusion of metrics for energy consumption and energy sources, distinguishing between renewables and other sources. These metrics are absent from IFRS S2. Finally, ESRS E1 is significantly more granular, in terms of both the actual disclosures to be provided, and the guidance to be followed in doing so (particularly with respect to calculation methods and scenario analysis).

Effective date and transitional arrangements

No effective date is proposed at this stage in the ISSB's exposure drafts. This date will be set when the standards are published and will only affect those jurisdictions that decide to make the application of the standards mandatory. Given the challenge that first-time application of these standards may pose, the ISSB has provided for phased-in implementation whereby no prior period disclosures are required in the first year of application.

The introduction of the European standards will follow a timetable that will ultimately be decided by the CSRD. At this stage, it is likely that only large entities will be affected by application to the 2024 reporting period (i.e. for publication in 2025). Beyond issues of scope and timing, the actual content of the first applicable ESRSs remains to be defined. EFRAG's public consultation contains a number of questions about their phased-in implementation. However, ESRS 1 also provides for an exemption from providing the usual comparative information in the first reporting year.

Different underlying principles and less important divergences

Single vs double materiality

The ISSB and European approaches to this key issue are distinct in the following respects:

- the ISSB has prioritised its work by focusing on the needs of investors, which has led it to adopt an approach based solely on financial materiality, with the objective of providing disclosures on those sustainability topics that are relevant to assessing an entity’s enterprise value. The disclosure

requirements therefore only focus on the main risks and opportunities, i.e. those that could reasonably be expected to affect the entity's business model, strategy and cash flows over the short, medium or long term;

- in Europe, however, the focus is on addressing the sustainability reporting needs of all stakeholders, not just investors. EFRAG has therefore had to develop standards around the fundamental principle of double materiality, which states that reporting should cover not only financial materiality (reflecting the impacts of environmental, social and governance issues on entities) but also impact materiality (in the sense that the entity's activities have an impact on the climate and on people). The disclosure requirements on impacts, absent in the ISSB reporting framework, are thus very detailed and numerous in ESRSs.

Materiality analysis

Another significant point of divergence lies in the way in which an entity identifies significant risks, opportunities and (for ESRSs only) impacts. This is an essential precondition for determining what disclosures are required to cover these aspects.

In both reporting frameworks, the entity is required to disclose how it conducted its materiality analysis and the outcome. In both cases the final decision as to what is or is not material is entirely a matter for the entity's own judgement.

However, the description and the structure of the materiality analysis process are very different. For example, IFRSs do not say what the materiality analysis consists of, or what aspects should be considered; whereas under ESRS 2, the materiality analysis performed by the entity should follow a fairly structured process, including a review of its own circumstances and engagement with stakeholders, and an analysis of pre-defined criteria.

Audit of disclosures

The information disclosed in sustainability statements will have to be audited in Europe, which is not foreseen by IFRS S1 and S2. This is consistent with the fact that the ISSB framework is only a “tool” for each jurisdiction, which is then free to decide whether or not to demand an audit.

Time horizons

The publication of forward-looking information requires the prior definition of short, medium and long-term time horizons.

Unsurprisingly, the ISSB framework is not prescriptive in this respect, taking account of the fact that these time horizons can vary and depend on many factors, including the characteristics of the sector to which the entity belongs.

In contrast, ESRS 1 is prescriptive, as the draft standard defines the short, medium and long-term horizons as one year, two to five years, and more than five years, respectively, from the end of the reporting period in question.

Location of disclosures

IFRS S1 requires sustainability disclosures to be located in an entity's general purpose financial reporting, which also includes its financial statements. In practice, IFRS S1 allows sustainability disclosure to be included in the management report, without imposing any requirements, in order to facilitate compatibility with local regulations. The draft standard does not otherwise contain any requirements as to how the disclosures should be organised.

ESRS 1, following the requirements of the CSRD, requires this information to be

provided in the management report, in clearly identified sections that constitute "sustainability statements". The draft standard offers three reporting options, at the entity's discretion:

- either in a single dedicated section of the management report, under four headings (general information, and disclosures relating to the environment, social aspects and governance). This is the preferred option;
- within existing parts of the management report, which means that the disclosures are more fragmented, but continue to respect the breakdown into four headings;
- or in an even more disaggregated manner, with a presentation by standard, in the appropriate parts of the management report.

Reporting frequency

Sustainability disclosures under ISSB procedures would be published at the same time as the financial statements to which they relate and should cover the same reporting period. If interim reporting is required by a local jurisdiction or regulation, IFRS S1 sets out the principles to be applied.

On the European side, the CSRD covers the subject directly, imposing annual reporting only (to be confirmed once the final text is available).

In spite of this, a convergence on the major principles

The materiality of disclosures

Both reporting frameworks emphasise the materiality of disclosures, as a second step once the significant risks, opportunities and impacts (if applicable) have been identified.

In practice, in both cases an entity will be able to decide what constitutes material information, which must therefore be disclosed, and what is not and can accordingly be omitted.

IFRS S1 defines information as material if omitting, misstating or obscuring that information could reasonably be expected to influence decisions that the primary users of general purpose financial reporting make on the basis of that reporting, which provides information about a specific reporting entity.

ESRS 1 also requires an entity to exercise judgement in ultimately assessing whether information is material, which in practice could lead it to omit disclosures relating to an impact, risk or opportunity that has been identified as material as a result of the materiality analysis. Under the draft standard, information is material when it is necessary to illustrate the importance of the phenomenon to which it relates, when it meets the needs of stakeholders (including by allowing for proper decision-making), and when it satisfies the public interest need for transparency. Assessing the materiality of disclosures will involve defining thresholds and/or criteria. As in the case of IFRS S1, EFRAG gives no particular guidance in this area.

Value chain

While sustainability disclosures are made from the perspective of the reporting entity (at the individual or consolidated level), both IFRS S1 and ESRS 1 require material disclosures about the key risks, opportunities and impacts (if applicable) identified across the company's value chain, a concept that is defined in both reporting frameworks in a broadly similar way.

Qualitative characteristics

IFRS S1 and ESRS 1 both describe the characteristics of high-quality information

(IFRS S1 making reference to the IASB's Conceptual Framework), mentioning relevance and faithful depiction as the key features. They also emphasise comparability, verifiability and understandability as secondary characteristics. IFRS S1 also mentions timeliness.

Reporting scope

In both frameworks, the scope of sustainability statements must be identical to that used when presenting financial statements. In practice, the consolidation scope (where applicable) is therefore unchanged.

Connected information

Both frameworks emphasise the need to disclose information that enables users to assess the connections both between the material aspects of sustainability and, more importantly, to the financial statements published elsewhere by the entity.

In practice, connectivity means using mutually consistent data and assumptions, but also the avoidance of duplicated disclosures as much as possible. This can be achieved by using cross-references, under the conditions set out in the draft standards.

Comparative information

The two approaches are identical, as the quantified information for a given period should be presented in comparison with the previous year's data. In some cases, EFRAG calls for more than two comparative periods to be provided.

In addition, where necessary to understand the figures provided for previous periods, qualitative information or descriptions for those periods should also be disclosed.

Estimations and uncertainties

Some metrics can require the use of estimations. In such cases, both frameworks require the entity to identify those metrics that have significant estimation uncertainty, disclosing the sources and nature of these uncertainties and the factors affecting them.

Where an estimation has changed from one period to another, the entity must make this explicit and restate the historical data where practicable. When it is impracticable to do so, the entity must disclose and explain this fact.

Statement of compliance

Both frameworks require entities to issue a statement of compliance with the framework applied, though the draft ESRSs call for more granular information, in particular about the entity-specific disclosures an entity has made.

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