Beyond the GAAP

Mazars' monthly newsletter on financial and sustainability reporting

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Editorial

The comment period for EFRAG's public consultation on its first set of 13 draft European Sustainability Reporting Standards (ESRSs) closed on 8 August. EFRAG's Sustainability Reporting Board, supported by its Technical Expert Group, now has to analyse the more than 750 responses received in order to submit the final version of its draft standards to the European Commission by next November. The EC will then adopt the final standards in June 2023 by means of a Delegated Act. The timetable for implementation by entities will be finalised by the adoption of the CSRD, which is expected by the end of the year.

Meanwhile, just a few months after its creation at COP26, the International Sustainability Standards Board (ISSB) held its first meeting in Frankfurt on 20 and 21 July. While the ISSB has not yet taken any decisions, it reviewed the first comments received in the public consultation on its two draft IFRS Sustainability Disclosure Standards, although the comment period did not close until 29 July. Over the coming months, the Board will likewise face the significant challenge of finalising its first two standards, with more than 1,400 comment letters received in total. With so much standard-setting activity going on at the European and international levels, one of the key issues for stakeholders will be interoperability between the two sets of standards.

IFRS Highlights

IFRS IC agenda decision on negative low emission vehicle credits

The IFRS Interpretations Committee (IFRS IC) has published a final agenda decision (available here) on government measures to encourage reductions in vehicle CO2 emissions. It was ratified by the International Accounting Standards Board (IASB) in July.

The request submitted to the IFRS IC related to government measures that apply to entities that produce or import passenger vehicles for sale. The measures operate as follows:

- if the entity has produced or imported vehicles over the calendar year whose average CO2 emissions are lower than the target set by the government, it receives positive credits. If the average CO2 emissions are higher than this target, it receives negative credits;
- an entity that receives negative credits for the year must eliminate them:
  - either by purchasing positive credits from entities that have a surplus;
  - or by generating positive credits itself the following year;
- if an entity does not eliminate its negative credits, the government can impose sanctions on it. The sanctions do not take the form of fines or financial penalties, but may limit the entity's future opportunities, e.g. by restricting its access to the market.

The Committee was asked whether an entity that has received negative credits (which must be eliminated) has a present obligation that meets the definition of a liability set out in IAS 37 – *Provisions, Contingent Liabilities and Contingent Assets*.

To reach its final decision, the Committee drew on the existing rules set out in the standard, and particularly the definition of a liability set out in paragraph 10 ("*a liability is a present obligation of the entity arising from past events, the settlement of which is expected to result in an outflow from the entity of resources embodying economic benefits*"). The agenda decision addresses the questions that must be considered in order to determine whether the entity has a liability:

- Is an outflow of resources embodying economic benefits necessary to settle the obligation to eliminate negative credits?
- What event gave rise to the present obligation to eliminate negative credits?
- Does the entity have a realistic alternative method of settling the obligation?

In answer to the first question, the Committee pointed out that if an entity receives negative credits, it will necessarily incur an outflow of resources embodying economic benefits, regardless of what form this takes, i.e. purchasing positive credits or generating positive credits the following year. The Committee explained that in the second scenario, the entity would have been able to use the positive credits for another purpose – e.g. selling them to other entities that themselves have negative credits – if it was not required to eliminate its own negative credits.

In answer to the second question, the Committee noted that the activity that gives rise to the present obligation to eliminate negative credits is the production or import of vehicles whose average CO_2 emissions (for all vehicles produced or imported over the calendar year) are higher than the government target. It also pointed out that the obligation may arise at any moment, not merely at the end of the reporting period.

Furthermore, the Committee noted that the government's right to impose sanctions derives from the law, and the sanctions are the means by which the measures can be enforced by law. Thus, the obligation to eliminate negative credits is an enforceable legal obligation, unless accepting the sanctions is a realistic alternative for the entity. On this point, the Committee emphasised that the use of judgement is required to determine whether accepting the sanctions is a realistic alternative, depending on the type of sanctions and the specific circumstances of the entity.

If the entity concludes that it does not have a legal obligation (because accepting the sanctions is a realistic alternative), it must still consider whether it has a constructive obligation to eliminate the negative credits. The entity may have created expectations in third parties, e.g. through sufficiently clear and specific public statements, that it will eliminate these negative credits.

The Committee concluded that the existing rules set out in IAS 37 are sufficient to determine whether such measures create an obligation that would require an entity to recognise a liability. However, it did not address the issue of how such a liability should be measured, simply referring back to the general principles of the standard.

IFRS IC agenda decision on transfer of insurance coverage under a group of annuity contracts

At the IASB's July meeting, it also ratified the agenda decision reached by the IFRS IC in June (available here) on methods for determining the amount of revenue to be recognised on immediate annuity contracts.

As a reminder, IFRS 17 requires an entity to measure the total margin (also called the contractual service margin or CSM) on a group of insurance contracts at the subscription date, and then to allocate the CSM by "coverage unit" over the expected coverage period. Immediate annuity contracts are those under which the policyholder makes a non-refundable payment upfront in exchange for a periodic payment that starts immediately after contract inception for as long as the policyholder survives.

The standard does not specify a particular method for identifying coverage units, other than that they should reflect the services provided in each period to the policyholder under the contract. The request submitted to the Committee related to how these services should be defined in order to determine whether a method is acceptable or not. The request sets out two possible methods: the first presupposes that the expected annuity payment remains constant over time, and the second presupposes that annuity payments will reduce over time, as the likelihood of the policyholder's survival diminishes as they get older.

The Committee concluded that the first method is acceptable. However, it rejected the second method on the grounds that, if the insurer has accepted and managed the risk that the policyholder may survive longer than expected, the compensation for pertains to the risk adjustment for non-financial risk that is recognised separately from the contractual service margin.

IFRS IC agenda decision on SPACs: classification of public shares as financial liabilities or equity

In July 2022, the IFRS IC published a final agenda decision (available here and now approved by the IASB) on whether public shares issued by a SPAC (Special Purpose Acquisition Company) should be classified as financial liabilities or equity. A SPAC is an ad hoc entity created by its founders to raise capital through an initial public offering, for the purposes of acquiring a target company within a time frame specified from the outset (e.g. 18 months).

In the fact pattern described in the request, the SPAC issues two classes of shares: class A shares, held by the founders, and class B shares, held by public investors. Class B shareholders:

- may ask for a reimbursement of their shares in cash if the general shareholders' meeting approves the acquisition of a target entity;
- are likewise reimbursed if the SPAC is liquidated because no target has been acquired within the specified time frame;
- may nonetheless decide, in conjunction with the class A shareholders, to extend the SPAC's life indefinitely if the target entity has not been acquired within the specified time frame.

The question submitted to the IFRS IC was whether the decision to extend the SPAC's life, which is made by the entire body of shareholders, is considered to be within the control of the SPAC, thus giving it the unconditional right not to reimburse class B shares – which would imply their classification as equity rather than as liabilities.

The IFRS IC observed that IAS 32 does not specify how to determine whether a decision of shareholders is treated as being under the control of the entity. Hence, this has been identified as one of the practice issues to be addressed as part of the FICE (Financial Instruments with Characteristics of Equity) project. The aim of the FICE project is to clarify the principles set out in

IAS 32, to address issues around practical application, and to improve disclosures in the notes (cf. Beyond the GAAP no. 124, July-August 2018).

As a result, the IFRS IC decided not to respond to this request, and instead to discuss the matter as part of the FICE project. However, it reminded preparers that it is important for SPACs to disclose information in the notes on whether public shares are classified as financial liabilities or equity.

Redeliberations continue on Primary Financial Statements project

At its July 2022 meeting, the IASB continued its redeliberations on the proposals in the December 2019 *General Presentation and Disclosures* exposure draft, in the wake of comments received from stakeholders.

This month, the Board reached decisions on the presentation of the income statement for entities with specified main business activities (such as banks and insurers) and on disclosures relating to operating expenses required in the notes.

These decisions are still tentative and will be confirmed once the final standard is published, which is currently scheduled for 2023.

Presentation of the income statement for entities with specified main business activities

At the July meeting, the IASB continued with the redeliberations on this topic, which began in March 2022 (cf. Beyond the GAAP no. 164, March 2022).

Readers will remember that the December 2019 exposure draft proposed that the categories in the income statement should be the same for all entities, but the content of each category could vary depending on the company's business model. Thus, an entity should classify income and expenses from investments made in the course of the entity's main business activities in the "operating" category rather than the "investing" category; and should classify income and expenses from financing activities, where these arise from the provision of financing as a main business activity, in the "operating" category rather than the "financing" category.

As regards the "investing" category, the IASB reached the following tentative decisions in July:

- to rephrase paragraph 48 of the exposure draft, which currently states that an entity shall not classify in the "investing" category income and expenses specified in paragraphs 47(a)-47(b) generated "in the course of its main business activities". Instead, it will specify that an entity that invests as a main business activity must classify in the "operating" category income and expenses from assets that would otherwise be classified in the "investing" category. This will make it simpler and clearer;
- to permit entities to make use of judgement when determining whether their investments constitute a main business activity, assessing this at the level of a group of assets with similar characteristics rather than at the level of individual assets. The way an entity groups financial assets in this context should be consistent with the way it groups financial assets into classes for the purposes of disclosures about financial instruments in accordance with IFRS 7;
- to add application guidance in order to clarify that income and expenses from financial assets arising from providing

financing to customers as a [main] business activity shall be classified in the "operating" category of the income statement.

The IASB also discussed a number of topics specific to the "financing" category, and reached the following tentative decisions:

- to confirm the accounting policy choice proposed in paragraph 51 of the exposure draft, which permits an entity that provides financing to customers as a main business activity to classify income and expenses from liabilities arising from transactions that involve only the raising of finance either (i) solely in the "operating" category; or (ii) by making a split between the "operating" and "financing" categories based on whether or not the liabilities are related to the entity's main business activity of providing finance to customers;
- to confirm, in line with the change in the definition of the "financing" category that was decided in July 2021 (cf. Beyond the GAAP no. 157, July-August 2021), that the accounting policy choice mentioned above does not apply to specified income and expenses arising from other liabilities (i.e. interest expenses and the effect of changes in interest rates related to liabilities arising from transactions that do not only involve the raising of finance). These must always be classified in the "financing" category of the income statement;
- to confirm the proposal in the exposure draft that entities that invest in financial assets as a main business activity should classify income and expenses from cash and cash equivalents in the "operating" category;
- to explore the possibility of withdrawing the accounting policy choice permitted to entities that provide financing to customers as a main business activity by paragraph 51 of the exposure draft, which currently specifies that they may classify income and expenses from cash and cash equivalents in either the "operating" category or the "financing" category. For entities that do not also invest in financial assets as a main business activity, the withdrawal of this choice would require them to classify all these items in the "investing" category. This would be the same accounting treatment as for entities that do not have specified main business activities, following the decision reached in May 2021 to require income and expenses related to cash and cash equivalents to be classified in the "investing" category (cf. Beyond the GAAP no. 155, May 2021). The Board will carry out targeted outreach to help it reach its decision.

Disclosures of operating expenses by nature in the notes

Also in July, the IASB continued redeliberations on a thorny issue, namely the level of disclosures required in the notes where an entity has elected to present its operating expenses by function in the income statement.

The exposure draft states that, if an entity opts for presentation by function in the income statement, it must also disclose an analysis of its total operating expenses using the nature of expense method in a single note to the financial statements (though this does not need to be broken down by line item).

Following initial discussions in October 2021 (cf. Beyond the GAAP no. 159, October 2021), and drawing on additional work and further discussions with

stakeholders, the IASB reviewed the scope of disclosures to be required in the notes in order to achieve a better balance between costs for preparers and benefits for users.

Thus, the Board has tentatively decided to require entities to disclose in the notes the amounts of depreciation, amortisation and employee benefits included in each line item in the statement of profit or loss (e.g. the "cost of sales" line item). This is still a more onerous requirement than the current paragraph 104 of IAS 1, which does not require these amounts to be broken down by line item.

The IASB also tentatively decided to explore a more broadly applicable approach that would require an entity to disclose, for all operating expenses disclosed in the notes, the amounts included in each line item in the income statement. The staff will carry out targeted outreach to test this proposal. If the Board ultimately opts for this broader requirement, it would *de facto* include the more specific requirement set out above regarding depreciation, amortisation and employee benefits. The IASB would also then need to decide whether a cost relief would be required to help entities to implement the broader requirement.

The results of the outreach work will be presented at the January 2023 Board meeting.

IASB publishes work plan priorities for 2022-2026

In July, the IASB published a snapshot (available here) of feedback from its Third Agenda Consultation (cf. Beyond the GAAP no. 154, April 2021). This is accompanied by a more detailed feedback statement (available here) identifying the key messages from the 161 written responses received in 2021.

The consultation document stated that the IASB's work plan was already quite full, due to large ongoing standard-setting projects (developing new standards, post-implementation reviews, and interpretations) which account for roughly 60% of the IASB's capacity. On top of this, stakeholder engagement accounts for a quarter of the Board's capacity.

Thus, the balance of the IASB's main activities and resources will remain largely unchanged. However, the Board is planning to significantly increase the amount of resources dedicated to digital financial reporting and to improving the understandability and accessibility of the IFRS framework – activities that currently account for just 10% of its time. This will require the Board to shift some resources away from the development of new standards and amendments.

There was also very little room for manoeuvre on the priorities for standard-setting and maintenance work, as several large projects are already under way (Primary Financial Statements, Goodwill and Impairment, Rate-regulated Activities) as well as the Post-implementation Reviews of IFRS 9, IFRS 15 and IFRS 16, scheduled for three years after implementation of the standards. However, the IASB retained a small amount of flexibility to allow it to respond to urgent issues. It has now decided to add new projects on some "emerging" issues:

- a comprehensive review of IAS 38 – *Intangible Assets*;
- a review of requirements relating to the statement of cash flows (scope yet to be determined);
- a targeted project to explore whether it is necessary to improve accounting for climate-related risks.

Finally, two projects are on a reserve list:

- operating segments; and
- pollutant pricing mechanisms.

The IASB noted that it had received a strong message on the importance of coordinating its work with its new sister organisation, the ISSB. The willingness to collaborate with the new Board and the choice of emerging projects – which potentially form a point of connection between the two Boards – present an opportunity to demonstrate that the organisations are mutually complementary and can provide the integrated approach that investors require.

New appointment to IFRS Interpretations Committee

On 15 July, the IFRS Foundation announced the appointment of Ms Yanli Liu to the IFRS Interpretations Committee (IFRS IC). She replaces Zheng Yang, whose second and final term ended on 30 June 2022.

Ms Liu is currently Executive Vice President and Chief Finance Officer of the State Grid International Development Company Ltd, which is the international arm of State Grid Corporation of China.

Lisa Bomba, Jens Freiberg, Karsten Ganssauge and Brian O'Donovan were reappointed to the IFRS IC from July 2022 to June 2025.

The press release is available here.

ISSB reaches full complement of members

During July and August, the IFRS Foundation continued with the recruitment process for the International Sustainability Standards Board (ISSB), and made the following announcements:

- the appointments of Tae-Young Pai and Elizabeth Seeger on 14 July (the IFRS Foundation press release on these appointments is available here);
- the appointments of Jenny Bofinger-Schuster, Hiroshi Komori and Veronika Pountcheva on 23 August (press release available here);
- the appointment of Jingdong Hua as second Vice-Chair of the ISSB on 31 August (press release available here). He will work in the ISSB's offices in Montreal and will oversee the development and implementation of the ISSB's strategies for supporting and including stakeholders in emerging and developing economies, as well as small and medium-sized companies. His role will thus complement that of the other Vice-Chair, Sue Lloyd (based in Frankfurt), who will oversee the overall organisation of the ISSB's work and its technical staff, as well as the link between the ISSB and the IASB to ensure the two boards' requirements are complementary. Mr Hua was formerly Vice President and Treasurer of the World Bank.

These six appointments bring the number of ISSB members to 14, the full complement as specified in the IFRS Foundation's Constitution.

European Highlights

EU endorses IAS 12, "Deferred Tax related to Assets and Liabilities arising from a Single Transaction"

The amendments to IAS 12, "Deferred Tax related to Assets and Liabilities arising from a Single Transaction", published in May 2021 by the IASB (cf. Beyond the GAAP no. 155, May 2021) have been endorsed by the European Union and published in the

Official Journal of the European Union (OJEU) of 12 August (Commission Regulation (EU) 2022/1392, available here).

Readers will remember that the amendments published by the IASB:

- specify how entities should account for deferred tax related to assets and liabilities arising from a single transaction, such as leases, and aim to reduce diversity in practice in this area;
- are mandatory for financial periods commencing on or after 1 January 2023. Early application of the amendments is permitted.

ESMA publishes update to ESEF Reporting Manual

On 24 August, the European Securities and Markets Authority published an update to its European Single Electronic Format (ESEF) Reporting Manual. The new online version, which is available here, shows the changes from the previous version.

The biggest change is the new guidance on how to perform block tagging of the notes to IFRS consolidated financial statements, in accordance with the new ESEF regulatory technical standards (RTS) requirement for financial periods commencing on or after 1 January 2022. For example, what elements of the taxonomy should be used, what level of granularity is expected for block tagging, etc.

Entities should use the new version of the ESEF manual as soon as possible, and no later than for financial periods commencing on or after 1 January 2022.

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