# Beyond the GAAP

## Mazars' newsletter on accounting standards

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# Editorial

**Here we are in March again with something of a feeling of déjà vu, and it is unfortunately still difficult to estimate the full extent of the pandemic's impact on companies' financial performance.**

In light of this, the new amendment to IFRS 16, which permits a lessee to apply the practical expedient to concessions on lease payments due up to 30 June 2022 (instead of 30 June 2021 initially), is very welcome.

For many readers, the impact of the pandemic on financial statements is doubtless still the major concern, but it is nevertheless worth taking a look at the sweeping changes to financial and non-financial reporting that are set to take effect over the next few years. The features in this issue of Beyond the GAAP thus cover both the IASB's initial redeliberations on its Primary Financial Statements project, and the possible roadmap for the elaboration of mandatory EU non-financial reporting standards, to be published by EFRAG if its mandate is extended by the European Commission.

# IFRS Highlights

## Amendment to IFRS 16 on rent concessions beyond 30 June 2021

As previously announced, the IASB has rushed through its proposed amendment to IFRS 16 on Covid-19-related rent concessions beyond 30 June 2021, as the public health crisis is dragging on longer than initially predicted.

On 31 March, less than two months after the publication of the exposure draft, the IASB published a new amendment to IFRS 16 entitled "Covid-19 Related Rent Concessions beyond 30 June 2021" (available here and free to access for three months). The new amendment extends the practical expedient set out in paragraph 46A, which permits an entity to account for any change in lease payments resulting from Covid-19-related rent concessions as if the change were not a lease modification. Thus, the impact of the rent concession would be recognised in profit or loss for the period, and not over the residual term of the lease.

The new amendment thus permits a lessee to apply the practical expedient to concessions on lease payments due up to 30 June 2022 (instead of 30 June 2021 as currently).

The newly published amendment specifies that:

- a lessee shall apply the practical expedient in paragraph 46A consistently to all eligible contracts with similar characteristics and in similar circumstances, regardless of whether the contract became eligible as a result of the original May 2020 amendment or the March 2021 amendment. This raises some practical application difficulties, in particular because of the retroactive effect of the amendment. Rent concessions that were initially excluded from the scope of the May 2020 amendment, as they related to lease payments due after 30 June 2021, may now fall within the scope of the new amendment and would therefore need to be restated retrospectively.

- the disclosures in paragraph 28 (f) of IAS 8 – Accounting Policies, Changes in Accounting Estimates and Errors are not required.

The amendment is applicable to financial periods beginning on or after 1 April 2021 and early application is permitted, including for financial statements not yet authorised for issue at 31 March 2021. It is now awaiting endorsement by the EU.

The amendment will be applicable retrospectively and the cumulative impact of initial application shall be recognised as an adjustment to the opening balance of retained earnings (or other component of equity, where appropriate).

## Pilot approach to disclosure requirements and proposed amendments to IFRS 13 and IAS 19

On 25 March, the IASB published an exposure draft entitled "Disclosure Requirements in IFRS Standards – A Pilot Approach (Proposed amendments to IFRS 13 and IAS 19)", which proposes:

- a new approach to developing and drafting disclosure requirements. If the IASB decides to use this approach going forward, in the light of the feedback received from stakeholders, the document would be used internally as guidance for the Board when developing disclosure requirements for each IFRS;
- amendments to IFRS 13 – Fair Value Measurement and IAS 19 – Employee Benefits, the result of testing out the proposed new approach to developing disclosure requirements by applying it to these standards.

The exposure draft is part of the IASB's longstanding project on Disclosure Initiative, with the last key milestone being the publication of a Discussion Paper entitled "Disclosure Initiative – Principles of Disclosure" in March 2017. The IASB's objective is for entities to provide more useful information to users of financial statements.

This means the project needs to address the current criticisms of disclosure, namely that financial statements:

- do not disclose enough relevant information;
- disclose too much irrelevant information; and
- do not communicate the information effectively.

Many stakeholders feel that these problems result from the fact that the current disclosure requirements lend themselves to a mechanistic checklist approach, with no real use of judgement.

In practice, the IASB is proposing that each standard should contain both an overall disclosure objective and specific disclosure objectives, which entities would be required to address. They would need to make use of judgement to determine what information is material and whether it ultimately meets the disclosure objectives set out in the standard.

The choice of IFRS 13 and IAS 19 as real-world test cases was not random: these two standards suffer particularly from the disclosure problems identified above and would therefore benefit from the proposed amendments to their disclosure requirements.

The exposure draft is available on the IASB's website here. The comment period is open until 21 October 2021.

## IASB extends comment period for exposure draft on regulatory assets and liabilities

At its March meeting, the IASB agreed a 30-day extension to the comment period for its exposure draft on accounting for regulatory assets and liabilities (cf. Beyond the GAAP no. 151, January 2021). The comment period now runs until 30 July 2021.

## IFRS Foundation makes rapid progress toward creation of international Sustainability Standards Board

At the start of February this year, the IFRS Foundation announced that it was investigating the feasibility of creating a Sustainability Standards Board (SSB) to be launched at the next United Nations Climate Change Conference (COP26) in November 2021 (cf. Beyond the GAAP no. 152, February 2021). As European institutions, too, show their commitment to this issue (see below for our feature on the EFRAG Task Force report), the Trustees of the Foundation met at the beginning of March to determine the key strategic directions for the new Board:

- the SSB would concentrate, at least initially, on information that is important to investors, lenders and other creditors. At this stage, materiality would be viewed in financial terms, i.e. relating to the impact of climate change on enterprise value. This should facilitate interconnectivity with financial reporting, which is the purview of the IASB;
- the SSB would initially focus on climate-related reporting, while continuing to work on addressing investors' information needs regarding other ESG (environmental, social and governance) matters;
- the SSB would build on the most widely-recognised existing frameworks, notably the recommendations of the Task Force on Climate-related Financial Disclosures (TCFD), an offshoot of the Financial Stability Board, as well as the work of a recently-formed alliance of organisations (CDP – Carbon Disclosure Project, CDSB – Climate Disclosure Standards Board, GRI – Global Reporting Initiative, IIRC – International Integrated Reporting Council and SASB – Sustainability Accounting Standards Board) that published a prototype climate-related financial reporting standard, based on the recommendations of the TCFD, in December 2020. The Foundation has stated that it wishes to establish a formal working relationship with these various organisations, and on 22 March it announced the creation of a working group in which the IASB will participate, with IOSCO (the International Organization of Securities Commissions) acting as an observer. As well as continuing to work on disclosures, the group will review how technical expertise and content on sustainability reporting could be transferred to the SSB in order to facilitate consolidation in this area;
- the SSB would take a building-blocks approach, developing a baseline that would ensure consistent and comparable information across different jurisdictions, while leaving the door open for requirements that would capture a broader range of information. The Trustees are keen to establish a framework that has flexibility built in, so that it can readily be adapted to suit different sustainability reporting requirements for different jurisdictions and stakeholders.

The next steps announced by the Trustees are as follows:

- publication of a feedback statement summarising the 576 responses to the consultation launched by the Trustees of the IFRS Foundation last September (cf. Beyond the GAAP no. 147, September 2020) to assess whether there is a need for global sustainability reporting standards, and the role that the Foundation could play in developing such standards. The report will also explain how these comments were taken into account by the Trustees in their decision-making process;
- publication of the proposed changes to the Constitution of the IFRS Foundation necessary to establish a new Board and determine its composition. These changes will be subject to a consultation with a 90-day comment period.

### IOSCO releases statement on going concern issues in the context of the Covid-19 pandemic

On 24 March, IOSCO published a press release (available here) on going concern issues in the context of the Covid-19 pandemic.

The statement reiterates some of the points made by the IASB in its educational material entitled “Going concern – a focus on disclosure” (cf. Beyond the GAAP no. 151, January 2021).

IOSCO emphasises the importance of providing high-quality information on the entity’s assessment of its ability to continue as a going concern, and on any material uncertainties that could affect this.

# European Highlights

### New EFRAG Board

The General Assembly of EFRAG (the European Financial Reporting Advisory Group) unanimously agreed the new composition of the EFRAG Board at its meeting on 25 March. The new members will start their three-year term on 1 May 2021.

The new members are Olivier Scherer, Michael Fechner, Roman Sauer, Serge Pattyn (vice-president) and Gerhard Prachner.

The outgoing members are Hans Buysse, Luca Cencioni, Benoit Jaspar, Claes Norberg, Laurence Rivat and Mark Vaessen.

Thus, the new composition of the EFRAG Board is as follows:

President:

Jean-Paul Gauzès

European stakeholder organisations:

- Olivier Scherer, representing the accountancy profession sector (France);
- Rosa Bruguera, representing the banking sector (Spain);
- Michael Fechner, representing the corporate sector (Germany);
- Roman Sauer, representing the insurance sector (Germany);
- Serge Pattyn, representing the user sector(Belgium).

National Standards Setters:

- Patrick de Cambourg, chairman of the ANC (France);
- Sven Morich, vice-president of the ASCG (Germany);

- Angelo Caso, chairman of the OIC (Italy);
- Gerhard Prachner, member of AFRAC (Austria);
- Søren Kok Olsen, international liaison observer, former vice-chair of the DASC (Denmark);
- Gerard van Santen, chairman of the DASB (Netherlands);
- Maria Urrea, member of the ICAC Board (Spain);
- Anders Ullberg, chairman of the SFRB (Sweden).

### Observers representing European institutions, with speaking rights:

- European Commission: Alain Deckers
- European Banking Committee (EBC): Jürgen Kirchhof / Kallol Sen
- European Banking Authority (EBA): Delphine Reymondon
- European Insurance and Occupational Pensions Authority (EIOPA): Sandra Hack
- European Securities and Markets Authority (ESMA): Isabelle Grauer-Gaynor

Finally, Jella Benner-Heinacher (Better Finance) has been appointed as an observer with speaking rights, representing private investors.

# Redeliberations begin on Primary Financial Statements project

At the meeting of the International Accounting Standards Board (IASB) on 24 March, the Board members began their redeliberations on the proposals set out in the General Presentation and Disclosures exposure draft, which was published in December 2019 (and was open for comment until 30 September 2020).

There is a long list of topics for redeliberation, given the number of comment letters received (cf. Beyond the GAAP no. 150, December 2020). In March, the IASB began discussing the following subjects:

- subtotals and categories in the statement of profit or loss, focusing on the requirement to present a new "operating profit" subtotal, and on its definition;
- disclosures required in the notes on management performance measures (MPMs), and whether the scope of MPMs should be expanded; and
- amendments to the statement of cash flows, focusing on the scope of these amendments and certain specific proposals.

## "Operating profit" subtotal

On this first topic, the IASB tentatively decided:

- to require all entities to present a new "operating profit" subtotal in the statement of profit or loss, confirming the proposal put forward in the exposure draft;
- to confirm that the "operating" category in the statement of profit or loss should not include items of income and expenses that are classified in the "investing", "financing", "income tax" or "discontinued operations" categories of the statement of profit or loss. The "operating" category will thus continue to be defined by what it is not (i.e. it is a "residual" or "default" category). The IASB will discuss the definitions of the "investing" and "financing" categories at a future meeting (including how these apply to banks and other financial institutions for which investing and financing are main business activities). The proposal that income and expenses from equity-accounted associates and joint ventures should be excluded from operating profit will also be discussed at a future meeting;
- to confirm that the "operating" category:
  - will comprise all income and expenses arising from an entity's operations, including volatile and unusual items arising from these operations (e.g. litigation or restructuring costs). "Operating profit" as proposed by the IASB would therefore not be equivalent to profit from recurring operations as it is sometimes used by some entities;
  - will include, but will not be limited to, income and expenses from an entity's main business activities. For example, operating profit could include income and expenses from a subsidiary whose operations are (currently) ancillary to the entity's main business activities. Thus, the IASB's perspective is that secondary or supporting activities are part of an entity's operations;
- not to directly define the "operating profit" subtotal.

## Information on MPMs

On this topic, the IASB tentatively decided:

- to require entities to present disclosures on MPMs in the notes to the financial statements, thus confirming one of the key proposals in the exposure draft;
- to explore possible approaches to expanding the scope of the requirements on MPMs beyond what was envisaged in the exposure draft (which was limited to certain subtotals of income and expenses). This was not unanimously approved (10 votes out of 13), as some of the Board members were concerned that the project would be delayed by the additional work required to identify a suitable approach.

## Statement of cash flows

On this last topic, the IASB provisionally decided:

- to retain the scope of its work as set out in the exposure draft, i.e. to only make a few limited-scope amendments to IAS 7. The IASB will discuss the possibility of closer alignment between the categories in the statement of profit or loss and the categories in the statement of cash flows at a future meeting (when it will also discuss the definitions of the “investing” and “financing” categories in the statement of profit or loss). At the same time, the Board will consider the labels to be used for the categories in the statement of profit or loss, to avoid any ambiguity over the extent of this alignment, in light of the many comments received on this subject;
- to require entities to use the new “operating profit or loss” subtotal as the starting point for the indirect method of presenting cash flows from operating activities, thus confirming one of the proposals set out in the exposure draft;
- to confirm the proposals in the exposure draft on the classification of interest paid and dividend cash flows for entities other than those for which investing and financing are main business activities. Thus, in practice:
    - interest and dividends paid would be classified as cash flows arising from financing activities;
    - dividends received would be classified as cash flows arising from investing activities;

  The IASB will decide on the classification of interest received at a future meeting (at the same time as it discusses the definitions of the “investing” and “financing” categories in the statement of profit or loss).

Redeliberations of the project proposals will continue at future IASB meetings.

## Report to the European Commission on potential changes to governance of EFRAG

As the European Union is about to publish a draft revision to its Non-Financial Reporting Directive (NFRD), EFRAG is already contemplating a possible extension to its mandate, if it were to be given responsibility for European standard-setting in this area (cf. our feature on the EFRAG Task Force report, below). Following extensive consultation, the EFRAG President Jean-Paul Gauzès has just submitted his *ad personam* report (available here) on "Potential need for changes to the governance and funding of EFRAG", as requested by the Executive Vice-President of the European Commission, Valdis Dombrovskis.

EFRAG's current role is to represent European interests to the IASB in the IFRS standard-setting process, and to advise the European Commission on the endorsement of these standards. Unlike some European supervisory authorities (ESAs), EFRAG is an association of various member organisations with no legislative power, which instead lies in the hands of the European Parliament and Council. However, its status permits it to receive financial and in-kind contributions from stakeholders in both the private sector (preparers, auditors, users) and the public sector (national standard-setters, academics). Thus, the organisation benefits from rich and varied technical input in the service of the public good, while the independence of EFRAG is ensured by the balanced composition of its governance and technical bodies whereby a single member of these bodies cannot exercise undue influence.

In his proposals, the President aimed to set out the current successful governance model, and extend it to a new "pillar", that of developing high-quality and proportionate non-financial reporting standards in the public interest.

This second pillar, like the first, would be composed of a Board that would set out the work plan and take responsibility for decision-making, and a Technical Expert Group (TEG) that would prepare standards and recommend them for approval, with the support of Working Groups and Advisory Panels. The support functions shared by both pillars would be brought together under a single Administrative Board. This board would not get involved in technical matters but would appoint members of the two Boards as nominated by the stakeholders represented by the General Assembly. The role of the General Assembly would not be limited to legal matters; it would also serve as a discussion forum for establishing strategic orientations.

The report suggests expanding the General Assembly to additional stakeholders, grouped into two new "Chapters", in addition to the existing Chapters representing European stakeholder organisations (preparers, auditors and analysts) and national organisations (standard-setters, ministries). One of the new Chapters would represent civil society (NGOs, academics, trade unions and consumer organisations) and the other would represent ESAs and other European institutions. Rather than merely having an observer role, as currently, these European institutions would become full members of EFRAG. However, to maintain their independence from EFRAG as a private organisation, they would have the option of submitting a "reasoned opinion" that is distinct from any opinion or proposed standard issued by EFRAG.

To strengthen this governance structure, the President proposes that: (i) the Chairs of the two Reporting Boards (IFRS and non-financial) would be nominated after consultation with the European Parliament and the Council; (ii) a due process would ensure that decisions are transparent, evidenced-based thanks to consultations and effect analyses, and subject to post-implementation reviews: the Administrative Board would be responsible for ensuring that the due process is appropriately followed; (iii) interconnectivity between the two pillars would be promoted through joint meetings and representation on one another's Boards and TEGs.

Given that there are many existing international initiatives on non-financial reporting, co-operation between EFRAG and other organisations will be vital. This "co-construction" should work both ways, sharing experience, tools and content between organisations, with a mutual goal of ensuring consistency between EU and global sustainability reporting. A key element in this will be the creation of a Consultative Forum within EFRAG that is open to national authorities, non-financial reporting standard-setters and other existing global players and initiatives.

To ensure that these new activities can be carried out effectively and sustainably, the EFRAG President estimates that an initial additional €3m in funding would be needed in the first years (EFRAG's annual budget is currently €5.2m). This budget, which would cover overhead and staff costs, does not reflect the leveraged value added by the technical in kind contributions to EFRAG's work .

The next steps will largely depend on the steer given in April when the draft revision to the Non-Financial Reporting Directive are published.

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# EFRAG Task Force submits report to European Commission on elaboration of possible EU non-financial reporting standards

At the beginning of March, the EFRAG Task Force led by Patrick de Cambourg, which was mandated to provide technical advice to the European Commission on a possible roadmap for the elaboration of EU non-financial reporting standards, submitted its report (available here) following six months of intensive work.

This highly technical report was published at the same time as a report from the EFRAG President on potential need for changes to the governance and funding of EFRAG if it were given the role of EU non-financial reporting standard-setter (cf. previous feature).

The two reports provide the European Commission with plenty of input for its review of the Non-Financial Reporting Directive (NFRD), which will contain an eagerly-awaited section on the role and success criteria for a mandatory EU non-financial reporting framework.

One of the key principles of the report, which sets out a clear roadmap for the future EU standard-setter, is that it is essential to align European aims and policies relating to sustainable development (such as the Green Deal and the Sustainable Finance Strategy) with global goals and initiatives. This will ensure that Europe is at the heart of international efforts in this area, rather than isolated from them. The need for a balance between European and global considerations recurs in each of the four substantive chapters of the report, which we present below.

## Foundations

One of the key overarching principles is that the legislative framework in the EU is principle-based (in contrast to the rule-based approach preferred in many Anglophone countries). In practice, the Task Force recommends that future reporting standards should be aligned with the European political agenda and legislative/regulatory framework for sustainable development. However, it also acknowledges the benefits of co-operating and co-constructing a set of standards that borrow, where appropriate, from the international standard-setters, conceptual frameworks and platforms currently used by many companies. Other distinctive characteristics of the European approach include an appropriate level of emphasis on the specific needs of financial institutions (which play a pivotal role in the European Sustainable Finance Strategy) and on SMEs (which are a key component of the European economic landscape), as well as recognition of the fact that financial reporting should aim to be useful to the greatest possible number of people[1].

## Conceptual guidelines

The conceptual framework and its translation into operational guidelines, as a necessary background to the development of the standards themselves, borrows heavily from the quality standards set by major international standard-setters, while incorporating some European particularities. It is thus necessary to reconcile:

[1] With the notable exception of the GRI, many organisations (e.g. the SASB, the TCFD and most recently the IFRS Foundation) view materiality in purely financial terms, with a view to providing the information that investors (rather than users more generally) need for their investment decisions.

- the need to develop standards that are consistent with European goals and objectives – but also in harmony with the global goals endorsed by the European Union (such as the UN's Sustainable Development Goals or the 2030 Sustainable Development Agenda and the Paris Agreement) – and that reiterate the principle of double materiality (that is, both financial materiality, which reflects the impact of environmental and social matters on entities, and impact materiality, which reflects the impact of an entity's own operations on the climate and on people);
- with broader conceptions of information quality (relevance, faithful representation, comparability, reliability and verifiability), reporting levels (entity, activities, assets, value chain, etc.) and reporting time frames (retrospective or forward-looking). The importance of interconnectivity with financial reporting reflects an international trend towards an integrated approach to corporate reporting.

## Standard-setting architecture and non-financial reporting

The architecture used for standard-setting and non-financial reporting also reflects this commitment to balance and to integrating a diverse range of approaches and goals, via a three-dimensional approach to reporting:

- **three complementary layers of reporting requirements**, covering information that is:
  a) common to all entities (sector-agnostic layer);
  b) common to entities in a given sector (sector-specific layer); and
  c) specific to a particular entity, depending on what is material to that entity (entity-specific layer).

  Layers a) and b) facilitate comparability across and within sectors. Layer c) permits each entity to determine how best to carry out and communicate its own materiality assessment, selecting the information that is most relevant to that entity (although appropriate justification must be provided, particularly if the entity is omitting information that would normally be required under the first two layers);
- **covering three key reporting areas**, namely:
  a) strategy (integration of sustainability into the entity's overall strategy, governance structures for sustainable development topics, and procedures for and results of the entity's (double) materiality assessment);
  b) implementation (policies and targets, action plans and resources); and
  c) performance measurement (past results and progress towards future targets);
- **and all the topics covered by the ESG+ classification**, namely:
  - environmental matters, structured in accordance with the environmental objectives set out in the EU's "green taxonomy";
  - human and societal matters, covering all possible aspects, ranging from workers' rights to human rights in the broadest sense, structured by the class of people affected: employees, workers in the

value chain, local communities, end consumers, etc.;

- and governance matters, taken in a broad sense to include business & ethics, organisational aspects and intangible capital.

## Roadmap for implementation

Finally, the roadmap for implementation, which aims to plan and organise the standard-setting process such that the first standards are available for initial application of the revised NFRD in January 2024 (for reporting year 2023), illustrates the principle of reconciling the urgent deadlines with the desire (or rather, need) to work towards a more comprehensive platform. The goal is to have an initial set of standards by the end of 2022, which will be added to each year until the target architecture is complete.

The roadmap will build on international standards that are currently in widespread use (such as the UN Global Compact, the GRI, the SASB, the CDP, the TCFD and the IIRC, to name but a few) and will adapt them where necessary in order to meet European requirements as set out in the foundations and the conceptual guidelines.

What comes of all these recommendations is now dependent on whether they are included (in full or in part) in the draft revisions to the NFRD, expected by the end of April. While the document is expected to confirm a number of key themes (notably the expansion of the scope of the revised NFRD, the location of non-financial information, digitalisation, and the mandatory audit and certification of non-financial information), the European Commission has made no secret of its desire to create an EU standard-setter for non-financial reporting: on the contrary, it has clearly stated this on several occasions since the start of the year. Therefore, the question is not whether an EU standard-setter (probably a restructured EFRAG) will exist, but when it can start work to support entities subject to the NFRD.

The significant progress in standard-setting for non-financial reporting at the European level also raises the question of interactivity with other global initiatives, such as the "group of five", now led by the Value Reporting Foundation (formed from the merger between the SASB and the IIRC), or the IFRS Foundation (cf. "IFRS Highlights", above), and where the European standard-setter will sit within this ecosystem.

While each initiative has its own objectives, approach and timescale, the proposals set out by the EFRAG Task Force seek to encourage harmonisation and convergence, providing a broad baseline framework that builds on current best practice and promotes inclusion rather than exclusion.

Despite how things might sometimes appear, it is not certain that the future of European and global non-financial reporting standard-setting will be one of petty rivalries and unproductive competition. Instead, we could see organisations working together constructively, led by the EU.

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The drafting of the present issue was completed on 1 April 2021



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[1] Where permitted under applicable country laws

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