



## Beyond the GAAP

# Mazars' newsletter on accounting standards

### Contents

02	Editorial
02	IFRS Highlights
06	European Highlights

## Editorial

**As 2021 gives way to 2022, the *Beyond the GAAP* editorial team would like to wish you all the best for the coming year! We expect another busy year in terms of accounting news, with an obvious major development being the expected completion of the Primary Financial Statements project. However, the key focus of the year is likely to be the development of sustainability reporting standards.**

On 16 December, the IFRS Foundation announced the appointment of the first Chair of the International Sustainability Standards Board: Emmanuel Faber, the former Chair and CEO of Danone, has taken the top job at the ISSB for an initial three-year term commencing on 1 January 2022. The ISSB plans to publish two draft standards for public comment during the first quarter of 2022: one on proposed general disclosure requirements, and the other on climate disclosures. Also in early 2022, the new EFRAG is expected to launch a public consultation on its first draft of European sustainability reporting standards.

## IFRS Highlights

### **IASB publishes amendment to IFRS 17 to provide insurers with IFRS 9 transition option**

When first applying IFRS 17 – *Insurance Contracts*, for financial periods commencing on or after 1 January 2023, insurance entities are required to present one year of comparative information (for the 2022 transition period).

In contrast, IFRS 9 does not require comparative information to be presented at the transition date. Entities may elect to present comparative information (IFRS 9.7.2.15), but only for financial instruments that remain on the balance sheet after the date of initial application, i.e. 1 January 2023 for insurance entities. Financial instruments that have already been derecognised at the date of initial application (1 January 2023) must be accounted for in accordance with IAS 39 in the 2022 financial period.

For many insurers, who will be applying both IFRS 9 (to their assets) and IFRS 17 (to their liabilities) for the first time at

1 January 2023, it is important to align the two standards from 2022 onwards in order to avoid accounting mismatches.

To address insurers' concerns, the International Accounting Standards Board (IASB) published an amendment to IFRS 17 on 9 December 2021, permitting an optional classification overlay so that comparative information can be presented as if IFRS 9 had been applied. The rules on applying this option are quite flexible, as they permit (i) an instrument-by-instrument approach; (ii) restatement of more than one comparative period; and (iii) a choice of whether to use expected or incurred credit losses when determining loss allowances.

The European Financial Reporting Advisory Group (EFRAG) was strongly in favour of the amendment in its draft endorsement advice. Unsurprisingly, then, final adoption of the amendment by the European Union is expected in early 2022.

### **Economic benefits from use of a windfarm: IFRS IC agenda decision**

The IFRS Interpretations Committee (IFRS IC) received a request as to whether, applying paragraph B9(a) of IFRS 16, an

electricity retailer (customer) has the right to obtain substantially all of the economic benefits arising from use of a windfarm throughout the entire term of an agreement with a windfarm generator (supplier).

The fact pattern in the request submitted to the IFRS IC was as follows:

- the customer and the supplier are registered participants in an electricity market, in which customers and suppliers are unable to enter into contracts with one another directly. Instead, customers and suppliers make purchases and sales via the market's electricity grid, at the spot price per megawatt, which is set by the market operator;
- the customer and the supplier enter into a 20-year agreement, which:
  - swaps the spot price per megawatt of electricity for a fixed price per megawatt of electricity, for the electricity the windfarm provides to the grid, and settles the difference in cash;
  - transfers all the renewable energy credits arising from use of the windfarm to the customer.

As a reminder, IFRS 16.9 states that, “a contract is, or contains, a lease if the contract conveys the right to control the use of an identified asset for a period of time in exchange for consideration”. To control the use of an identified asset, the customer must have both the right to obtain substantially all of the economic benefits from use of the identified asset, and the right to direct the use of the asset, throughout the period of use (IFRS 16 B9).

As a further reminder, IFRS 16 B21 states that, “a customer can obtain economic

benefits from use of an asset directly or indirectly in many ways, such as by using, holding or sub-leasing the asset. The economic benefits from use of an asset include its primary output and by-products (including potential cash flows derived from these items), and other economic benefits from using the asset that could be realised from a commercial transaction with a third party.”

Regarding the fact pattern submitted in the request, the IFRS IC noted that:

- the economic benefits from use of the windfarm include the electricity produced (the primary output) and the renewable energy credits (a by-product or other economic benefit from use of the windfarm);
- it is true that the agreement results in the customer settling with the supplier the difference between the fixed price and the spot price per megawatt of electricity produced by the windfarm, throughout the term of the agreement, but it does not convey to the customer either the right or the obligation to obtain any of the electricity the windfarm produces and supplies to the grid;
- the agreement conveys to the customer the right to obtain the renewable energy credits, but does not convey the right to obtain substantially all the economic benefits from use of the windfarm, because it has no right to obtain the electricity produced by the windfarm throughout the term of the agreement.

The Committee therefore concluded that the customer does not have the right to obtain substantially all of the economic benefits arising from use of the windfarm

and, as a result, the contract is not a lease under IFRS 16.

The IFRS IC felt that IFRSs already provide an adequate basis for assessing this situation, and thus decided not to add this issue to its work plan.

In its agenda decision, the Committee cited two previous agenda decisions on which it drew when reaching its conclusions:

- the agenda decision “Meaning of Delivery” (IFRS 9 – *Financial Instruments*, August 2005);
- and the agenda decision, “Application of the Highly Probable Requirement when a Specific Derivative is Designated as a Hedging Instrument” (IFRS 9 and IAS 39, March 2019), for entities applying hedge accounting.

The November IFRIC Update has not yet been modified to include the final agenda decision, which was ratified by the IASB in December.

### **Redeliberations continue on Primary Financial Statements project**

At its December meeting, the IASB continued its redeliberations on the Primary Financial Statements project. It is already two years since the publication of the *General Presentation and Disclosures* Exposure Draft, and one year since the Board began its redeliberations on this major project. Eventually, IAS 1 – *Presentation of Financial Statements* will be replaced by a new IFRS standard, while narrower-scope amendments will be made to IAS 7 – *Statement of Cash Flows*.

### **Unusual income and expenses**

This month, the IASB began redeliberations on unusual income and expenses, which are defined in the Exposure Draft as income and expenses with limited

predictive value. The draft goes on to state that 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.

Readers will remember that the Exposure Draft requires specific disclosures in the notes on these items:

- the amount of each item of unusual income or expenses recognised in the reporting period;
- a narrative description of the transactions or other events that gave rise to that item and the reasons why income or expenses that are similar in type and amount are not expected to arise in forthcoming reporting periods;
- the line item(s) in the statement(s) of financial performance in which each item of unusual income or expenses is included;
- if the included expenses are broken down by function of expense in the statement of profit or loss, the entity shall include a breakdown by nature of expense in the notes.

In December, the IASB tentatively decided:

- to further explore how to proceed with a definition of “unusual income and expenses”, which are key elements of financial reporting for many companies;
- to remove the phrase “limited predictive value” from the definition, and to clarify in the final standard that this is a necessary characteristic of unusual income and expenses, but not the only characteristic;

- to develop application guidance to clarify the definition of unusual income and expenses. This guidance would:
  - clarify that the definition means that unusual income and expenses can be dissimilar in type or amount from income and expenses expected in the future;
  - help an entity to assess whether similar income or expenses will arise in the future; and
  - explain that when assessing whether income and expenses are similar to those that will arise in the future, an entity must take account of the characteristics of the income and expenses, including the underlying event or transaction that gives rise to the income or expenses.

### “Investing” category

At the December meeting, the IASB also discussed the definition of the new “investing” category of the statement of profit or loss and the items to be presented in this category. The Board also agreed to retain the “investing” label.

Readers will remember that the IASB had previously decided, during its redeliberations on the “financing” category (cf. Beyond the GAAP no. 155, May 2021), that income and expenses related to cash and cash equivalents should be presented in the “investing” category (rather than the “financing” category, as proposed in the exposure draft).

Also at the May meeting, the IASB tentatively decided to retain the requirement for entities to present a new sub-total in the

statement of profit or loss, for “profit or loss before financing and income tax”. This subtotal would appear after the “investing” category (thus also including income and expenses from the “operating” category) but before the “financing” category.

This month, the IASB tentatively decided:

- to confirm that income and expenses from assets that generate returns individually and largely independently of other resources held by the entity should be classified in the “investing” category. The standard itself will not include the objective for this category, but the Basis for Conclusions will explain the reasons for presenting certain items in the “investing” category (i.e. this category provides information on returns from investments, which users of financial statements generally analyse separately from operating profit);
- to retain the application guidance on this category proposed in the Exposure Draft, but with some additional clarifications;
- to classify all income and expenses from associates and joint ventures in the “investing” category, thus in theory concluding the Board’s discussions on this topic (cf. Beyond the GAAP no. 159, October 2021). This means that preparers will not need to distinguish between “integral” associates and joint ventures (those that are integral to the main business activities of the entity) and “non-integral” associates and joint ventures, as originally proposed in the Exposure Draft. However, the discussions revealed that not all of the Board members

were convinced by the final decision, which ultimately is a pragmatic choice.

Redeliberations are expected to continue throughout much of 2022. For example, the IASB still needs to decide on the classification of income and expenses arising from transactions that result in a change in the category in which the income and expenses generated by the assets are classified (e.g. where should an entity classify the gains and losses arising when an associate or joint venture becomes a subsidiary?).

### **ISSB Chair appointed**

On 16 December, the Trustees of the IFRS Foundation announced the appointment of Emmanuel Faber as the first Chair of the newly-created International Sustainability Standards Board (ISSB) (cf. Beyond the GAAP no. 160, November 2021). Mr Faber has been appointed for an initial term of three years.

He was formerly Chair and CEO of Danone, which has led the field in the publication of high-quality sustainability information. His diverse range of experience also reflects his commitment at the international level to developing a recognised sustainability reporting framework.

## **European Highlights**

### **ESMA publishes report on banks' expected credit loss disclosures**

On 15 December 2021, the European Securities and Markets Authority (ESMA) published its report on banks' application of the requirements of IFRS 7 – *Financial Instruments: Disclosures* and IFRS 9 – *Financial Instruments* regarding expected credit losses (ECL).

The report provides a snapshot of banks' compliance with the requirements of IFRS 7 and IFRS 9 in terms of ECL disclosures, with a focus on the relevance and comparability of disclosures.

ESMA analysed the 2020 financial statements of a sample of 44 European banks from 21 jurisdictions.

It found room for improvement in terms of compliance, comparability and transparency when applying the relevant IFRSs, and makes recommendations for issuers on the following topics:

- general disclosures on expected credit losses;
- assessing whether there has been a significant increase in credit risk;
- forward-looking information;
- explanations of changes in loss allowances;
- transparency of disclosures on credit risk exposures; and
- ECL sensitivity disclosures.

ESMA's report is available [here](#).

### **ESMA publishes 2021 ESEF XBRL taxonomy files**

On 10 December, ESMA published the 2021 XBRL taxonomy files for the European Single Electronic Format (available [here](#)), together with an update to the conformance suite (available [here](#)). This follows the publication last May of a draft new version of the Regulatory Technical Standards for the ESEF (available [here](#)).

The 2021 ESEF taxonomy takes account of the updates made by the IASB to the IFRS taxonomy in 2021 (available [here](#)).

The 2021 version of the ESEF taxonomy was adopted by the European Commission on 29 November and is currently subject to

the scrutiny of the European Parliament and Council. Provided that there are no objections, the updated ESEF taxonomy should come into force at the beginning of March 2022 and will be mandatory for financial periods commencing on or after 1 January 2022.

For the electronic reporting of 2021 financial statements, issuers may use either the 2020 or 2021 versions of the taxonomy, provided that the 2021 version has come into effect by the publication date of the report.

Readers will remember that the ESEF is mandatory for financial periods commencing on or after 1 January 2021 for issuers whose securities are traded on a regulated market and that are required to publish an annual financial report under the Transparency Directive.

### **Delegated Regulations on climate objectives and Article 8 published in OJEU to supplement taxonomy for sustainable activities**

On 10 December, two Delegated Regulations were published in the Official Journal of the European Union (OJEU) to supplement the June 2020 taxonomy Regulation for sustainable activities. They were:

- the Delegated Regulation on climate change mitigation and adaptation (available [here](#)), which was adopted by the European Commission on 4 June 2021. It lists Taxonomy-eligible activities and the technical screening criteria to be used for determining whether these activities contribute substantially to climate change mitigation or adaptation and can thus be classified as Taxonomy-aligned and sustainable;
- the Delegated Regulation on Article 8 of the “green taxonomy” Regulation (available [here](#)), which was adopted by the European Commission on 6 July 2021. It specifies the disclosures to be presented in non-financial statements (most importantly, the proportion of turnover, capital expenditure and operating expenditure that relate to Taxonomy-aligned economic activities).

For more details, see Beyond the GAAP no. 157, July-August 2021.

### **European Commission publishes FAQ on disclosures required under Article 8 of Taxonomy Regulation**

On 20 December, the European Commission published a first FAQ, available [here](#), to assist stakeholders with first-time application of the Disclosures Delegated Act, which supplements Article 8 of the taxonomy Regulation for sustainable activities.

Readers will remember that, from 1 January 2022, non-financial undertakings must publish information on the proportion of their activities classified as “Taxonomy-eligible” according to the delegated act on climate change mitigation and adaptation. From 1 January 2023, they must publish information on the proportion of their activities classified as “Taxonomy-aligned” (i.e. meeting the technical screening criteria). There are specific requirements for financial undertakings.

The FAQ has been eagerly awaited, as application raises a number of practical issues. However, it does not address the trickiest issues, such as the definition of operating expenditures (for the OpEx key performance indicator). The answer to question 9, “How does the Disclosures

Delegated Act define capital and operating expenditures?” simply refers back to the section of the Article 8 Delegated Act that includes the existing definition of the OpEx denominator.

However, question 5, which deals with the use of the annexes provided in the Delegated Act, appears to confirm that the templates for each key performance indicator are not mandatory for the 2022 eligibility reporting, but their use on a voluntary basis is encouraged in order to facilitate comparability between eligibility reporting and alignment reporting (from 2023 onwards), as well as consistency between different entities. In practice, this may lead entities to publish the absolute monetary amounts of turnover, CapEx and OpEx for eligible activities, as well as the proportions. This is specifically suggested in the answer to question 10.

Furthermore, question 6 specifies that a company with no eligible economic activities must nonetheless present the required disclosures on non-eligible economic activities.

In addition to the FAQ, the Platform on Sustainable Finance has published a document (available [here](#)) summarising its views on the publication of voluntary disclosures in the first year of reporting. These perspectives supplement the FAQ and set out useful principles for non-financial disclosures published on a voluntary basis as part of the Taxonomy reporting.

This document states that disclosures published voluntarily should be prepared on a basis that does not contradict or misrepresent the mandatory disclosures. Moreover, voluntary disclosures should not be given more prominence than mandatory disclosures.

The Platform also notes that estimates and approximations are not allowed to be used in mandatory disclosures. However, additional information may be published on a voluntary basis, separately from the Article 8 disclosures, and clearly labelled as estimates or approximations (for example, if an entity has carried out a preliminary analysis of Taxonomy-alignment and wishes to publish this in 2022, even though the figures have not yet been finalised).

Lastly, the Platform has also published an Excel document (available [here](#)) which provides an indicative mapping to help companies to match their activities to those included in the climate objectives delegated act.

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## Contact us

Michel Barbet-Massin, Partner, Mazars  
[michel.barbet-massin@mazars.fr](mailto:michel.barbet-massin@mazars.fr)

Edouard Fossat, Partner, Mazars  
[edouard.fossat@mazars.fr](mailto:edouard.fossat@mazars.fr)

Carole Masson, Partner, Mazars  
[carole.masson@mazars.fr](mailto:carole.masson@mazars.fr)

Contributors to this issue:

Vincent Guillard, Carole Masson, Cédric Tonnerre  
and Arnaud Verchère

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