Newsletter no. 184 – January 2024

Beyond the GAAP

Mazars' monthly newsletter on financial and sustainability reporting

Sommaire

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Editorial

This month, sustainability reporting has again dominated the news, with the provisional agreement from the European Parliament to delay Commission adoption of the next sets of ESRS (namely sector-specific ESRS and ESRS for non-EU groups) by two years, i.e. by 30 June 2026 instead of 30 June 2024 as initially indicated in the Corporate Sustainability Reporting Directive. Sector-specific standards in eight areas will nonetheless be published as soon as they are ready with respect to high-impact sectors. In January, EFRAG also issued its proposals regarding an ESRS for listed SMEs and a voluntary standard for non-listed SMEs.

With respect to financial reporting, the IASB continued its deliberations on draft amendments to IFRS 9 and IFRS 7, considering comment letters received. The IASB's discussions focused on the SPPI qualification and associated indicators, as well as on financial assets with non-recourse features and contractually linked instruments, for which stakeholders expressed reservations about the existence of alternative structures avoiding the application for requirements of the standard.

IFRS Highlights

IASB deliberations on draft amendments to IFRS 9 and IFRS 7

At its meeting on 23 January 2024, following its first deliberations (IASB meeting of 13 November 2023, see Beyond the GAAP no.182 of November 2023), the IASB continued its analysis of the feedbacks received to the Exposure Draft on Amendments to IFRS 9 and IFRS 7 on the classification and Measurement of financial instruments (see the study published in Beyond the GAAP no.176 of April 2023).

General requirements

As a reminder, at the IASB meeting on 25 October 2023, the staff papers initially suggested that the SPPI nature of a contingent loan compensation clause could be indicated analysing whether or not the fair value of the clause was insignificant at initial recognition. The IASB has now tentatively decided to:

- clarify, in paragraph B4.1.8A of the Exposure Draft, that the quantitative aspect of the adjustment linked to the compensation clause shall be taken into account in the SPPI analysis, in addition to the qualitative analysis linked to the nature of the clause;
- clarify, in paragraph B4.1.10A of the Exposure Draft, that, when the nature of a contingent event is not directly related to a change in basic lending risks or costs, a financial asset has contractual cash flows that are SPPI:
    - when, irrespective of the probability that the contingent event will occur, the contractual cash flows before and after any contingent event(s), considered in isolation, are solely payments of principal and interest; and
    - when the contractual cash flows arising from a contingent event are not significantly different from the cash flows on a similar financial asset without such a contingent event and do not represent an

investment in particular assets or cash flows;

- delete from paragraph B4.1.10A of the Exposure Draft the notion of investment "specific to the debtor", which had received mixed feedback from stakeholders.

Financial assets with non-recourse features and contractually linked instruments

Many stakeholders who commented on the Exposure Draft expressed reservations about the existence of alternative structures to avoid applying requirements of the standard for contractually linked instruments (CLIs). This would be the case, for example, where the junior debt instrument is held by the sponsor on initial recognition and subsequently transferred to a third party, with no possible reassessment of the instrument as a CLI.

The IASB tentatively decided to finalise the proposed amendments in the Exposure Draft, subject to a requirement, under paragraph B4.1.20A, that the junior debt instrument be held by the debtor (the sponsoring entity) throughout the life of the transaction.

Minor drafting suggestions will also be made to clarify the proposed amendments. The staff papers suggest, in particular:

- For assets with non-recourse features: removing the reference to non-recourse feature “throughout the life of the instrument” in paragraph B4.1.16A of the Exposure Draft, to retain only the case of default of the debtor;
- For contractually linked instruments: clarifying, in paragraph B4.1.23 of the Exposure Draft, the existence of a rebuttable presumption of SPPI nature when a group of underlying assets includes lease receivables.

Joint IASB-ISSB meeting to discuss feedback on ISSB consultation on its future priorities

The inaugural joint IASB-ISSB meeting was held on 25 January 2024 to hold preliminary discussions on the feedback from the ISSB’s consultation launched in May 2023 on its priorities for the next two years (see Beyond the GAAP no 177 of May 2023).

The meeting focused on:

- a potential project on integration in reporting, including consideration of the IASB Exposure Draft *Management Commentary* and the Integrated Reporting Framework, and
- connectivity of the work of the two Boards.

A brief joint IASB-ISSB update is available summarising the matters discussed and the next steps.

A podcast episode is also available where IASB Vice-Chair Linda Mezon-Hutter and ISSB Vice-Chair Sue Lloyd share their reflections on the meeting, including the importance of connectivity in the work of the two Boards.

The IASB will then reconsider the direction of its Exposure draft *Management Commentary* of May 2021 (a project that had been temporarily paused in view of the ISSB consultation) in light of this discussion and the ISSB will continue to discuss feedback on its consultation on future priorities, including other sustainability-related topics which were seen as higher priority by most respondents.

Illustration of interoperability between GRI and ISSB standards through the reporting on GHG emissions

On 18 January 2024, the IFRS Foundation and GRI jointly published the following document: *Interoperability considerations for GHG emissions when applying GRI Standards and ISSB Standards*, focussing on Scope 1, 2 and 3 GHG emissions disclosures (the press release is available here).

The GHG disclosure requirements of both standards GRI 305, *Emissions* and IFRS S2, *Climate-related disclosures* are highly aligned, for example both cover the same gases, require disclosure of location-based emissions in CO_2e, emissions and scope 3 categories as well as disclosure of approach and methodologies used. As a result, entities already reporting Scope 1, 2 and 3 GHG emissions under GRI standards will be well placed to comply with IFRS S2.

Some other GHG emissions disclosures may be aligned depending on the decisions the entity makes in applying these standards (such as those related to the choice of global warming potential (GWP) rates and the emissions factors used).

In addition, there are some requirements specific only to either GRI 305 or IFRS S2, and all such disclosures would need to be made to ensure compliance with both standards.

European Highlights

European Parliament provisionally agrees to delay Commission adoption of the next sets of ESRS standards by two years

On 24 January 2024, the European Parliament's (EP) Committee on Legal Affairs (JURI) approved the two-year delay (see Beyond the GAAP no.181 of October 2023) for the adoption by the European Commission (EC) of sector-specific European Sustainability Reporting Standards (ESRS) and ESRS for non-EU groups (press release available here).

This would mean a deadline for the adoption of these two sets of standards of 30 June 2026 instead of 30 June 2024, as initially indicated in the Corporate Sustainability Reporting Directive (CSRD), thus leaving time for both (i) companies to implement the ESRS Set 1[1] and (ii) the European Financial Reporting Advisory Group (EFRAG), the EC's technical advisor, to develop them.

However, members of the EP urged the EC to publish eight sector-specific standards relating to high-impact sectors as soon as they are finalised (i.e. before the deadline) in order to meet market needs. The setting-up of an annual consultation of the EP was also requested so as to monitor the development of these standards, as well as EFRAG's planning and prioritisation work in this area.

This provisional decision must now be approved by a plenary vote so that the EP can begin negotiations with the Council.

EFRAG publishes exposure drafts of sustainability reporting standards applicable to SMEs

On 22 January 2024, EFRAG published the exposure drafts (available here) on sustainability reporting standards for SMEs (mandatory ESRS for listed SMEs in scope of the CSRD and voluntary standard for non-listed SMEs) as part of a four-month public consultation open until 21 May 2024.

EFRAG has also invited preparers and users to participate in a field test that will be run in parallel (the deadline to submit interest in the field test was on 31 January 2024).

[1] The Set 1 comprises the 12 first sector-agnostic ESRS which were endorsed by the EC on 31 July 2023 and published in the Official Journal of the EU on 22 December 2023.

In developing the mandatory ESRS for listed SMEs (hereafter "ESRS LSME"), EFRAG has sought to set disclosure requirements that are proportionate and relevant to the specific capabilities and characteristics of listed SMEs, while taking account of (i) the requirements of the CSRD and (ii) the need to support a better access to finance through increased standardisation of sustainability information disclosed by these companies.

The draft ESRS LSME prepared by EFRAG includes:

- three general sections: 1) General requirements, (2) General disclosures and (3) Policies, actions and targets;
- and three sections dedicated to metrics: (4) Environment, (5) Social and (6) Business conduct.

EFRAG is expected to take into account the feedback received from its stakeholders and deliver its technical advice to the EC no later than November 2024, with a view to adopting the ESRS LSME by 30 June 2025. This standard will then enter into force on 1 January 2026 (with publication of the sustainability statement in 2027 in respect of the 2026 financial year), with listed SMEs benefiting from a two-year deferral option (publication in 2029 in respect of the 2028 financial year)[2].

The voluntary standard for non-listed SMEs (hereafter "VSME standard") has been developed as part of the general measures to support SMEs in their access to sustainable finance. EFRAG's exposure draft sets out a simple and proportionate reporting tool to assist these companies in responding to the many requests for sustainability information that they receive from banks, investors and the larger companies for which they act as suppliers. The VSME standard should therefore help to standardise and reduce these demands, which represent a significant burden for non-listed SMEs. However, this voluntary standard is not among the requirements laid down in the CSRD and will therefore not be adopted by the EC.

The draft VSME standard prepared by EFRAG is structured into a *Basic Module* and two additional optional modules: (1) a *Narrative-Policies, Actions and Targets (PAT) Module* and a (2) a *Business Partners Module*.

These draft standards (ESRS LSME and VSME) will be the subject of a detailed study in a future issue of Beyond the GAAP.

New composition of EFRAG's Administrative Board

On January 17, EFRAG announced the new composition of its Administrative Board, approved by the EFRAG General Assembly on 11 December 2023, and effective from 22 January 2024.

Helmut Maukner was appointed as the new representative for Austria, replacing Andrea Sternisko. All other EFRAG Administrative Board members were (re)appointed for a two-year term effective from 22 January 2024.

In place since January 2022 as a result of the Gauzes governance reform, the EFRAG Administrative Board is responsible for EFRAG's organisation, administration, finance and due process encompassing both the Financial reporting and Sustainability reporting pillars. It is not involved in technical activities or positions.

[2] This standard will also apply to small and non-complex credit institutions and captive insurance and reinsurance companies, but without the two-year deferral option (first mandatory application from 1 January 2026).

At the same time, EFRAG announced that two new members joined its governance bodies:

- Martin Thygesen: appointed as EFRAG FRB member (Danish Funding Mechanism, Denmark) by the EFRAG General Assembly on 11 December 2023.
- Alexander Bassen: appointed as EFRAG SRB member (EFFAS and Eurosif, user sector) by the EFRAG General Assembly on 11 December 2023.

The full composition of the EFRAG Administrative Board is available on the EFRAG website (the press release is available here).

Contact us

Edouard Fossat, Partner, Mazars
edouard.fossat@mazars.fr

Carole Masson, Partner, Mazars
carole.masson@mazars.fr

Contributors to this issue:

Colette Fiard, Vincent Gilles, Clémence Lordez, Laura Niewiadomskyj, Arnaud Verchère and Paul Winrow

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[1] Where permitted under applicable country laws

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