



Beyond the GAAP

Mazars' newsletter on accounting standards

Contents

02	Editorial
02	IFRS Highlights
05	European Highlights
07	IASB consults on its agenda to 2026
12	European Commission publishes proposed revision to Non-Financial Reporting Directive

Editorial

In its final report on the “fitness check” on the EU framework for public reporting by companies, which began in 2018, the European Commission has concluded that IFRSs ensure high-quality financial information and comparability of financial statements. However, the findings on non-financial reporting were less encouraging, despite some progress thanks to the Non-Financial Reporting Directive (NFRD).

In this context, most stakeholders no longer have many urgent requirements for changes to the IFRS framework. Despite this, it is important to engage with the consultation recently launched by the IASB on its work plan for the next five years, as this will help to identify any remaining standard-setting requirements and priorities in terms of ensuring consistency of practice (although much of the work for the next few years is already mapped out).

However, a key priority for everyone at this point is to eventually bring the quality of non-financial reporting into line with that of financial reporting. The IFRS Foundation has therefore launched another consultation, this time on amendments to its Constitution to permit the creation of an International Sustainability Standards Board (ISSB). Meanwhile, the European Commission has published its ambitious and long-awaited proposals for a Corporate Sustainability Reporting Directive (CSRD), which would replace the NFRD. The proposals would establish EFRAG as the standard-setter for non-financial reporting in Europe.

IFRS Highlights

IFRS IC agenda decision on Configuration or Customisation Costs in a Cloud Computing Arrangement (IAS 38 – *Intangible Assets*)

At its April meeting, the International Accounting Standards Board (IASB) approved the tentative agenda decision on Configuration or Customisation Costs in a Cloud Computing Arrangement (IAS 38 – *Intangible Assets*) that was finalised by the IFRS Interpretations Committee (IFRS IC) at its March meeting and published in the IFRIC Update for that month (available [here](#)).

The Committee received a request as to how a customer should account for the configuration and customisation costs associated with software purchased from a

supplier in a Software as a Service (SaaS) arrangement.

The Committee considered that this topic was covered by existing standards, so decided not to add the issue to its work plan.

In the fact pattern submitted, the contract grants the customer the right to access the supplier’s software and is therefore recognised in the customer’s accounts as a service received (i.e. the right to receive access is not recognised as an asset).

The customer also incurs two types of costs:

- configuration costs (e.g. defining parameters); and
- customisation costs (e.g. changing or adding new lines of code that will generally modify or create additional functionalities within the software).

The Committee analysed the request to determine whether these costs should be recognised as an intangible asset under IAS 38. It also considered what accounting principles should be applied if the costs are not recognised as an intangible asset.

Do configuration and customisation costs meet the definition of an intangible asset?

After drawing attention to the rules set out in IAS 38 on accounting for intangible assets, the Committee pointed out that in the situation under consideration, the software is controlled by the supplier and not the customer.

Thus, in order to determine whether or not the costs meet the definition of an intangible asset, the entity must consider the nature of the costs and the impact of the configuration or customisation on the software.

The Committee noted that, in most cases, the customer would not recognise an intangible asset because it does not control the software, and the configuration and/or customisation activities do not create a resource controlled by the customer that is separate from the software.

However, the Committee observed that in some situations, the contract might result in additional lines of code, for example, from which only the customer would derive future economic benefits. In such a case, the customer must assess whether these lines of code are identifiable and meet the criteria for recognition of an intangible asset under IAS 38.

If the configuration and/or customisation costs do not meet the definition of an intangible asset, what accounting treatment should be used?

If the costs do not meet the definition of an intangible asset, the customer shall apply paragraphs 68–70 of IAS 38:

- the customer recognises the costs as an expense when it receives the configuration and/or customisation services from the supplier (and not when the customer uses those services);
- IAS 38 does not include any specific guidance on how to assess the contract with the supplier to determine when the supplier provides the configuration and/or customisation services. In accordance with IAS 8.10 and 11, which specifies that in such a situation an entity shall draw on other standards that cover similar topics, the Committee referred to the provisions of IFRS 15. This standard specifies how to identify the performance obligations in the contract and when the underlying goods or services are transferred to the customer;
- if the configuration or customisation services are carried out by the supplier of the software (or a subcontractor of the supplier), the customer shall apply the requirements of IAS 38.69 and 69A and must determine when the configuration or customisation services are provided:
 - if these services are distinct from the right to access the software, the customer recognises the costs as an expense when the supplier configures or customises the software (this would also be the case if the services are provided by a third party);
 - if these services are not distinct from the right to access the software, the costs are recognised as an expense when the supplier provides the customer with access to the

software, over the contract term (i.e. the costs are spread over the contract term);

- if the customer makes a payment for the configuration and/or customisation services in advance, this prepayment is recognised as an asset (in accordance with IAS 38.70).

Exposure Draft on lack of exchangeability

On 20 April, the IASB published an exposure draft (ED/2021/4) entitled Lack of Exchangeability (available [here](#) and open for comment until 1 September 2021).

The exposure draft sets out proposed amendments to IAS 21 – *The Effect of Changes in Foreign Exchange Rates* that would extend the provisions of the standard regarding situations where there is a lack of exchangeability between two currencies. IAS 21 currently only specifies the exchange rate to be used when exchangeability is *temporarily* lacking.

The proposed amendments aim to provide answers to the following questions:

When is a currency exchangeable into another currency and when is it not?

According to the exposure draft, a currency is exchangeable when an entity is able to exchange it for another currency, even indirectly (i.e. via a third currency), through a market or exchange mechanism that creates enforceable rights and obligations, and within a normal time frame.

Conversely, a currency is not exchangeable if an entity is able to obtain no more than an insignificant amount of the other currency.

How should an entity determine the exchange rate to be applied when a currency is not exchangeable?

If a currency is not exchangeable, the IASB is proposing to specify that the **spot**

exchange rate at the measurement date should be estimated as follows:

- the rate at which the entity would have been able to enter into an exchange transaction had the currency been exchangeable into the other currency;
- that would have applied in an orderly transaction between market participants; and
- that is a faithful reflection of the prevailing economic conditions at that date.

The IASB is also proposing to specify that an entity could use an **observable** exchange rate as the estimated spot exchange rate if that exchange rate is either: a spot exchange rate for a purpose other than that for which the entity assesses exchangeability; or the first exchange rate at which an entity is able to obtain the other currency after exchangeability has been restored (first subsequent exchange rate).

What additional disclosures should be presented if a currency is not exchangeable?

When a currency is not exchangeable, an entity shall disclose information that enables users of its financial statements to understand how the lack of exchangeability affects or is expected to affect its financial performance, financial position and cash flows.

Bertrand Perrin appointed member of IASB

On 14 April, the IFRS Foundation announced the appointment of Mr Bertrand Perrin as a member of the IASB from 1 July 2021 for a five-year term. He will take over from Françoise Florès, whose term ends at the end of next June.

Mr Perrin is currently Director of Accounting Standards and Special Projects at Vivendi and has been working closely with the IASB and the IFRS Foundation for several years, notably as a member of the IFRS IC since 2016.

IFRS Foundation consults on creation of International Sustainability Standards Board

Last September, the Trustees of the IFRS Foundation launched a consultation (see 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. Now, as announced in March (see Beyond the GAAP no. 153, March 2021), the Trustees have published an exposure draft (available [here](#)) proposing targeted amendments to the IFRS Foundation Constitution to permit the creation of an International Sustainability Standards Board (ISSB) that would set IFRS Sustainability Standards.

The IFRS Foundation's proposals for the governance structure of the ISSB are similar to the existing structure of the IASB (International Accounting Standards Board). Some slight differences would permit the new Board to reach an appropriate level of maturity in its standard-setting and to develop its technical expertise within the limits of the Trustees' strategic direction.

The due process for the publication of IFRS Sustainability Standards would also be very similar to the existing due process for IFRSs published by the IASB.

Stakeholders have until 29 July 2021 to send comments to the IFRS Foundation, which will take these comments into account when deciding whether to create the new Board. If the plan goes ahead, the formation of the ISSB will be announced at

the next United Nations Climate Change Conference (COP26), scheduled for November 2021.

The IFRS Foundation has also published a Feedback Statement (available [here](#)) on last September's consultation, summarising the feedback received in the 577 comment letters.

European Highlights

ESMA publishes 2020 report on European enforcers' regulatory and enforcement activities

On 6 April, the European Securities and Markets Authority (ESMA) published its annual report on its own activities and those of European enforcers (available [here](#)).

The report provides an overview of the activities of ESMA and European enforcers in 2020, focusing particularly on compliance of financial and non-financial information published by issuers for 2019 (i.e. prior to the Covid-19 crisis).

European enforcers undertook 729 examinations to check compliance of financial information with the IFRS framework, representing around 17% of all listed European issuers (compared with 19% in 2019). Of these, 265 resulted in enforcement actions taken against issuers due to material departures from IFRSs, which represents an action rate of 38% (compared with 33% in 2019). ESMA noted that, as previously, the majority of shortcomings were in the areas of accounting for financial instruments, impairment of non-financial assets, presentation of financial statements and revenue recognition.

In addition, European enforcers examined the 2019 financial statements of 101 issuers to assess the extent to which they had taken into account ESMA's

European Common Enforcement Priorities for year-end financial statements. This resulted in enforcement actions being taken against 18 issuers in relation to the application of IFRS 16 – *Leases* (out of 84 issuers significantly impacted by this standard, which was mandatory for the first time in 2019). ESMA's report also includes an overview of disclosures provided in accordance with IFRS 16.

As regards non-financial statements, European enforcers carried out 737 examinations, representing 37% of the estimated total number of issuers required to publish this information (compared with 45% in 2019). Of these, enforcement actions were taken against 5% (compared with 10% in 2019). As for financial information, enforcers assessed the extent to which ESMA's European Common Enforcement Priorities were taken into account, examining the non-financial statements of 118 issuers and taking actions against 54 of these.

Regarding alternative performance measures (APMs), European enforcers examined 611 management reports to assess compliance with ESMA's guidelines on this topic. These management reports represented 14% of listed European issuers publishing IFRS financial statements. 15% of these examinations resulted in actions being taken, the majority of which were to require a correction in a future management report.

In the report, ESMA also reminds issuers of the European Common Enforcement Priorities for 2020 (for more details of these recommendations, see *Beyond the GAAP* no. 148, October 2020). Such priorities focused particularly on the importance of high-quality financial reporting in the context of the Covid-19 crisis. Enforcers will be looking closely at these topics when they

review the 2020 financial statements in 2021.

This year, ESMA will also be continuing with its work on convergence of financial reporting supervision at European level. It will be paying particular attention to topics related to the public health crisis, as well as ensuring consistent application of recently applicable standards (IFRS 9 – *Financial Instruments*, IFRS 16 – *Leases* and IFRS 15 – *Revenue from Contracts with Customers*).

IASB consults on its agenda to 2026

The IASB is currently consulting on its activities and its work plan for the next five years (document available [here](#), comment period open until 27 September).

This is the third agenda consultation; an exercise that began in 2011, at the start of outgoing chairman Hans Hoogervorst's first term. It is also an opportunity to reflect on the IASB's activities over the past decade.

The beginning of the 2000s saw a first wave of standard-setting that laid the foundations for the framework. A second wave of cornerstone standards has completed it in recent years (IFRS 9 – *Financial Instruments*, IFRS 15 – *Revenue from Contracts with Customers*, IFRS 16 – *Leases* and IFRS 17 – *Insurance Contracts*). Now the framework is almost complete and the focus has shifted to consolidation.

Since 2015, the work plan has focused on three main areas: standard-setting, maintenance and research. Going forward, the IASB's activities will be grouped into four technical work areas (standard-setting, maintenance of standards, digital financial reporting and IFRS for SMEs), which will account for 70% of the IASB's resources (Board members and technical staff). The remaining capacity is devoted to cross-cutting activities, namely stakeholder engagement (to which the IASB devotes a quarter of its time) and improving the understandability and accessibility of the IFRS framework (5%).

In the current consultation, the three main focal areas of the previous work plan are largely subsumed into a single work area, "New IFRS standards and major amendments to IFRS standards," which accounts for nearly half of the IASB's time

currently. Post-implementation Reviews (PIRs), which shall take place three years after the implementation of a standard, will fall within this work area, meaning that it will continue to account for a significant portion of the IASB's capacity despite the completion of the last major standards.

The proposed changes reflect a shift from a sequential approach (research / standard-setting / application), which is more suited to developing a framework, to a functional approach that distinguishes between standard-setting, development of guidance (which will form the lion's share of the "maintenance" work area) and communication, and is thus more suited to a mature, established framework of standards.

Classic standard-setting activities

The new "standard-setting" work area will focus on (i) finishing current projects; (ii) post-implementation reviews (PIRs); and (iii) potentially, some new projects. In practice, the available capacity for this work area is already mostly taken up by various large ongoing projects.

One of these is the Better Communication in Financial Reporting project, which can be further broken down into three parts:

- the Primary Financial Statements project, which focuses particularly on presentation of financial performance in the statement of profit or loss, and which is currently at the redeliberations stage following the publication of an exposure draft (see Beyond the GAAP no. 120, March 2018);
- the Disclosure Initiative, which focuses firstly on producing a simplified version of the disclosure requirements for SMEs, and secondly on a proposed new approach to disclosure that would centre on objectives rather than a list of

requirements (with an initial pilot phase focusing on two standards, IAS 19 – *Employee Benefits* and IFRS 13 – *Fair Value Measurement*);

- and, finally, the Management Commentary project. However, management commentaries do not form part of the financial statements and thus do not fall within the IASB's current remit. Consequently, the project is focused on updating the non-binding guidance and principles set out in the Practice Statement published in 2010. The objective is to improve interconnectivity between financial and non-financial reporting (the latter being a key focal area for the IFRS Foundation currently: see 'IFRS Highlights', above).

The other main area of ongoing standard-setting research derives from the post-implementation review of IFRS 3 – *Business Combinations*; it aims to develop reporting requirements for business combinations under common control (which are currently excluded from the scope of the standard) and to improve the impairment test of goodwill, or even to reopen the debate on its amortisation.

Finally, the proposed new standard on rate-regulated activities, on which an exposure draft was recently published, will form the final building block in the standards framework, which now covers all major areas of activity.

The most recent wave of standard-setting means that there is also a full programme of post-implementation reviews (PIRs) upcoming over the next few years. This will include completing the ongoing PIR of the consolidation package (IFRS 10, IFRS 11 and IFRS 12); continuing with the PIR of IFRS 9 – *Financial Instruments*, which began this year; and carrying out PIRs for

IFRS 15 – *Revenue from Contracts with Customers* and IFRS 16 – *Leases*. Each of these reviews is likely to give rise to new research and standard-setting projects.

In this context, the (lack of) capacity for other projects is one of the challenges of the consultation. Most of the planned or suggested projects are not new, but rather (i) new approaches to issues that have been tackled before (e.g. financial instruments with characteristics of equity, macro-hedging, discount rates, operating segments) or (ii) projects that had previously been shelved (e.g. extractive activities, provisions, the equity method, and the PIR of IFRS 5 – *Non-current Assets Held for Sale and Discontinued Operations*).

Most of these topics currently involve a compromise between conceptual and rules-based approaches, due to conflicting user expectations or low priorities. Is there really a benefit to trying to reopen compromises at this point? If standards were to be rewritten, might any improvement in clarity and comparability be counterbalanced by a loss of relevance? Is it worth devoting more time to subjects that have already been shelved once because they were too niche, showed little hope of reaching compromise, or had a low cost-benefit ratio? These are some of the questions that stakeholders are likely to ask themselves when responding to the consultation. After two decades spent developing a robust framework of key standards, adding these finishing touches and improving overall consistency is likely to come at a high marginal cost, while the benefits are uncertain.

Finally, it is necessary to set aside some capacity for dealing with unexpected urgent issues that arise. Relatedly, the IASB is monitoring emerging issues, including: cryptocurrencies and related transactions;

climate-related risks; emission allowances (although this topic emerged a long time ago); and updating IAS 38 – *Intangible Assets*, given the increase and change in types of intangible assets over the past 20 years. Some of these topics could be boosted up the priority list by the IFRS Foundation’s plan to create a standard-setter for non-financial information.

To ensure that decisions are made as objectively as possible, the IASB has proposed seven criteria for determining priority: (1) The importance of the matter to investors; (2) Whether there is any deficiency in the existing presentation of the financial information; (3) The type of companies/jurisdictions affected; (4) How pervasive or acute the matter is likely to be for companies; (5) The potential project’s interaction with other projects on the work plan; (6) The complexity and feasibility of the potential project and its solutions; (7) The capacity of the IASB and its stakeholders to make timely progress on the potential project.

As noted above, the “standard-setting” work area already has a lot of capacity taken up by ongoing projects and scheduled post-implementation reviews, which leaves little scope to take on other projects if the allocation of resources to each area remains the same, as the IASB has proposed. As Board member Zach Gast writes [here](#), the consultation is as much about the balance of the IASB’s activities (question 1) and the criteria for prioritising reporting issues (question 2) as it is about the choice of specific projects (question 3). Input from stakeholders on the priority criteria will perhaps be the most useful of all.

Assisting the IFRS IC with developing supporting documentation

The second work area, “Maintenance and consistent application of IFRS standards” is devoted to the increasing amount (20%) of interpretation work that the IASB does alongside the IFRS Interpretations Committee (IFRS IC). For the past few years, the outcomes of this work have tended not to take the form of interpretations, but rather agenda decisions, educational materials, articles, webinars, and so on. Thus, the decisions published by the Committee, and the Bases for Conclusions and other materials produced by the IASB, are contributing to a rapidly-growing guidance that is theoretically non-binding but that is closely followed by enforcers, particularly market regulators.

The attention that the Foundation pays to the application of its standards helps to ensure their internal coherence and their relevance to real-world situations. But does this application support address the same objectives of consistency and uniformity as standard-setting itself? If so, this raises some important questions. Currently there is no mechanism for European endorsement of this guidance, despite its significance. But for how long can it continue to slip under EFRAG’s radar? We may see new life breathed into the debate that was opened in 2018 by a proposed amendment to IAS 8 on the status and scope of agenda decisions. That amendment was shelved in 2020, but the debate may not be over and raises questions about the need for the IASB to step up its activity in this area.

Currently, the IASB has oversight over the Committee’s agenda decisions, and contributes to the guidance by producing

educational materials and articles. The consultation raises the question of the expanded role that the IASB could play in helping the Committee to produce guidance. The recent consultation review of the Due Process Handbook suggested that the IASB could also issue agenda decisions. Ultimately, this suggestion was not taken forward. Hence how might the IASB provide greater support to the Committee in the future?

Should other activities be expanded?

The last two work areas – the IFRS Taxonomy and the simplified set of standards for SMEs – account for only a tenth of the IASB's capacity. Are these emerging areas, or does this betray a certain hesitancy?

The digitalisation of financial reporting is a key focal area for market regulators. The European Single Electronic Format (ESEF, which becomes mandatory for issuers from the financial period to 31 December 2021) is based on the IFRS Taxonomy. At the moment, this taxonomy is still largely based on current practice rather than standards, but it will improve thanks to the project on the format of primary financial statements.

As for the IFRS for SMEs, they have just been reviewed and will be updated with recently-published standards. It should be noted that this simplified set of standards, which is not strongly promoted in Europe, is proving attractive to new markets: the IFR4NPO initiative has just launched a consultation (available [here](#)) on potentially using the *IFRS for SMEs* as the basis for an international accounting framework for the non-profit sector.

To give a complete overview of the IASB's activities, we must also mention its work on

understandability and accessibility of the standards. Some issuers feel IFRSs are too complicated and expensive to implement and prefer to raise capital on unregulated markets. It is not certain that the *IFRS for SMEs* would meet their expectations any better.

In any case, these issues raise a number of challenges: how is it possible to make IFRSs the single framework for all countries and sectors without having an overwhelming amount of documentation? The increasing volume of guidance militates against concision, and the efforts to improve accessibility seem to focus on support rather than simplification. More generally, the IASB endeavours to influence practice through its deliberations (notably through the practice statement on 'materiality', the quality of disclosures in the notes, and so on). However, we must ask whether it is really possible to modify behaviour through standard-setting?

Your input is important!

While a significant amount of the IASB's work plan for the next five years already seems to be set, with relatively little scope for new projects, the consultation is still important. In the past, it has been obvious which topics were the most important and urgent, but this time round, it is perhaps more important than ever for stakeholders to express (i) their needs in terms of supporting documentation (ii) their priorities in terms of ensuring consistency of practice and (iii) their criteria for assessing costs and benefits for effect analyses of future projects (as now required by the new Due Process Handbook, updated in 2020).

Key points to remember

- The IASB is currently consulting on its work plan for the next five years; the comment period closes on 27 September.
- The IASB currently divides its time between four technical work areas (standard-setting 40%, application 20%, digitalisation 5% and simplified framework for SMEs 5%) and two cross-cutting activities (stakeholder engagement 25% and accessibility/understandability of standards 5%).
- The agenda for the standard-setting work area is already largely taken up by ongoing projects (better communication in financial reporting, business combinations, rate-regulated activities) and scheduled post-implementation reviews of recent standards (consolidation, financial instruments, revenue, leases).
- There is limited capacity for new projects, and many of the options are topics where the IASB has previously had to settle for a compromise or failed to find a solution. What has changed for making it worth re-opening these debates?
- The IASB is also consulting on how it could best assist the IFRS Interpretations Committee with developing supporting documentation.
- Finally, it is devoting 10% of its time to the last two technical work areas (the IFRS Taxonomy and the simplified framework for SMEs): are these emerging areas, or does this betray a certain hesitation?
- Ultimately, the consultation is at least as much about the balance of the IASB's activities and the criteria for prioritising reporting issues as it is about the choice of specific projects.

European Commission publishes proposed revision to Non-Financial Reporting Directive

On 21 April, at the same time as the agreement between EU member states to reduce greenhouse gas emissions in Europe by at least 55% from 1990 levels by 2030 (with a view to becoming the first climate-neutral continent by 2050), the European Commission (EC) published a proposed Corporate Sustainability Reporting Directive (CSRD).

The proposed directive aims to revise and strengthen the existing rules set out in Directive 2014/95/EU on the disclosure of non-financial and diversity information by certain large undertakings and groups (known as the Non-Financial Reporting Directive or NFRD). Readers will remember that companies have been required to publish information in accordance with the NFRD (as transposed into national law) since 2018, i.e. financial reports for the year 2017 onwards.

The NFRD applies to nearly 12,000 companies across Europe, i.e. large companies with more than 500 employees (also taking account of turnover, balance sheet total and legal structure) and public-interest entities (i.e. listed companies, banks and insurance companies), although each country has the option to extend the requirements. The CSRD would affect nearly 50,000 companies, namely all those listed on a regulated market, including SMEs (as defined in Directive 2013/34/EU on the annual financial statements, consolidated financial statements and related reports of certain types of undertakings, known as the “accounting directive”), as well as all non-listed

companies with more than 250 employees and a balance sheet total of €20m or revenue of €40m, whatever their legal structure.

The revision of the NFRD began in 2019 following the announcement of an ambitious “green deal” by the EU, which will mobilise substantial investments to support the agreed sustainability objectives. Things are just beginning but have already resulted in the publication of a plethora of new (or proposed) strategic and regulatory documents over the past few months. The CSRD aims to encourage a transparent and long-term approach to sustainability in the economic and financial sectors, notably by improving sustainability reporting and the regulations that govern it.

By strengthening the requirements of the NFRD, the EC hopes to eventually bring the quality of non-financial reporting into line with that of financial reporting under the IFRS framework. This objective is set out in the Commission’s final report on the “fitness check” on the EU framework for public reporting by companies (available [here](#)), which was launched in 2018 (see Beyond the GAAP no. 120, March 2018) and published at the end of April this year. The report notes that the IAS Regulation ensures high-quality financial information and comparability of financial statements across Europe. However, as regards non-financial reporting, while the NFRD has resulted in an increase in the quantity of non-financial information disclosed, significant weaknesses in reporting have been identified. Some relevant information is not disclosed, and the information that is published has limited comparability and reliability.

It is now clear that it is time to establish a common language for non-financial reporting (as the IFRS framework has done

for financial reporting), as there is today significant diversity in practice. Companies can currently pick and choose what they disclose, drawing on a whole range of different frameworks and indicators (such as those published by the TCFD, the IIRC, the GRI and the SASB, to name but a few). The goal of the CSRD is to provide a fit-for-purpose solution to the new corporate reporting challenges, in light of the increasing need for sustainability information expressed by investors and other stakeholders.

To establish this common language for non-financial reporting, the proposed CSRD will draw heavily on the work carried out by EFRAG over the past few months, focused on the development of future EU non-financial reporting standards (see Beyond the GAAP no. 153, March 2021). In contrast to the NFRD, the CSRD will allow member states very little latitude when transposing the disclosure requirements into national law, to ensure consistent application across all EU countries.

EFRAG will thus effectively be the European standard-setter and is expected to submit the first set of standards to the European Commission by mid-2022, for adoption in October 2022 by means of a delegated act. A second set of standards will follow in mid-2023 (for adoption in October 2023). No time will be wasted in the drive to establish European sustainability reporting standards, with companies required to publish a sustainability report in 2024, based on the 2023 data and the initial set of reporting standards published in October 2022. Specific standards will be developed for SMEs, which will have an additional three years before they are required to apply the standards.

While the EC is hoping to make rapid progress, it is also aware that it cannot ignore the work and planning carried out on this topic at the international level by the IFRS Foundation (see 'IFRS Highlights', above). Both standard-setters have already clearly stated their intention of capitalising on existing frameworks by picking the best.

The standards developed by EFRAG will also align with the existing obligations under the Sustainable Finance Disclosure Regulation, which comes into effect for financial market participants alone from 2023 (i.e. for reporting on the 2022 financial period), and under the Taxonomy Regulation, which requires affected companies to publish the proportion of the turnover, CapEx and OpEx associated with activities deemed to be economically sustainable in accordance with the technical criteria set by the EU (from 2022 for the 2021 financial period, focusing initially on the first two environmental objectives set by the EU, namely climate change mitigation and climate change adaptation).

The fine print of the proposed new CSRD clarifies the principle of double materiality, which already applied under the NFRD and which requires companies to consider both financial materiality (the impact of environmental and social matters on companies' ability to create value) and social materiality (the impact of an entity's own operations on the climate and on people).

The proposed directive also provides more details on the type of disclosures required from companies. In comparison with the NFRD, the CSRD introduces additional requirements for disclosures on their business model and strategy, their sustainability objectives and progress towards achieving these objectives, the role

of the administrative, management and supervisory bodies, the main negative impacts associated with the business and its value chain, intangible assets, and how the company has identified the information disclosed. It also specifies that companies should disclose both qualitative and quantitative information, retrospective and forward-looking information, and information on the short, medium and long-term outlook, as appropriate. All these disclosures must be presented in the consolidated management report.

The proposed CSRD would also strengthen moves towards digital financial reporting, as it would also require companies to prepare their financial statements and management report using the XHTML format in accordance with Regulation 2019/815/EU (known as the European Single Electronic Format regulation). Companies would thus need to tag their sustainability disclosures based on a taxonomy to be developed in line with the future sustainability standards.

Finally, the proposed new directive on non-financial reporting includes a mandatory audit requirement (limited assurance initially, with an option to move towards a reasonable assurance requirement in three years' time) to be performed by statutory auditors or an independent assurance services provider (at the option of member states).

Final adoption of the Corporate Sustainability Reporting Directive by the European Council and Parliament is scheduled for the first half of 2022.

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Key points to remember

- On 21 April, the European Commission published a proposed Corporate Sustainability Reporting Directive (CSRD).
- The proposed directive aims to revise and strengthen the existing rules set out in Directive 2014/95/EU, known as the Non-Financial Reporting Directive or NFRD.
- The key objectives of the revisions to the NFRD are as follows:
 - to simplify and standardise non-financial reporting requirements for European companies;
 - to reflect a comprehensive and inclusive approach to sustainability that will encourage corporate responsibility;
 - to improve the quality and reliability of non-financial reporting in order to bring it into line with financial reporting;
 - to ensure as much consistency as possible across the European Union.
- The proposed CSRD is broader in scope and has stricter requirements:
 - it encompasses a significantly larger number of companies: nearly 50,000, compared with almost 12,000 currently;
 - mandatory reporting standards would be drawn up by EFRAG, which will become the European standard-setter for non-financial reporting;
 - disclosure requirements are specified and certain areas are strengthened;
 - disclosures must be brought together in one place (specifically, the management report) and in a specific format (the ESEF is to be extended to the management report, and non-financial disclosures will be tagged);
 - disclosures must be audited;
 - member states have very little room for manoeuvre when transposing the directive into their national law.
- Companies will be required to publish a sustainability report in 2024, based on the data for 2023 and the initial set of reporting standards published in October 2022.
- Final adoption of the Corporate Sustainability Reporting Directive is scheduled for the first half of 2022.

Contact us

Dingeman Manschot, Partner, Mazars
dingeman.manschot@mazars.nl

Inge van Sloun, Director, Mazars
inge.vansloun@mazars.nl

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

Contributors to this issue:

Claire Dusser, Maud Gaudry (Sustainability Director), Florence Michel, Cédric Tonnerre and Arnaud Verchère

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[1] Where permitted under applicable country laws

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