



Beyond the GAAP

Mazars' newsletter on accounting standards

Contents

02	Editorial
02	IFRS Highlights
06	European Highlights
10	Standards and Interpretations applicable at 30 June 2021
13	Covid-19: disclosed financial performance – a focus on expected credit losses for a sample of 26 European banks as per 31 December 2020

Editorial

As is now traditional at this time of year, this issue of Beyond the GAAP presents a rundown of the new standards that are mandatory or permitted at the 30 June 2021 half-yearly closing.

Just like last year, preparers, auditors and regulators are waiting with bated breath for the EU endorsement of the amendment to IFRS 16 – *Leases* on rent concessions. There is no question as to whether the EU will endorse the amendment, but this may happen only after the date when the financial statements are authorised for issue, which would once again leave it up to companies to decide whether to apply the amendment anyway (otherwise, an entity would be required to assess whether rent concessions are lease modifications, for lease payments originally due between 30 June 2021 and 30 June 2022).

In this month's issue, we also present the key lessons to be learned from a study of a sample of 26 European banks, which looks at the impacts of the public health crisis on expected credit losses in IFRS consolidated financial statements as per 31 December 2020.

IFRS Highlights

IASB publishes amendments to IAS 12 – *Income Taxes*: “Deferred Tax related to Assets and Liabilities arising from a Single Transaction”

On 7 May 2021, the IASB published the amendments to IAS 12 – *Income Taxes*: “Deferred Tax related to Assets and Liabilities arising from a Single Transaction”. These amendments are intended to establish a general principle for the accounting treatment of deferred tax related to leases, and thus to reduce diversity in practice in this area (see Beyond the GAAP no. 135, July-August 2019, and no. 148, October 2020).

The amendments are mandatory for financial periods beginning on or after 1 January 2023. Early application is permitted (subject to their endorsement by the European Union).

However, if an entity wishes to change its accounting policy starting with the interim financial statements as per 30 June 2021, enabling it to recognise deferred tax for leases accounted for in accordance with

IFRS 16 – *Leases*, it may do this by applying the principles set out in IAS 8 – *Accounting Policies, Changes in Accounting Estimates and Errors* regarding changes in accounting policies. The impact of the change in accounting policy would then be recognised retrospectively in the opening balance of retained earnings for the first period presented. In other words, the entity may not yet apply the specific transition provisions set out in the amendments to IAS 12 – *Income Taxes*.

IFRS IC publishes agenda decision on Attributing Benefit to Periods of Service (IAS 19 – *Employee Benefits*)

At its May meeting, the International Accounting Standards Board (IASB) approved the tentative agenda decision on Attributing Benefit to Periods of Service (IAS 19 – *Employee Benefits*) that was finalised by the IFRS Interpretations Committee (IFRS IC) at its April meeting and published in the IFRIC Update for that month (available [here](#)).

Readers will remember that the original request concerned a defined benefit plan under which employees are entitled to a

lump sum benefit payment when they reach retirement age, provided that they are employed by the entity at that point.

The amount of the payment depends on the employee's length of service but is capped at a set number of consecutive years of service.

In the fact pattern submitted to the IFRS IC:

- the employees are not entitled to a retirement benefit from the plan until they reach the retirement age of 62, provided that they are still employed by the entity at this point;
- the amount of the benefit is one month of final salary for each consecutive year of service prior to retirement;
- the amount of the lump sum is capped at 16 years of service (in other words, the maximum retirement benefit to which an employee may be entitled is 16 months of their final salary);
- the amount is calculated using only the number of consecutive years of service immediately before the retirement age.

The request asked which periods of service the benefits should be attributed to, if the employee has rendered service to the entity for more than 16 consecutive years. In other words, should these benefits be attributed to the last 16 consecutive years of service immediately prior to retirement, or should they be attributed to the entire length of service, i.e. more than 16 years?

At its May meeting, the IASB approved the conclusions of the IFRS IC, which were based on the provisions of IAS 19 – *Employee Benefits* (paragraphs 70 to 74 and the first part of example 2, illustrating paragraph 73). The IFRS IC had concluded that the entity should attribute retirement benefits to each year in which the employee renders service between the ages of 46 and 62 (or, if employment commences at or after the age of 46, from the date the

employee first renders service until the age of 62).

Redeliberations continue on Primary Financial Statements project

At the meeting of the International Accounting Standards Board (IASB) in late May, the Board members continued their redeliberations on the proposals set out in the General Presentation and Disclosures exposure draft, which was published in December 2019.

Two topics were discussed in the light of the comments received:

- the definition of the 'financing' category for companies that do not provide financing to their customers or invest in financial assets as part of their main business activities (banks and insurance companies will be discussed separately later);
- the presentation of a subtotal for 'profit or loss before financing and income tax'.

Readers will remember that the exposure draft proposed:

- that the 'financing' category of the statement of profit or loss should include income and expenses from cash and cash equivalents, income and expenses on liabilities arising from financing activities (loans, lease liabilities, trade payables, etc.) and interest income and expenses on other liabilities (the interest component of pension liabilities, the unwinding of discounts on long term liabilities, etc.) with a view to enabling investors to compare entities' performance independently of the impact of those entities' financing decisions;
- that 'financing activities' should be defined as those that involve the receipt

or use of a resource from a provider of finance, with the expectation that (a) the resource will be returned to the provider of finance and (b) the provider of finance will be compensated through the payment of a finance charge that is dependent on both the amount and the duration of the credit. An amendment to IAS 7 – *Statement of Cash Flows* was intended to specify the definition of 'financing activities' to be used in the statement of cash flows in relation to borrowings, and would be based on the definition above;

- that entities should be required to present a new subtotal in the statement of profit or loss, namely 'profit or loss before financing and income tax', thus creating a clear distinction between the 'operating', 'integral associates and joint ventures' and 'investing' categories on the one hand, and the 'financing' and 'income tax' categories on the other.

On the first topic, the IASB provisionally decided:

- not to amend IAS 7 and to retain the current definition of financing activities. The IASB felt that the addition originally proposed would not in fact reduce diversity in practice where transactions involve a financing activity and another activity (operating or investing) and that the addition could in some cases result in a less relevant presentation in the statement of cash flows by preventing entities from using the financing category for the part of the cash outflow that does in fact relate to a financing activity;
- to redefine the items to be presented within the 'financing' category of the statement of profit or loss in line with the objective for this category, as set out in the exposure draft. The IASB, with the

help of the staff, will explore a new approach under which the following would be classified in this category:

- all income and expenses from liabilities arising from transactions that involve only the raising of finance; and
- interest income and expenses from other liabilities.

This means that the definition of 'financing activities' presented in the exposure draft will be removed – as stakeholders pointed out several practical difficulties with interpreting this definition – and will be replaced by a simpler, clearer approach. However, the change is not expected to result in a substantially different classification than the one the IASB was aiming for with the proposals set out in the exposure draft.

On the second topic, the IASB provisionally decided:

- to retain a separate 'investing' category within the statement of profit or loss, with the exact definition to be discussed at a later date, in addition to the two broad categories of 'operating' and 'financing'. Readers will remember that the objective of the investing category is to communicate information about returns from investments that are generated individually and largely independently of other resources held by the entity;
- to retain the requirement to present a subtotal for 'profit or loss before financing and income tax';
- to require entities to classify income and expenses related to cash and cash equivalents in the 'investing' category. Many stakeholders questioned whether it was appropriate to have different presentation requirements for, on the

one hand, income from investments in cash and cash equivalents as defined in IAS 7 – *Statement of Cash Flows* (which should be presented in financing according to the proposals in the exposure draft) and, on the other hand, income from short-term investments (which should be presented in investing according to the proposals in the exposure draft), given that some entities treat all these as a component of net debt. In its redeliberations, the IASB concluded that it is easier to justify presenting all income and expenses from excess cash and investment of this excess cash in the 'investing' category. In practice, this would mean that entities would no longer be permitted to include a 'cost of net financial debt' subtotal in the statement of profit or loss.

Redeliberations on the Primary Financial Statements project are expected to continue over the next few months.

IASB publishes exposure draft to replace IFRS Practice Statement 1 – *Management Commentary*

On 27 May, the IASB published an exposure draft (available [here](#)) that is intended to replace IFRS Practice Statement 1 – *Management Commentary*, published in December 2010.

The management commentary is generally viewed as a key document that complements the financial statements. The IASB's proposals are intended to encourage entities to produce a single document that brings together all the information that is useful to investors for assessing an entity's long term prospects in order to understand how the entity's business model creates value and generates cash flows. The proposals focus particularly on improving information on the environmental and social impacts of an

entity's activities and on intangible elements that are not reflected in the balance sheet.

The revised Practice Statement would still not be mandatory, but would continue to provide a framework for publishing a management commentary, to which stakeholders may refer if they wish.

The comment period is open until 23 November 2021.

Masamichi Kono appointed as Trustee of IFRS Foundation

On 28 May, the IFRS Foundation announced that Masamichi Kono has been appointed as a Trustee, for a term beginning on 1 July 2021.

Masamichi Kono is currently the Deputy Secretary General of the Organisation for Economic Cooperation and Development (OECD), where his responsibilities include setting the strategic direction of OECD policy on the environment, tax, trade and agriculture. He oversees initiatives on infrastructure and sustainable growth and represents the OECD at the Financial Stability Board.

Over the course of his career, Masamichi Kono has also held management positions at the Ministry of Finance and the Financial Services Agency of Japan, and has held the position of Chair of the International Organization of Securities Commissions (IOSCO) Technical Committee, and subsequently Chair of the IOSCO Board. He has also been Co-chair of the Financial Stability Board's regional consultative group for Asia and Chair of the IFRS Foundation Monitoring Board from 2013 to 2016.

European Highlights

European Commission publishes draft delegated act on Article 8 of “green taxonomy”

At the start of May, the European Commission published a draft delegated act (available [here](#)) to clarify the disclosure obligations under Article 8 of Regulation (EU) 2020/852 of 18 June 2020 on the establishment of a framework to facilitate sustainable investment.

Readers will remember that this Regulation establishes a standardised classification system for assessing the sustainability of around 80 economic activities across a dozen broad sectors, representing around 80% of the European Union’s greenhouse gas emissions. The European ‘green taxonomy’ thus provides technical criteria, based on scientific evidence, for evaluating the sustainability of an economic activity with regard to six environmental objectives.

Currently, only two of the objectives (climate change mitigation and climate change adaptation) are enshrined in law (the relevant delegated acts were published in April 2021). The other delegated acts specifying the technical screening criteria for the four other environmental objectives (sustainable use and protection of water and marine resources, transition to a circular economy, pollution prevention and control, and protection and restoration of biodiversity and ecosystems) are scheduled for publication at the end of this year.

Article 8 of Regulation 2020/852 specifies that any ‘undertaking’ that is subject to the obligation to publish non-financial information shall include in its non-financial statement information on how and to what extent the undertaking’s activities are associated with economic activities that qualify as environmentally sustainable.

In particular, non-financial undertakings shall disclose:

- the proportion of their turnover derived from products or services associated with economic activities that qualify as environmentally sustainable; and
- the proportion of their capital expenditure (CapEx) and the proportion of their operating expenditure (OpEx) related to assets or processes associated with economic activities that qualify as environmentally sustainable.

The draft delegated act on Article 8 clarifies the following key points:

- the date on which the new regulation enters into force;
- the methods to be used for calculating the key performance indicators (turnover, CapEx and OpEx) and how the data should be presented;
- additional qualitative and quantitative information to be presented alongside the KPIs.

There are specific rules on the information to be disclosed by financial undertakings, which we do not cover in this article.

Entry into force

Given the complexity of implementing the green taxonomy and the fact that the delegated acts permitting the application of the Regulation for the first two environmental objectives have only recently been published, the new draft delegated act sets out a two-stage application process:

- from 1 January 2022 (i.e. for 2021 data), entities shall disclose the ‘share’ of ‘Taxonomy-eligible’ and ‘Taxonomy non-eligible’ economic activities relative to the entity’s total activities, plus the relevant qualitative information. ‘Taxonomy-eligible’ activities are those that meet the definition of sustainable

activities, regardless of whether they comply with the technical screening criteria that specify the environmental thresholds to be met in order for the activities to be classified as 'Taxonomy-aligned';

- from 1 January 2023, entities shall disclose the three financial performance indicators and all the necessary accompanying information.

Calculating the three financial performance indicators

Annex I of the draft delegated act sets out how to calculate the denominator and numerator for each key performance indicator (KPI). This annex is based largely upon the work of the European Securities and Markets Authority (ESMA), which submitted its final advice to the European Commission in a report published at the end of February (available [here](#)).

An entity that prepares its consolidated financial statements in accordance with IFRSs shall calculate the denominator for each indicator as follows:

- for turnover: it equates to 'revenue' as specified in IAS 1.82(a), which includes revenue recognised under IFRS 15 – *Revenue from Contracts with Customers*, revenue recognised under IFRS 16 – *Leases* (for lessors) and all other sources of revenue as defined in IAS 1;
- for CapEx: it comprises all additions to tangible and intangible assets over the period (including those from business combinations) before depreciation, amortisation and re-measurements. In practice, CapEx shall be calculated in accordance with IAS 16 – *Property, Plant and Equipment*, IAS 38 – *Intangible Assets*, IAS 40 – *Investment Property*, IAS 41 – *Agriculture* and

IFRS 16 – *Leases*, and shall include for instance additions over the period relating to right-of-use assets arising from leases;

- for OpEx: it comprises direct non-capitalised costs relating to R&D, building renovation, short-term leases, maintenance and repair, and any other direct expenditures relating to the day-to-day servicing of property, plant and equipment that are necessary to ensure the continued and effective functioning of these assets.

These data shall be calculated for each Taxonomy-eligible economic activity, distinguishing between the aligned and non-aligned shares, and for each environmental objective. They shall be presented in tables in a specified format as illustrated in Annex II of the draft delegated act.

Additional disclosures required

Entities are required to produce a lot of additional, primarily qualitative, information to explain the judgements made when determining the financial indicators, as well as to cross-reference to the financial statements and to any alternative performance measures used by the entity to depict turnover, CapEx or OpEx.

Forward-looking information must also be provided, with entities required to disclose their future targets for the key financial indicators and their plan for how to achieve them.

Some questions remain unanswered

The publication of the draft delegated act has left some questions unanswered, notably the following:

- what is meant by the 'share' of Taxonomy-eligible and non-eligible activities to be published in 2022: does

this refer to the three financial indicators?

- entities are required to provide information on the five previous reporting periods, but when should this information be provided: from 2023 onwards or not until 2027, when the entity has been able to collect comparative data over five successive reporting periods?
- in practice, how should entities identify the CapEx and OpEx relating to Taxonomy-aligned activities, given that the draft delegated act does not always provide the necessary detail in its explanation of how to calculate the numerator and the denominator for OpEx?
- does the materiality principle apply to the quantitative and qualitative disclosures required?

Stakeholders had until 2 June to send comments to the European Commission.

Clarifications on some of the above points will hopefully be forthcoming in the definitive delegated act, which is expected to be published at the end of June and adopted during the summer, in order to ensure the comparability of published data.

Work begins on sustainability reporting standards

In an open letter dated 12 May 2021, the European Commission officially requested the European Financial Reporting Advisory Group (EFRAG) to begin work on developing draft sustainability reporting standards, without waiting for EFRAG's new governance structure to be in place (see Beyond the GAAP no. 153, March 2021).

The timescale is tight, with the first set of draft standards to be delivered by EFRAG

by mid-June 2022. Readers will remember that these new standards will provide a framework for sustainability reporting as required under the new European Corporate Sustainability Reporting Directive (see Beyond the GAAP no. 154, April 2021).

The letter from the European Commission to EFRAG is available [here](#).

ESMA publishes draft amended Regulatory Technical Standards on ESEF

On 25 May, ESMA published a new version of the Regulatory Technical Standards (RTS) on the European Single Electronic Format (ESEF), in order to take account of the updates made to the IFRS Taxonomy (available [here](#)) by the IASB in March 2021.

In practice, the new IFRS Taxonomy includes more than 100 new tags, to take account of:

- recent amendments to existing standards (such as the amendment to IFRS 16 – *Leases* on rent concessions);
- common reporting practice;
- a review of extensions created by companies applying IFRS that are listed in the United States;
- issues raised by stakeholders.

ESMA's draft RTS (available [here](#)) is a purely technical update and does not affect the general principles of the existing regulation on ESEF.

The draft RTS has been submitted to the European Commission, which has three months to decide whether to endorse the amended standard; however, this is only a formality. We may therefore expect a delegated regulation adopting the new standard to be published in the Official Journal of the European Union over the coming months.

The new RTS will be mandatory for annual financial statements from 1 January 2022. Early application will be permitted. Thus, entities may draw on the draft RTS right away if they wish so.

Readers will remember that ESEF is now mandatory for 2021 financial reports (to be issued in 2022) in all EU countries for issuers whose securities are traded on a regulated market and that are required to publish an annual financial report under the Transparency Directive.

Standards and Interpretations applicable at 30 June 2021

Now that interim final reports are being finalised for periods ending 30 June 2021, Beyond the GAAP presents an overview of the IASB's most recent publications. For each text, we clarify whether it is mandatory for this closing of accounts, or whether early application is permitted, based on the EU endorsement status report (position as at 7 May 2021, available on EFRAG's website [here](#)).

As a reminder, the following principles govern the first application of the IASB's standards and interpretations:

- The IASB's draft standards cannot be applied as they do not form part of the published standards.
- Standards published by the IASB but not yet endorsed by the European Union at 30 June may be applied if the European endorsement process is completed before the date when the interim financial statements are authorised for issue by the relevant authority (i.e. usually the board of directors).
- IFRS IC's Interpretations published by the IASB but not yet endorsed by the European Union at the date when the interim financial statements are authorised for issue may be applied unless they are in conflict with standards or interpretations currently applicable in Europe.

It should be noted that the notes of an entity applying IFRSs must include the list of standards and interpretations published by the IASB but not yet effective that have not been early applied by the entity. In addition to this list, the entity must provide an estimate of the impact of the application of those standards and interpretations.

Regarding minor amendments and interpretations, it seems relevant to limit such list to only those amendments and/or interpretations which are likely to apply to the entity's activities.

It should also be noted that under IAS 34 – *Interim Financial Reporting*, the changes in accounting policies required by new standards must also be disclosed in the interim financial reporting published in the course of the year.

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Standard	Subject	Effective date according to the IASB	Date of publication in the Official Journal	Application status at 30 June 2021
IFRS 14	Regulatory Deferral Accounts (issued on 30 January 2014)	1/01/2016 Early application permitted	No endorsement The EC has decided not to launch the endorsement process of this interim standard and to wait for the final standard	Not permitted
Amendments to IFRS 10 and IAS 28	Sale or Contribution of Assets between an Investor and its Associate or Joint Venture (issued on 11 September 2014)	Postponed Early application permitted	Deferred	Permitted ⁽¹⁾
Amendments to IFRS 4	Insurance Contracts – deferral of IFRS 9 (issued on 25 June 2020)	1/01/2021 (the fixed expiry date for the temporary exemption in IFRS 4 from applying IFRS 9 has been deferred to 1 January 2023)	16 December 2020	Mandatory
Amendments to IFRS 9, IAS 39, IFRS 7, IFRS 4 and IFRS 16	Interest Rate Benchmark Reform – Phase 2 (issued on 27 August 2020)	1/01/2021 Early application permitted	14 January 2021 Effective for annual periods beginning on or after 1 January 2021	Mandatory
IFRS 17	IFRS 17 Insurance Contracts (issued on 18 May 2017); including Amendments (issued on 25 June 2020)	1/01/2023 Early application permitted	Awaiting endorsement by the EU (date not yet announced)	Not permitted
Amendments to IAS 1	Classification of Liabilities as Current or Non-current (Issued on 23 January 2020) - Deferral of Effective Date (Issued on 15 July 2020)	1/01/2023 Early application permitted	Awaiting endorsement by the EU (date not yet announced)	Not permitted
Amendments to IAS 1	Presentation of Financial Statements and IFRS Practice Statement 2: Disclosure of Accounting policies (issued on 12 February 2021)	1/01/2023 Early application permitted	Awaiting endorsement by the EU (date not yet announced)	Not permitted

⁽¹⁾ If the entity had not developed an accounting policy.

Standard	Subject	Effective date according to the IASB	Date of publication in the Official Journal	Application status at 30 June 2021
Amendments to IAS 16	Property, Plant and Equipment: Proceeds before Intended Use (issued on 14 May 2020)	1/01/2022 Early application permitted	Awaiting endorsement by the EU (expected Q3 2021)	Not permitted
Amendments to IFRS 3	Reference to the Conceptual Framework (issued on 14 May 2020)	1/01/2022 Early application permitted (if the entity applies at the same time all other updates to the Conceptual Framework of March 2018)	Awaiting endorsement by the EU (expected Q3 2021)	Not permitted
Amendments to IAS 37	Onerous Contracts - Cost of Fulfilling a Contract (issued on 14 May 2020)	1/01/2022 Early application permitted	Awaiting endorsement by the EU (expected Q3 2021)	Permitted ⁽²⁾
Annual Improvements to IFRSs 2018–2020 Cycle	Annual improvements to various Standards (issued on 14 May 2020)	1/01/2022 Early application permitted	Awaiting endorsement by the EU (expected Q3 2021)	Not permitted
Amendments to IAS 8	Definition of Accounting Estimates (issued on 12 February 2021)	1/01/2023 Early application permitted	Awaiting endorsement by the EU (date not yet announced)	Not permitted
Amendments to IFRS 16	Covid-19-Related Rent Concessions beyond 30 June 2021 (issued on 31 March 2021)	1/04/2021 Early application permitted	Awaiting endorsement by the EU (date not yet announced)	Permitted ⁽³⁾
Amendments to IAS 12	Deferred Tax related to Assets and Liabilities arising from a Single Transaction (issued on 7 May 2021)	1/01/2023 Early application permitted	Awaiting endorsement by the EU (date not yet announced)	Not permitted

⁽²⁾ The amendment is a clarification of an existing standard and is not in contradiction with current standards.

⁽³⁾ If the amendment is endorsed before the date when the financial statements are authorised for issue.

Covid-19: disclosed financial performance – a focus on expected credit losses for a sample of 26 European banks as per 31 December 2020

Throughout the public health crisis, banks have played a significant role in supporting companies – but what has been the impact on their credit risk?

This study (available in English [here](#)) draws on audited financial information published in the annual reports of a sample of 26 European banks for the year ending 31 December 2020 (and published by 1 April 2021). It provides a snapshot of the impact on expected credit losses, which are the key indicator of the level of credit risk borne by banks.

A webinar presenting the study is also available to watch in English [here](#).

We present some of the key findings of our study below.

Sample and methodology

The sample used for the study comprised **26 banks** domiciled in **11 different European countries**.

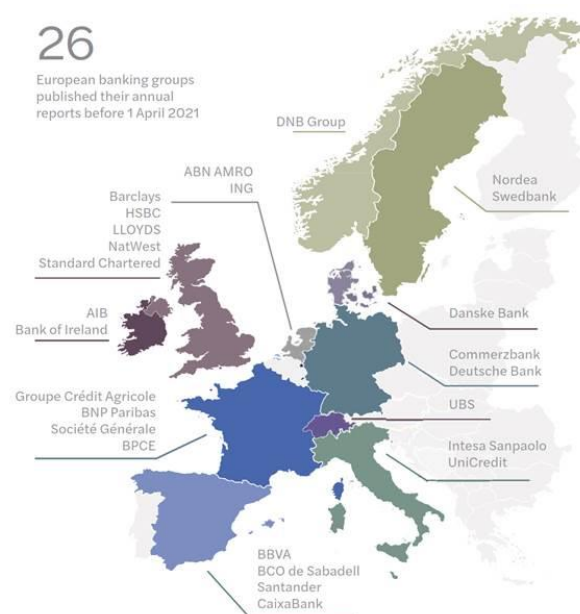
To help identify geographical trends (or the lack thereof), each bank is represented in the graphs by an alphanumeric code made up of two letters to represent the country, and one figure reflecting the number of banks in that country. For example, UK banks are represented by the codes UK 1 to UK 5.

To maintain anonymity, the countries with only one bank are represented by the letter O for 'other countries'.

The methodology focused on **comparing** the different banks rather than investigating how each individual bank was affected.

Thus, the indicators used in the study are those frequently disclosed by banks, as well as some indicators calculated by the authors (which sometimes required some assumptions).

Thus, the interpretations of the graphs should be treated with due consideration, as the scope of the instruments covered by the indicators may vary from one bank to another.



Unsurprisingly, cost of risk had a significant impact on banks' profitability as per 31 December 2020

Most banks experienced a **significant decrease in their operating profit or loss before the cost of risk** was taken into account. The 'operating profit or loss' indicator was calculated by the authors and comprises profit or loss from banking activities, excluding the share of profit or loss from associates or joint-ventures, disposals of assets, cost of risk (or expected credit losses charge (ECL)) but including salary expenses and amortisation, depreciation or impairment charges for tangible and intangible assets (including goodwill).

Over the same period, banks saw their **cost of risk multiply by 3.5 on average from Year End (YE) 2019 to YE 2020**. It should be noted that as per 30 June 2020, the cost of risk was on average six times that as per 30 June 2019.

The combination of these two impacts resulted in the **cost of risk accounting for 78% on average of the operating cost before cost of risk** as per 31 December 2020.

To analyse this increase in the cost of risk in more depth, we needed to compare it to the ECL allowance at the start of the period. We therefore calculated the incremental ECL charge by dividing the cost of risk for the period by the ECL allowance presented in the balance sheet at YE 2019 (see graph below). A figure higher than 100% indicates that the ECL allowance has more than doubled from end-2019.

By comparing the results for end-December 2020 and end-June 2020, we can see that **most of the impacts were accounted for in the first half of 2020**. The average incremental ECL was 57% as per 31 December 2020 compared with 41% as per 30 June 2020.

The highest percentages result from a large increase over the period combined with a relatively low ECL allowance at YE 2019. This was particularly the case for UK and Irish banks.

Graph 4: Incremental ECL charge at YE 2020 and H1 2020 expressed as a % of ECL allowance at YE 2019



The average global ECL coverage ratio increased by nearly 12% between YE 2019 and YE 2020

The global coverage ratio at end-2020 was calculated by dividing the ECL allowance in the balance sheet by the relevant total gross credit exposure.

- The global coverage ratio can be used as an indicator of the trend, as it takes account of all financial instruments that fall within the scope of the impairment section of IFRS 9, i.e. assets at amortised cost, assets (debt instruments) at fair value through profit or loss, and off-balance sheet commitments (loan commitments and guarantees).

The average global coverage ratio rose by 12% on average, from 1.03% at YE 2019 to 1.15% at YE 2020.

This is largely due to an average increase in ECL allowances of 28% between YE 2019 and YE 2020, compared with an average increase in gross credit exposures of 7% over the same period.

- The coverage ratio for assets at amortised cost (AC) is shown in the graph below. These assets may include loans and receivables, debt securities, balances with central banks and other assets.

The average coverage ratio for assets at amortised cost was 1.56% as per 31 December 2020 (ranging from 0.4% to 3.2%), compared with 1.42% at YE 2019.

It is interesting to note that French banks have higher-than-average coverage ratios compared with the rest of the sample, whereas English banks have lower-than-average coverage ratios (despite their significant efforts over the course of 2020, as discussed above).

The study also includes a more detailed analysis of changes in the coverage ratio by credit quality (stages 1, 2 and 3 as set out in IFRS 9, including transfers between the different stages).

Graph 7: AC coverage ratio YE 2020 vs. 2019



Post-model adjustments weighted for 27% of the cost of risk on average at YE 2020

Under normal circumstances, banks estimate their expected credit losses using statistical models based on historic data. These models do not accurately reflect the unusual circumstances arising from the public health crisis, such as the high level of uncertainty and the support measures implemented. Thus, it has been necessary to make post-model adjustments, which are any adjustments made to the output of the models. Our indicator comprises all post-model adjustments, as some banks mentioned several different types of adjustment.

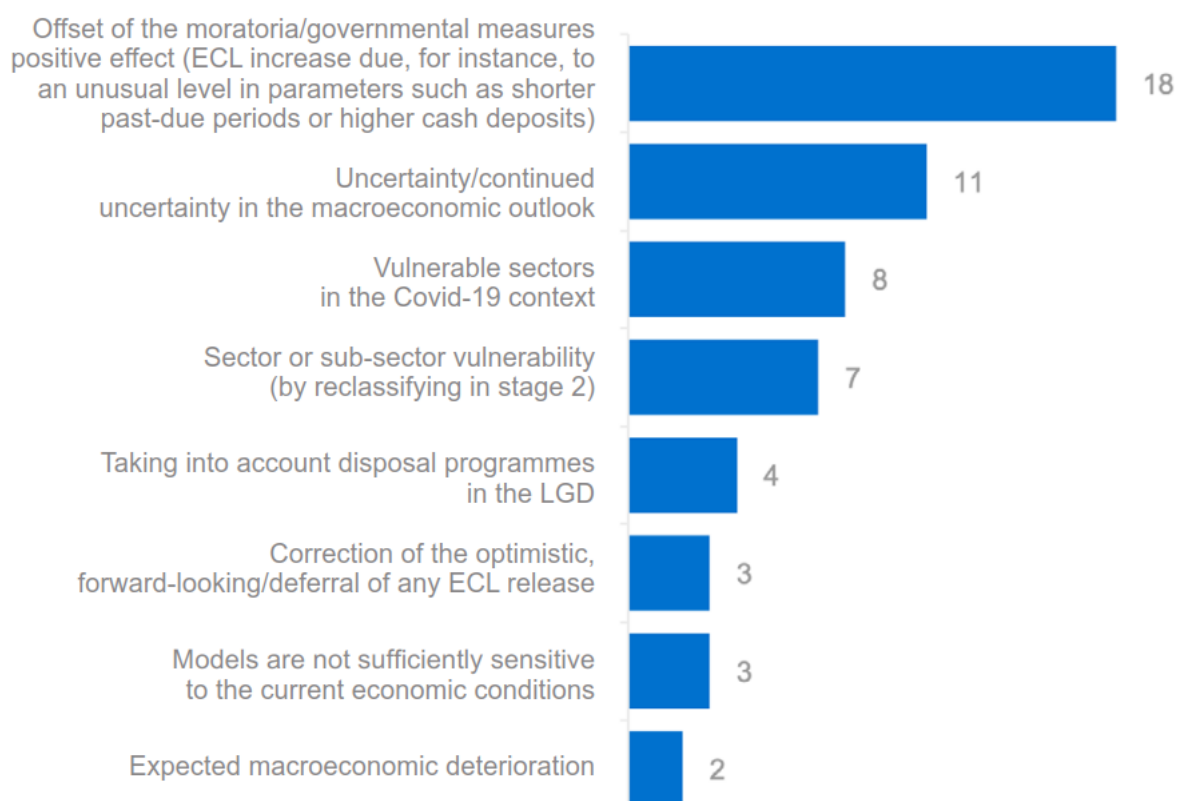
Twenty-five of the banks in the sample disclosed that they had made one or more post-model adjustments. Of those, 20 also published the amount of these adjustment(s).

Thus, on average at YE 2020, **the total post-model adjustments weighted for 27% of the cost of risk for the period.**

While the weighting of the post-model adjustments varied between 5% and 95%, 11 banks in the sample reported adjustments between 20% and 35%. No clear geographical trend was apparent.

The graph below shows the various underlying reasons given for the post-model adjustments made. The most frequently-stated reason was to offset governmental measures.

Graph 12.2: Most frequent underlyings of the post-model adjustments YE 2020



Quality of information has improved overall, particularly for forward-looking information, but comparison of banks remains uneasy due to lack of granularity

Forward-looking information summarises an entity's expectations of future changes in the macro-economic environment. This is usually calculated by identifying optimistic, neutral (baseline) or negative scenarios, and assigning them each a weighting.

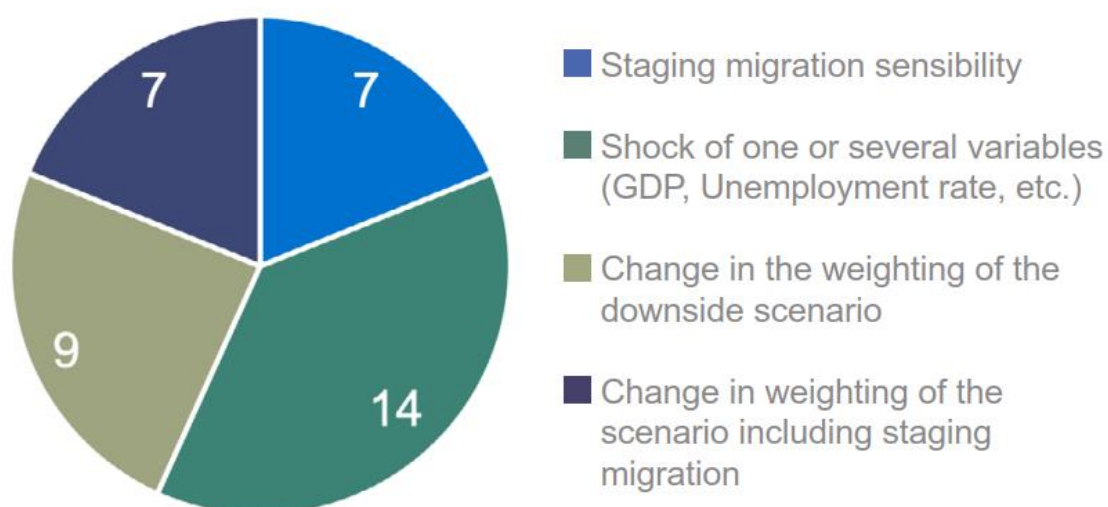
Eighteen banks in the sample disclosed the weighting of their scenarios at YE 2019 and YE 2020, with a diverse range of approaches taken by different banks. Banks differed in both the weightings given to different types of scenarios (for example, the weighting of optimistic scenarios varied between 0% and 44% at YE 2020) and the changes in the weightings from 2019 to 2020: some banks increased the weighting of optimistic scenarios, others that of baseline scenarios, and still others that of negative scenarios.

Significant diversity in practice for sensitivity analyses

All banks disclosed at least one sensitivity analysis for the amount of expected credit losses. The types of sensitivity analysis used by banks ranged from changes in the weighting of macro-economic scenarios or the level of a specific parameter (such as GDP), or indeed the migration rate of stage 2 assets.

The graph below shows the range of methodologies used, which makes it uneasy to draw comparisons between banks.

Graph 14.9: Different methodologies



Key points to remember

- The study drew on audited financial information published in the annual reports of a sample of 26 European banks from 11 countries for the year ending 31 December 2020 (and published by 1 April 2021).
- The cost of risk accounted for 78% on average of the operating profit or loss before cost of risk. Most of the impacts were accounted for in the first half of 2020.
- The average global coverage ratio rose by 12% on average, from 1.03% at YE 2019 to 1.15% at YE 2020. Studying the depreciation rate for assets at amortised cost shows that French banks have higher-than-average coverage ratios compared with the rest of the sample. Meanwhile, UK banks saw among the biggest increases in the cost of risk over the period, but still had a lower-than-average coverage ratio compared with the rest of the sample.
- Total post-model adjustments weighted for 27% of the cost of risk on average. The weighting of the post-model adjustments varied significantly between 5% and 95%. The most frequently-stated reason for post-model adjustments among the banks in the sample was the offset of governmental measures.
- The quality of information has improved overall, but comparison between banks remains uneasy. For example, while all the banks published a sensitivity analysis, the range of different methodologies used made it difficult to draw meaningful comparisons.
- The study is available [here](#) and a webinar on the study is also available to watch [here](#).

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