



Beyond the GAAP

Mazars' monthly newsletter on financial and sustainability reporting

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Editorial

As reported in our previous issue, Turkey was recently added to the list of hyperinflationary economies. As a result, groups will need to apply IAS 29 – *Financial Reporting in Hyperinflationary Economies* to their Turkish operations for all financial periods that include 1 April 2022, in particular the interim financial statements to 30 June 2022. Beyond the GAAP provides a recap of this little-used standard, which can often prove complicated to apply.

As previously announced, the EFRAG Sustainability Reporting Board launched the public consultation on its first set of draft European Sustainability Reporting Standards (ESRSs) on 29 April 2022. Stakeholders have until 8 August 2022, or 100 days exactly, to submit their comments on the 13 Exposure Drafts published so far. The schedule set out in the draft Corporate Sustainability Reporting Directive (CSRD) is extremely tight, although this could potentially change when the final version of the directive is published in a few weeks' time.

IFRS Highlights

IASB stops project on IAS 19 pension benefits that depend on asset returns

From 2018 to 2021, the IASB (International Accounting Standards Board) studied the feasibility of amending IAS 19 – *Employee Benefits* to address pension benefits that depend on the returns on specified assets, such as shares or bonds.

For these pension benefits, there is an inconsistency between (a) the cash flows included in the estimate of the pension benefits, which depend on the expected returns on the specified assets, and (b) the discount rate applied to measure the present value of the defined benefit obligation, which is determined by reference to the high-quality corporate bond market. This inconsistency means that the present value of the pension obligation will exceed the expected cash outflow if the expected rate of return on the specified assets is higher than the IAS 19 discount rate.

To address this, the IASB investigated whether it would be possible to add a

capped approach to IAS 19. Applying the capped approach, an entity would estimate the pension benefit by applying the IAS 19 discount rate, if that discount rate is lower than the expected rate of return on those assets.

The IASB has just announced that it is calling a halt to the project, as its research has not provided sufficient evidence that such pension benefits are common in all jurisdictions. It concluded that the cost of implementing such a change would outweigh the potential advantages in terms of improved financial reporting. It also noted that by amending the standard to permit a capped approach, it would be introducing an exception to the measurement requirements of IAS 19.

The project summary is available [here](#).

IFRS IC clarifies presentation rules for demand deposits with restrictions on use arising from a contract with a third party

In March 2022, the IFRS Interpretations Committee (IFRS IC) reached a final decision, ratified by the IASB in April 2022 and available [here](#), on the presentation rules for demand deposits with restrictions

on use arising from a contract with a third party.

The request submitted to the IFRS IC related to the appropriate presentation in the statement of financial position of a demand deposit in the following situation:

- an entity holds a demand deposit whose terms and conditions do not place any limit on the amount of the deposit that the entity can access;
- the entity has a contractual obligation with a third party to keep a specified amount of cash in that demand deposit and to use that amount only for specified purposes. If the entity were to use the amounts in the demand deposit for another purpose, it would be in breach of its contractual obligation to the third party.

The IFRS IC noted that the answer depends largely on whether these amounts met the definition of 'cash' under IAS 7 – *Statement of Cash Flows*. The IFRS IC observed that the definition of 'cash' relates only to the contract between the entity and the establishment holding the deposit, and there is thus no reason why the amounts would not be classified as 'cash'. The contract with the third party would not affect this.

Thus, the amounts in the demand deposit should be presented as 'cash and cash equivalents' as they meet the definition set out in IAS 7.

However, the IFRS IC also emphasised that the entity would need to comply with the disclosure requirements in IFRS 7 relating to liquidity risk, as well as those in IAS 7 on components of 'cash and cash equivalents'. It also noted that IAS 1 – *Presentations of Financial Statements* would require the entity to consider whether it needs to disclose additional information, to enable

users of financial statements to understand the nature of the restrictions on the amounts and their impact on the entity's financial position.

Updates to IASB work plan for 2022-2026

At its April 2022 meeting, the IASB continued its redeliberations on its work plan for 2022 to 2026, following the third public agenda consultation. It discussed in more detail the seven projects that were shortlisted in March 2022 to potentially be added to the work plan for the next five years, and decided:

- to add a maintenance and consistent application project on climate-related risks;
- to launch research projects on:
 - intangible assets; and
 - the statement of cash flows and related matters;
- to create a reserve list of projects that could be added to the work plan if the IASB has the capacity in future;
- to add the following projects to the reserve list:
 - operating segments; and
 - pollutant-pricing mechanisms;
- not to add the following projects to its work plan:
 - cryptocurrencies and related transactions; and
 - going concern disclosures.

ISSB creates working group to enhance compatibility of sustainability disclosure standards

On 27 April 2022, the International Sustainability Standards Board (ISSB) announced the creation of a working group comprising representatives of different

jurisdictions, to establish a dialogue to enhance compatibility between the proposed IFRS Sustainability Disclosure Standards and jurisdictional initiatives (particularly in Europe and the United States). The ISSB's goal is to establish a global baseline of recognised international standards, used across the world, in order to meet users' needs.

The members of the working group are the Chinese Ministry of Finance, the European Commission, the European Financial Reporting Advisory Group (EFRAG), the Japanese Financial Services Authority, the Sustainability Standards Board of Japan Preparation Committee, the United Kingdom Financial Conduct Authority and the US Securities and Exchange Commission (SEC).

The ISSB also announced that a new advisory body, the Sustainability Standards Advisory Forum, would be created during the next quarter to facilitate regular dialogue with a broad range of jurisdictions and to obtain high-level advice.

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Hyperinflation in Turkey: IAS 29 on the agenda again

Preparers with significant exposure to Turkey will need to apply IAS 29 – *Financial Reporting in Hyperinflationary Economies* when drawing up their interim financial statements for 2022, after the country was classified as a hyperinflationary economy under IFRSs from 1 April 2022. On 16 March 2022, the International Practices Task Force (IPTF) of the Center for Audit Quality (CAQ), which is the standard reference for identifying hyperinflationary economies, published a document for discussion adding Turkey to the list (see Beyond the GAAP no. 164, March 2022).

Under IAS 29, preparers must restate the financial statements of an entity whose functional currency is the currency of a hyperinflationary economy. This rule takes effect from the opening of the reporting period in which the economy was first deemed to be hyperinflationary.

In the case of Turkey, IAS 29 thus applies from 1 January 2022 for entities whose reporting period coincides with the calendar year and whose functional currency is the Turkish lira. This applies to both the interim and annual financial statements. For other entities, financial statements should be restated in accordance with IAS 29 for any financial period including 1 April 2022.

Restating separate financial statements under IAS 29: a practical guide

Under IAS 29, entities are required to restate amounts in order to reflect the impacts of inflation by applying a general price index (GPI) to items in the financial statements that are not already expressed in terms of the measuring unit current at the end of the reporting period (thus excluding

monetary items, i.e. money held and items to be received or paid in money). The standard does not specify which GPI should be used, but notes that all entities should use the same index. There is as yet no market consensus as to which GPI should be used for Turkey.

Thus, non-monetary assets and liabilities (such as inventories, property, plant and equipment and intangible assets) should be restated at two different points in time:

- at the beginning of the reporting period, by applying the change in the GPI between the date of initial recognition and the start of the period at 1 January 2022 (including owners' equity but excluding reserves, which are derived from all the other amounts); and
- at the end of the reporting period, by applying the change in the GPI between the beginning of the reporting period (or the date of initial recognition, if this is later) and 30 June 2022 (including all components of equity except profit or loss).

The items in the statement of comprehensive income for the period (i.e. profit or loss and other comprehensive income) must also be restated by applying the change in the GPI since their date of initial recognition. Depreciation and changes in inventories shall be calculated in such a way as to take account of the effect of restatement in accordance with IAS 29 (as described above) on property, plant and equipment and inventories.

The gain or loss on the net monetary position, resulting from the restatements detailed above, is recognised in profit or loss and must be presented separately. As the restatement process is complex, it is important to carry out a consistency check to rationalize the sign of the gain or loss relative to the net monetary position.

Finally, IAS 29 will apply to separate financial statements drawn up to 31 December 2022 (with restatement of the opening balance sheet at 1 January 2022). This should make it easy to identify restatements under IAS 29 for the purposes of the IFRS consolidated financial statements.

Converting the subsidiary's financial statements from the functional currency to the presentation currency of the IFRS consolidated financial statements

When establishing the IFRS consolidated financial statements, the separate financial statements (restated in accordance with IAS 29) must then be converted into the group's presentation currency, if this differs from the entity's functional currency. The closing rate method is used to do this. Here it is useful to refer to an IFRS IC agenda decision from September 2018 (which referred to the situation in Venezuela at the time, but the basic principles still apply). The decision specified how to determine the closing rate when a currency is subject to a long-term lack of exchangeability.

In accordance with IAS 21 – *The Effects of Changes in Foreign Exchange Rates*, the consolidated figures for comparative periods presented in a stable currency (such as the euro, US dollar or pound sterling) are not restated. The gain or loss on the net monetary position (as calculated at the entity level) is also presented in the consolidated financial statements. However, the IFRS standards do not specify exactly where in the income statement this gain or loss should be presented. In practice, it is often presented within the financial result.

Finally, an IFRS IC agenda decision in March 2020 confirmed that a preparer may choose where to present the effect of

restating an entity's non-monetary items and equity: either in reserves (i.e. directly in consolidated equity) or in other comprehensive income. The choice must be applied consistently over time and for all entities whose functional currency is the currency of a hyperinflationary economy. The decision should also be disclosed in the notes.

It should furthermore be noted that if the Turkish subsidiary is subsequently sold, the effect of IAS 29 restatements shall only be recycled to profit or loss if it was previously presented in other comprehensive income.

Other points to note

In addition to the impacts discussed above, first-time application of IAS 29 to the financial statements of Turkish subsidiaries could have the following effects:

- remeasurement of deferred tax (in accordance with IAS 12 – *Income Taxes* and with reference to IFRIC 7 – *Applying the Restatement Approach under IAS 29* following the restatement of non-monetary assets, insofar as this increases the difference between the carrying amount of the assets and their tax base (depending on the relevant local legislation); and
- an impairment review of restated non-current assets (including when there is no indication of an impairment loss).

In practice, applying IAS 29 requires significant use of judgement (many estimates required, reliability of available information, etc.). However, the standard states that "The consistent application of these procedures and judgements from period to period is more important than the precise accuracy of the resulting amounts included in the restated financial statements."

For entities with significant investments in Turkey, it is important to start considering how to apply IAS 29 as soon as possible, so that all the impacts can be accurately reflected in the interim financial statements for 2022. The restatement process is complicated and will take time, as well as requiring significant input from local teams.

Even if the impact is not significant, it is important to carry out the calculations (in a simplified form if necessary) in order to be able to document this.

To help our readers implement IAS 29 in their consolidated interim financial statements for 2022, we present a simplified example on the following pages.

Illustrative example

The financial statements used in this example have been simplified for educational purposes.

A subsidiary issues its interim financial statements at 30 June 2022 in Turkish lira (its functional currency). It applies the provisions of IAS 29 for the first time at 1 January 2022. It only owns one non-monetary asset (a plot of land).

Movements in the GPI are as follows:

	GPI
At the date of share capital contribution	1.00
At the date of land acquisition	1.15
At 31 December 2021	1.30
At 30 June 2022	3.20
Average on the 1 st semester 2022	2.80

Step 1: The subsidiary draws up its financial statements in Turkish lira before restating under IAS 29.

	Step 1		
	31 Dec. 2021 (published)	1 Jan. 2022 (before rest.)	30 June 2022 (before rest.)
Land	65 000	65 000	65 000
Cash	35 000	35 000	54 000
Total Assets	100 000	100 000	119 000
Share capital	50 000	50 000	50 000
Reserves	-	50 000	50 000
Net income	50 000	-	19 000
Total Equity	100 000	100 000	119 000
Provisions and non financial debts	-	-	-
Financial debts	-	-	-
Total Liabilities	100 000	100 000	119 000
	31 Dec. 2021 (published)	1 Jan. 2022 (before rest.)	30 June 2022 (before rest.)
Revenue	82 000	-	42 000
Operating expenses	(32 000)	-	(23 000)
Net income	50 000	-	19 000

Step 2: the subsidiary restates the non-monetary items in the opening balance sheet (land and share capital) to reflect the GPI changes between their date of initial recognition and 1 January 2022. Reserves are derived by calculating the difference in order to balance the statement of financial position.

Step 2.1

1 Jan. 2022
(after rest.)

Land	73 478	= 65 000 * (1.30 / 1.15)
Cash	35 000	
Total Assets	108 478	
Share capital	65 000	= 50 000 * (1.30 / 1.00)
Reserves	43 478	
Net income	-	
Total Equity	108 478	
Provisions and non financial debts	-	
Financial debts	-	
Total Liabilities	108 478	

At the reporting date, the subsidiary restates the non-monetary items remeasured in the previous step (land, share capital and reserves) to reflect the GPI changes between 1 January 2022 and 30 June 2022. The net income for the period is not restated at this stage.

Step 2.2

30 June 2022
(after rest. on
closing B/S)

Land	180 870	= 73 478 * (3.20 / 1.30)
Cash	54 000	
Total Assets	234 870	
Share capital	160 000	= 65 000 * (3.20 / 1.30)
Reserves	107 023	= 43 478 * (3.20 / 1.30)
Net income	19 000	
Total Equity	286 023	
Provisions and non financial debts	-	
Financial debts	-	
Total Liabilities	286 023	

The subsidiary then restates the items recorded in profit or loss by applying the change between the average index over the first half of 2022 and the index at 30 June 2022.

An average index for the period can only be used where the activity is not seasonal, and where the change to the index is regular over the period concerned.

Step 2.3

30 June 2022
(after rest. on
P&L)

Revenue	48 000	= 42 000 * (3.20 / 2.80)
Operating expenses	(26 286)	= (23 000) * (3.20 / 2.80)
Net income	21 714	

Finally, the subsidiary recognises the loss on the net monetary position in order to balance the statement of financial position following all the previous steps, and presents it separately in profit or loss.

Step 2.4

30 June 2022
(after gain/loss
on net position
accounting)

Land	180 870
Cash	54 000
Total Assets	234 870

Share capital	160 000	
Reserves	107 023	
Net income	(32 154)	= 234 870 - 160 000 - 107 023
Total Equity	234 870	
Provisions and non financial debts	-	
Financial debts	-	
Total Liabilities	234 870	

30 June 2022
(after gain/loss
on net position
accounting)

Revenue	48 000	
Operating expenses	(26 286)	
Gain / loss on net monetary position	(53 868)	= (32 154) - 48 000 - (26 286)
Net income	(32 154)	

For the requirements of the Group consolidated financial statements in euros, the assets, liabilities, equity, income and expense items deriving from the subsidiary's consolidation package are then converted at the closing exchange rate of the reporting period concerned (i.e. 30 June 2022).

The loss on the net monetary position is also presented in profit or loss in the consolidated financial statements.

EFRAG puts finishing touches to new sustainability reporting pillar and launches public consultation on first set of draft ESRS standards

The European Financial Reporting Advisory Group (EFRAG) appointed its new Sustainability Reporting Board (SRB) in March 2022. The SRB met three times in April to appoint the members of the new EFRAG Sustainability Reporting Technical Expert Group (SR TEG) and to prepare and launch the public consultation on the future European Sustainability Reporting Standards (ESRSs), which takes the form of a survey and exposure drafts.

Composition of SR TEG

The composition of the SR TEG was officially announced on 25 April 2022, marking the last major step in EFRAG's governance reform to incorporate the new sustainability reporting pillar. The SR TEG is made up of 22 members from 11 different countries with a range of different professional backgrounds and demographic characteristics, to achieve an overall balance at the global level.

The role of the SR TEG will be to provide technical advice to the SRB on the draft ESRSs. The SR TEG will be supported in developing the draft standards by expert working groups and advisory panels. Initially, the SR TEG will draw primarily on the work carried out so far by the PTF-ESRS (which was formed in June 2021 and took over from the PTF-NFRS, which was itself created in July 2020). The PTF-ESRS held its final plenary meeting on 25 and 26 April 2022.

The EFRAG SRB will have the final say over the content of draft standards and amendments before submitting them to the European Commission in the form of technical advice. The European Commission will then adopt the standards by means of delegated acts (potentially after a further public consultation).

Public consultation launched on first set of draft ESRSs

Tight schedule has required some tweaks to due process

According to the schedule set out in the draft Corporate Sustainability Reporting Directive published in April 2021 (of which the final version is expected by the end of the first half of 2022), EFRAG is expected to submit a first set of draft standards to the European Commission by 15 November 2022 at the latest.

In light of this particularly tight schedule, the public consultation launched on 29 April 2022 will last for 100 days (i.e. 20 days fewer than the period stipulated in EFRAG's Sustainability Reporting Due Process Procedures) and will close on 8 August 2022. EFRAG will organise a range of stakeholder outreach events prior to the closing date.

If the final version of the Directive changes the schedule for adoption of the first set of ESRSs to allow more flexibility, EFRAG may extend the consultation period to the standard 120 days.

Given this context, the brand-new SRB has decided to launch the public consultation using Exposure Drafts prepared under the sole oversight of the PTF-ESRS. The SRB itself has not yet had chance to review or discuss the draft standards and has thus not taken any official position on their content. However, the cover note for the public consultation (available [here](#)) states

that the SRB has reviewed and approved the questions put to stakeholders in the consultation. The SRB and SR TEG will review the Exposure Drafts in parallel with the public consultation.

The need to accelerate the due process has also led the SRB to move forward on three key tasks in parallel with the public consultation:

- finalising the Bases for Conclusions relating to the ESRS Exposure Drafts: these will be made available to stakeholders by the end of May at the latest;
- carrying out a cost-benefit analysis to enable the SRB, with the support of the TEG, to provide complete technical advice to the European Commission in accordance with the draft CSRD; and
- developing guidance on digital reporting.

Key features of the draft ESRSs

The Exposure Drafts were prepared on the basis of the legislative proposals set out in the April 2021 CSRD. As noted above, the legislative process is still ongoing and is expected to be completed in a few weeks' time, i.e. after the launch of EFRAG's public consultation. This means that any changes to the final version of the CSRD must be reflected in the final draft standards approved by EFRAG's SRB and submitted to the European Commission in November 2022.

The Exposure Drafts reflect existing European legislation and initiatives arising from the European Green Deal (such as disclosures required under Article 8 of the 'green taxonomy' regulation). However, they also take account of other European and international sustainability initiatives, as follows:

- lessons were learned from the implementation of the Non-Financial Reporting Directive and its transposition into national legislation;
- the PTF-ESRS also considered:
 - existing frameworks that are already widely used, such as the Task Force on Climate-Related Financial Disclosures (TCFD) framework (see Appendix IV of the cover note for the public consultation, available [here](#)); and
 - projects launched around the same time at other levels, notably by the ISSB. A reconciliation of the two ISSB Exposure Drafts (see Beyond the GAAP no. 164, March 2022) and the draft ESRS 1 *General provisions* and ESRS E1 *Climate change* has also been made available to stakeholders (see Appendix V, available [here](#)).

The draft standards submitted for public consultation by EFRAG thus represent the PTF-ESRS's best efforts to achieve a right balance between consolidating good practice observed to date in terms of corporate sustainability reporting, and the European Commission's goal as set out in the draft CSRD: namely to improve the quality of European sustainability reporting sufficiently quickly as to support the move towards a greener economy and sustainable finance.

In practical terms, the 13 Exposure Drafts published on 29 April 2022 are based on the working documents published by the PTF-ESRS between January and March 2022 (see Beyond the GAAP no. 164, March 2022); however, significant revisions have been made following plenary meetings and discussions with expert working groups.

The ESRS framework has a tripartite structure, with:

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

The first two layers facilitate comparability across and within sectors, while the last layer permits each entity to determine how best to carry out and communicate its own materiality assessment, selecting the information that is most relevant to that entity – although appropriate justification must be provided, particularly if the entity is omitting information that would normally be required under the first two layers (a 'comply or explain' approach, with a rebuttable presumption of materiality). The standards in the sector-specific layer will be included in the second set of draft standards, which EFRAG is still working on;

- covering three key reporting areas, namely:
 - strategy (integration of sustainability into the entity's overall strategy, governance structures for sustainable development topics, and procedures for and results of the entity's double materiality assessment);
 - implementation (policies and procedures, action plans and resources); and

- performance measurement (past results and progress towards future targets);
- and all the topics covered by the ESG classification, namely:
 - environmental matters, structured in accordance with the environmental objectives set out in the EU's 'green taxonomy', with the climate change adaptation and mitigation objectives both covered by ESRS E1 *Climate change* (Exposure Draft available [here](#)). The other environmental standards are: ESRS E2 *Pollution* (available [here](#)); ESRS E3 *Water and marine resources* (available [here](#)); ESRS E4 *Biodiversity and ecosystems* (available [here](#)) and ESRS E5 *Resource use and circular economy* (available [here](#));
 - human and societal matters, covering all possible aspects, ranging from workers' rights to human rights in the broadest sense, structured by the class of people affected: ESRS S1 *Own workforce* (Exposure Draft available [here](#)); ESRS S2 *Workers in the value chain* (available [here](#)); ESRS S3 *Affected communities* (available [here](#)) and ESRS S4 *Consumers and end-users* (available [here](#));
 - and governance matters, taken in a broad sense to include business ethics, organisational aspects and intangible capital. These are addressed in two Exposure Drafts: ESRS G1 *Governance, risk management and internal control* (available [here](#)) and ESRS G2 *Business conduct* (available [here](#)).

These draft ESG topical standards cover disclosures required from all entities.

The sustainability reporting architecture also includes cross-cutting standards, now reduced to two, which cover general requirements for all sustainability reporting, including both standardised and sector-specific disclosures: ESRS 1 *General principles* (available [here](#)) and ESRS 2 *General, strategy, governance and materiality assessment* (available [here](#)).

Ultimately, the ESRS architecture seeks to strike a balance between the need to significantly improve the quality of sustainability reporting; the increased expectations from stakeholders (particularly users); and the desire to avoid placing undue demands on preparers. In practice, the architecture seeks to strike this balance based on the central articulation of:

- on the one hand, the disclosure requirements prescribed by ESRSs; and
- on the other hand, the fundamental importance of the entity's own assessment of its material impacts, risks and opportunities.

In practice, the combination of the two should ensure that the entity will present information on all its material impacts, risks and opportunities. Thus, by carrying out a materiality assessment at the entity level, the entity will be able to identify which of the mandatory requirements from the various standards are relevant to its own specific situation and will enable it to address its material impacts, risks and opportunities.

Standards for SMEs that fall within the scope of the CSRD will be published for comment at a later date (subject to confirmation), in line with the two-stage process set out in the April 2021 draft Directive.

Practical aspects of the public consultation

The public consultation is designed to gather comments from stakeholders on three key aspects of the Exposure Drafts:

- the relevance of (i) the proposed architecture, (ii) the implementation of the principles set out in the CSRD, and (iii) the general content of each Exposure Draft;
- the various possible options for prioritising/phasing in the implementation of ESRSs; and
- the adequacy of the disclosure requirements in each of the draft standards.

Thus, the survey is structured in three sections that can be accessed and answered independently:

- one section on the overall substance of the Exposure Drafts;
- one section on the prioritisation/phasing-in of ESRSs; and
- one section on the adequacy of the disclosure requirements.

In order to facilitate navigation between the different parts of the survey, the three sections are organised in a chapter menu, as follows:

- 1A. Overall ESRS Exposure Drafts relevance – Architecture (available [here](#));
- 1B. Overall ESRS Exposure Drafts relevance – Implementation of CSRD principles (available [here](#));
- 1C. Overall ESRS Exposure Drafts relevance – Exposure Drafts content (available [here](#));
- 2. ESRS implementation prioritisation/phasing-in (available [here](#));

- 3A. Adequacy of Disclosure Requirements – Cross cutting standards (available [here](#));
- 3B. Adequacy of Disclosure Requirements – Environmental standards (available [here](#));
- 3C. Adequacy of Disclosure Requirements – Social standards (available [here](#));
- 3D. Adequacy of Disclosure Requirements – Governance standards (available [here](#));

Respondents are strongly encouraged to respond to the entirety of sections 1 and 2. Due to the comprehensive nature of section 3, respondents may choose the disclosure requirements on which they wish to comment.

Respondents must provide their responses to the consultation questions via the online survey, designed by EFRAG using the EUSurvey tool, for which users must first create a password. Additional comments may be sent in the form of comment letters, preferably by uploading them to the survey tool.

In a future issue, Beyond the GAAP will present a detailed analysis of the Exposure Drafts included in this first set of ESRS standards.

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