



## Beyond the GAAP

# Mazars' monthly newsletter on financial and sustainability reporting

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## Editorial

**In September 2022, the IASB issued amendments to IFRS 16 – Leases to clarify the subsequent measurement of a lease liability arising from sale and leaseback transactions where the lease payments are variable and not dependent on an index or rate. As requested by stakeholders, the IASB has ultimately provided no clarification on how to measure the proportion of the seller-lessee's retained interest in the asset. This issue of Beyond the GAAP presents the details of this amendment, which has been expected for several months.**

This month, the ISSB and EFRAG have taken stock of the extensive stakeholder feedback received on their respective draft standards on sustainability disclosures. Although the ISSB, unlike EFRAG, is not required to have finalised its deliberations by mid-November 2022, the ISSB is also under pressure to publish the initial basis of the 'global baseline' called for by many stakeholders as rapidly as possible. EFRAG continues to press ahead with the timetable imposed by the draft CSRD, bearing in mind that immense work is involved in finalising the draft European Sustainability Reporting Standards (ESRSs) in order to meet the expectations of preparers and users, but also the requirements of the European Union, while being aligned, as far as possible, with the future ISSB standards.

## IFRS Highlights

### Redeliberations continue on Primary Financial Statements project

At its September 2022 meeting, the IASB continued its redeliberations on the proposals in the December 2019 *General Presentation and Disclosures* exposure draft.

Beyond the GAAP presents a summary of the most important decisions made this month, with the caveat that the content of the future standard will not be set in stone until the final standard is published (currently scheduled for 2023).

All the decisions reached by the IASB in September 2022 are available [here](#).

### Unusual income and expenses

After redeliberating this topic at several meetings (see Beyond the GAAP no. 166, May 2022), the IASB has ultimately decided that it will not proceed with its work on so-

called 'unusual' income and expenses. The plan had been to 'only' require specific disclosures on these items in a separate note to the financial statements, as part of a broader range of new disclosures in line with the general requirement to better disaggregate information.

However, in practice, the IASB ran up against the difficulty of defining 'unusual income and expenses', after initially proposing a definition in the exposure draft that was based solely on the non-recurrence of the income or expenses. Discussions with stakeholders in parallel with IASB meetings revealed that not everybody agreed on what should be classified as 'unusual income or expenses'.

Given that redeliberations have now been going on for almost two years, the IASB decided not to discuss this complex and difficult issue any further, so as not to hold up the overall project.

### Specified subtotals

Readers will remember that the December 2019 exposure draft identified certain 'specified' subtotals, which are not required to be presented in the income statement and which are not management performance measures (MPMs) as defined in the proposed standard. MPMs are defined in the exposure draft as subtotals of income and expenses that are used in external communications and that reflect management's view of an aspect of an entity's financial performance. The proposed standard requires specific disclosures on MPMs, to be presented in a single note to the financial statements.

In practice, following the redeliberations in October 2021 (see Beyond the GAAP no. 159, October 2021), the four specified subtotals set out in the future standard will be as follows:

- gross profit or loss (revenue less cost of sales) and similar subtotals (see below);
- operating profit before depreciation and amortisation (which entities could label as EBITDA);
- profit or loss from continuing operations; and
- profit or loss before income tax.

At the September 2022 meeting, the IASB confirmed that these specified subtotals would not be MPMs. It also added a new specified subtotal to the list above: 'operating profit or loss and income and expenses from investments accounted for using the equity method'. Readers will remember that, in the course of the previous redeliberations, the IASB decided that the share of profit or loss from entities accounted for using the equity method should be presented in the 'Investing' category, below operating profit or loss (although the IASB did not specify the level

of the 'Investing' category at which this share should be presented).

The IASB also confirmed the list of 'subtotals similar to gross profit' presented in paragraph B78 of the exposure draft.

These are:

- net interest income;
- net fee and commission income;
- insurance service result;
- net financial result (investment income minus insurance finance expenses); and
- net rental income.

Finally, the IASB also decided to specify, in the application guidance for the new standard, that if an MPM is reconciled to a specified subtotal that is not presented in the income statement, the entity is required to reconcile that specified subtotal to a subtotal that is presented in the income statement. The entity will not be required to disclose any other information on this specified subtotal.

### Presentation of operating expenses

Readers will remember that the December 2019 exposure draft proposed – as part of a range of proposals relating to the aggregation/disaggregation of information – that entities should not be permitted to use a 'mixed' approach (i.e. broken down by both nature and function) to present operating expenses. Presentation by nature or function would not be a free choice for entities, but should be made in the light of a set of factors proposed by the IASB.

The IASB made the following decisions relating to the application guidance for presentation by function:

- to expand the explanation in the description of the 'presentation by function' method to clarify how this

method involves allocating and aggregating operating expenses according to the activity to which the consumed economic resource relates;

- to clarify the role of primary financial statements and the aggregation and disaggregation principles in applying the presentation by function method;
- to require entities to include in cost of sales the carrying amount of inventories recognised as an expense during the period when presenting cost of sales; and
- to require an entity that presents its operating expenses by function to provide a narrative description in the notes detailing the types of expenses (based on their nature) included in each functional line item.

The IASB also decided to confirm the proposals in the exposure draft to produce application guidance to help entities to assess whether presentation by nature or by function provides the most useful information. The guidance will draw heavily on the factors set out in paragraph B45 of the exposure draft.

Finally, as many preparers were no doubt hoping, the IASB has decided to withdraw its initial proposal to prohibit a mixed approach to presenting operating expenses. The final standard will provide examples of situations where a mixed presentation would provide the most useful information. Application guidance will also be produced, in order to clarify:

- the need for consistent presentation of operating expenses from one reporting period to the next; and
- how to label line items by nature when a mixed presentation is used (in order to faithfully represent the nature of the expenses included in these line items).

Furthermore, the IASB is organising consultations in different jurisdictions over the coming weeks, in conjunction with members of ASAF (the Accounting Standards Advisory Forum). This will allow it to gather feedback from stakeholders on a number of important topics that have already been redeliberated (i.e. an impact analysis) or on which the IASB is seeking input on the best way forward. These outreach meetings will also enable the IASB to assess whether it might be necessary to publish a new exposure draft of some of the proposals in this flagship project.

### **Redeliberations continue on Goodwill and Impairment project**

At its September 2022 meeting, the IASB re-examined the preliminary proposals for improving disclosures on business combinations that were put forward in its *Goodwill and Impairment* discussion paper (which is the stage prior to an exposure draft) and reached a number of tentative decisions.

The IASB tentatively decided to propose adding two new disclosure objectives to IFRS 3 – *Business Combinations*. An entity should present disclosures that will help users of financial statements to understand:

- the benefits that an entity expects from a business combination at the point when it reaches an agreement on the acquisition price; and
- the extent to which an entity's objectives for a business combination are being met.

The IASB has tentatively decided to require entities to disclose the 'strategic rationale for undertaking the business combination' instead of the 'primary reasons for the business combination' (IFRS 3.B64d) and to disclose, in the year of the business

combination, quantitative information about the expected synergies.

Moreover, for 'strategically important' business combinations, the IASB is planning to require disclosures on:

- management's objectives for the business combination;
- the indicators and targets management will use to assess whether these objectives are being met; and
- for subsequent periods, the extent to which management's objectives are being met, using these indicators, for as long as management is monitoring whether the objectives are being met.

A 'strategically important' business combination is to be defined as one for which failure to meet the objectives would seriously put at risk the entity achieving its overall business strategy. At present, the IASB is proposing that any business combination that meets one of the following thresholds would be classified as 'strategically important':

- the operating profit (or revenue) of the acquired business exceeds 10% of the acquirer's operating profit before the business combination;
- the assets of the acquired business (including goodwill) exceed more than 10% of the acquirer's assets before the business combination; or
- the business combination involves the entity breaking into a new geographical area of operations or a major new line of business.

In specific circumstances (yet to be determined), an entity would be exempt from presenting disclosures on:

- management's objectives for the business combination (only required for

'strategically important' business combinations);

- the indicators and targets management will use to assess whether these objectives are being met (only required for 'strategically important' business combinations); and
- quantitative information on the expected synergies.

However, this exemption would only apply in situations where disclosing information would seriously prejudice any of the entity's objectives for the business combination. Application guidance will be produced to help entities to identify such situations.

In contrast, no exemption will be permitted for:

- the strategic rationale for undertaking the business combination; and
- the comparison between the actual performance in subsequent periods and the objectives originally set, based on the indicators used by management (only required for 'strategically important' business combinations).

Finally, the IASB has tentatively decided to reject the proposal to specify indicators that all entities would be required to disclose information about, as well as the proposal to only require qualitative disclosures in the year of a business combination.

The next step will be for the IASB to decide, by the end of the year, whether the current impairment-only model should be retained or whether it should consider reintroducing amortisation of goodwill.

### **Proposed amendments to IAS 32 on instruments containing obligations for an entity to redeem its own equity instruments**

In September 2022, the IASB continued its redeliberations on the *Financial Instruments*

*with Characteristics of Equity (FICE)* project. Readers will remember that the aim of this project is to clarify the principles set out in IAS 32 – *Financial Instruments: Presentation*, to address issues around practical application, and to improve disclosures in the notes (see *Beyond the GAAP* no. 124, July-August 2018).

The IASB has been looking at the accounting treatment of financial instruments containing obligations for an entity to redeem its own equity instruments, particularly written put options on non-controlling interests.

This month, it tentatively decided to make amendments to IAS 32 as detailed below.

#### **Clarification of the scope of paragraph 23 of IAS 32**

Paragraph 23 states that a contract that contains an obligation for an entity to redeem its own equity instruments for cash gives rise to a financial liability for the present value of the purchase price. The proposed amendment would clarify that a financial liability should also be recognised when the purchase of own equity instruments is to be settled in a variable number of different equity instruments (e.g. delivery of a variable number of shares in the parent company to purchase shares in a subsidiary).

This clarification would change current practice by entities who have assumed that, since the standards are silent on this specific topic, they have a choice of accounting method, and therefore do not necessarily need to recognise a financial liability if the purchase of own equity instruments is to be settled in this way.

#### **Initial recognition of a liability representing an obligation to redeem an entity's own equity instruments**

The IASB has proposed the following clarifications on the initial recognition of the obligation:

- if the obligation involves non-controlling interests, and the entity does not already have access to the risks and benefits associated with the shares, the liability is recognised against a component of equity other than non-controlling interests;
- otherwise, the liability is recognised against a component of equity other than issued share capital.

Where non-controlling interests are involved, the proposed clarification would change the very frequent current practice of entities that anticipate the eventual purchase and recognise the liability as if the option had been exercised, i.e. recognise it against non-controlling interests first, and against group equity only to the extent the amount exceeds the value of non-controlling interests.

#### **Accounting for the expiry of a written put option on an entity's own equity instruments**

The IASB has proposed the following clarifications on the accounting treatment for the expiry of a written put option on an entity's own equity instruments:

- the liability is derecognised by reclassifying it to the same component of equity as that from which it was reclassified on initial recognition of the put option; and
- the cumulative amount in retained earnings related to remeasuring the liability may be reclassified to another component of equity, but may not be reversed in profit or loss.

The IASB is also proposing to clarify that written put options and forward purchase contracts on an entity's own equity instruments must be presented gross, in order to:

- ensure the accounting treatment is consistent with that used for other obligations that are conditional on events or decisions that are beyond the entity's control; and
- help users of financial statements to understand the impact of these transactions on the entity's exposure to liquidity risk.

#### **Tentative decisions to be confirmed in a future exposure draft**

As noted previously, the proposed amendments to IAS 32 set out above are at this stage only tentative decisions by the IASB.

It remains to be seen whether the IASB will confirm them in the future exposure draft to be published as part of the FICE project. This exposure draft is included in the IASB's work plan, but no date has been set as yet.

#### **Proposed amendments to IFRS 9 on the SPPI test for debt assets: general principles, assets with non-recourse features and contractually-linked instruments**

At its September 2022 meeting, the IASB continued its redeliberations on potential amendments to be made to IFRS 9 – *Financial Instruments* as part of the first phase of the Post-implementation Review (PiR) of IFRS 9.

Readers will remember that this phase, which began in September 2021, covers the classification and measurement section of IFRS 9. If necessary, the IASB may propose amendments to improve parts of

the standard that the various stakeholders have found challenging to implement (for more information on the first phase of the IFRS 9 PiR, see Beyond the GAAP no. 159, October 2021).

As part of this review, the IASB has tentatively decided to amend IFRS 9 to clarify how the SPPI test ('solely payments of principal and interest') should apply to debt assets. The SPPI test permits an entity to classify a debt asset as a basic lending arrangement if its contractual cash flows are solely payments of principal and interest. A debt asset that passes the SPPI test may be recognised at amortised cost or at fair value through other comprehensive income with recycling to profit or loss, depending on the business model.

The IASB has reached tentative decisions on a number of topics, detailed below.

#### **General principles of the SPPI test**

The IASB has tentatively decided to make the following amendments to IFRS 9:

- if the contractual cash flows of a debt asset comprise variability arising from risks and factors that are unrelated to the borrower, the asset does not pass the SPPI test, even if such variability is common in the market in which the entity operates;
- however, a debt asset does pass the SPPI test if the variability in the contractual cash flows meets all of the following four criteria:
  - the contractual cash flows arising from contingent events are solely payments of principal and interest, regardless of the probability of the event;
  - the contingent event is specific to the borrower;

- the timing and amount of any variability in contractual cash flows are predetermined; and
- the contractual cash flows arising from contingent events specific to the borrower do not represent exposure to the borrower's business risk or the performance of any underlying assets.

The IASB will produce examples to illustrate these principles.

This proposal would mean that certain debt assets may be classified as basic lending arrangements if their return is affected by ESG metrics that are specific to the borrower.

#### Debt assets with non-recourse features

The IASB has tentatively decided to amend IFRS 9 to clarify that a debt asset has 'non-recourse features' if:

- the lender is exposed to the performance risk of the underlying asset both throughout the life of the instrument and in the event of default; and
- the lender's contractual right is limited over the life of the instrument to the cash flows generated by the underlying asset.

To help entities determine whether debt assets with non-recourse features pass the SPPI test, the IASB has also tentatively decided to add examples of relevant criteria for analysing the characteristics of contractual cash flows, such as:

- the legal or capital structure of the borrower;
- the extent to which the expected cash flows from the debt asset with non-recourse features are covered by the expected cash flows from the underlying assets; or

- whether there are other sources of finance that are subordinated to the debt asset with non-recourse features.

#### Contractually-linked instruments

Readers will remember that contractually-linked instruments (CLIs) are usually issued by an ad hoc structure and backed by underlying financial assets held by that structure.

The IASB has tentatively decided to amend IFRS 9 to clarify that a debt asset can only be classified as a CLI if it meets all of the following four criteria:

- the structure has issued multiple instruments that are contractually linked to one another;
- the debt asset has no recourse to other assets apart from the underlying pool held by the structure;
- payments to investors are prioritised through a waterfall payment structure; and
- the prioritisation of payments results in a disproportionate reduction of the contractual rights of some investors in the event that insufficient cash flows are generated by the underlying financial assets.

The IASB also tentatively decided to expand the scope of eligible underlying financial assets to include some that are not entirely within the scope of IFRS 9, such as certain lease receivables.

#### Tentative decisions to be confirmed

Further discussions are required on these topics, and the IASB may make additional clarifications.

The proposed amendments to IFRS 9 set out above will not be finalised until the IASB's due process has been completed. A key stage in this process is the publication

of an exposure draft to gather feedback from stakeholders on the proposals.

### **New IASB appointments**

On 30 September 2022, the Trustees of the IFRS Foundation announced the appointment of Patrina Buchanan and Hagit Keren as members of the IASB for a five-year term, representing Europe and Asia-Oceania respectively.

Ms Buchanan has played a key role in IASB projects on leases, revenue recognition and consolidation, and has led IFRS Foundation projects to support consistent application of IFRS standards, including the work of the IFRS Interpretations Committee.

Ms Keren has particular knowledge and expertise on insurance contracts.

For more details on these appointments, see [here](#).

### **IFRS Sustainability Disclosure Standards: ISSB reviews comments received and plans redeliberations**

At its September 2022 meeting, the International Sustainability Standards Board (ISSB) reviewed a summary of the comment letters (available [here](#)) that it received in the public consultation on the draft standards IFRS S1 – *General Requirements for Disclosure of Sustainability-related Financial Information* and IFRS S2 – *Climate-related Disclosures*, for which the comment period closed at the end of July 2022.

Although the ISSB was not asked to make any decisions on the content of the standards this month, it set out a plan for redeliberations, with a view to establishing a global baseline of recognised international standards used across the world by the end of the year, to be published in early 2023.

The ISSB received more than 700 comment letters on IFRS S1, and slightly fewer on IFRS S2. The summary of responses, prepared by the technical staff, highlighted the following key points:

- broad stakeholder support for the ISSB's overall purpose, for IFRS S1 as an overarching standard setting out the general principles to be applied to all IFRS Sustainability Standards, and for IFRS S2 as a standard that would address the urgent need for disclosures on climate-related challenges;
- general support for drawing on the recommendations of the TCFD (Task Force on Climate-related Financial Disclosures) to structure the standards, based on the four pillars of governance, strategy, risk management, and metrics and targets;
- a need for guidance and illustrative examples to enable efficient implementation of the proposals, e.g. how to identify significant sustainability-related risks and opportunities. Stakeholders also requested clarification of some terms and concepts, particularly the definition and application of materiality concept;
- the need to permit gradual implementation of the proposals, depending on the capability and preparedness of companies across the world (scalability). At the September 2022 meeting, the ISSB began to identify some strategies and mechanisms that would enable progressive implementation of the disclosure requirements set out in the standards;
- the need to work with the IASB in order to improve the connectivity and consistency of disclosures within and outside the financial statements;

- the need to work closely with jurisdictions around the world that are simultaneously developing local sustainability standards, including the European Union and the United States, in order (among other things) to use identical terminologies where possible and appropriate, and to ensure that the global baseline is fully interoperable in practical terms with the requirements of other international standards; and
- the need to rework some of the more technical proposals set out in the standard on climate-related disclosures. For example, the minor amendments made by the ISSB to the industry-based standards developed by the Sustainability Accounting Standards Board – which were presented as an appendix to the draft IFRS S2, but which would be mandatory – were generally felt to be insufficient to enable IFRS S2 to be applied efficiently in all jurisdictions (i.e. outside the United States).
  - breadth of disclosures required;
  - 'significant' sustainability-related risks and opportunities;
  - identifying significant sustainability-related risks and opportunities and disclosures (including using materials prepared by other standard-setters);
  - implementation of the materiality assessment;
  - related information (cf. the principle of connectivity of information); and
  - frequency of sustainability reporting;
- topics relating to IFRS S2:
  - strategy and decision-making, including transition planning;
  - climate resilience;
  - greenhouse gas emissions; and
  - industry-based requirements, including financed and facilitated emissions.

The ISSB will continue to analyse stakeholder feedback at its next meeting in October 2022.

This month, the ISSB identified the following priority topics for the upcoming redeliberations:

- topics relating to both IFRS S1 and IFRS S2:
  - scalability of disclosure requirements; and
  - current and anticipated effects of sustainability-related and climate-related risks and opportunities on an entity's financial performance, financial position and cash flows;
- topics relating to IFRS S1:
  - enterprise value;

The ISSB will begin its redeliberations on the first two IFRS Sustainability Disclosure Standards at its October 2022 meeting.

## European Highlights

### EU endorses amendment to IFRS 17 - *Initial Application of IFRS 17 and IFRS 9 – Comparative Information*

The amendments to IFRS 17 – *Insurance Contracts: Initial Application of IFRS 17 and IFRS 9 – Comparative Information*, published in December 2021 by the IASB (see Beyond the GAAP no. 161, December 2021) have been endorsed by the European Union and published in the Official Journal of the European Union (OJEU) of 9 September 2022 (Commission Regulation (EU) 2022/1491, available [here](#)).

Readers will remember that the amendment published by the IASB covered only the presentation of comparative information, to resolve an accounting mismatch between insurance liabilities and financial assets in comparative information presented by insurers at initial application of IFRS 17 and IFRS 9.

### **EFRAG publishes annual review for 2021**

On 8 September 2022, EFRAG published its annual review for 2021 (available [here](#)). It reports on the organisation's key activities over 2021 and the significant developments in the first half of 2022, such as EFRAG's governance reform and its new role as technical advisor to the European Commission on the draft European Sustainability Reporting Standards (ESRSs).

## Amendments to IFRS 16 – *Lease Liability in a Sale and Leaseback*

On 22 September 2022, the IASB published the amendments to IFRS 16 – *Leases: Lease Liability in a Sale and Leaseback*. These amendments clarify the subsequent measurement of sale and leaseback transactions where the initial sale of the underlying asset meets the IFRS 15 criteria for recognition as a sale. In particular, these amendments clarify the subsequent measurement of the lease liability arising from these transactions where there are variable lease payments that do not depend on an index or rate.

### Reminders

In IFRS 16, these transactions are analysed in substance as a sale of the right to use the underlying asset at the end of the lease. As a result, the standard requires the seller-lessee to recognise only a partial disposal gain or loss and to retain on its statement of financial position a proportion of the underlying asset (corresponding to the right to use the asset over the lease term).

To do so, the seller-lessee must determine the proportion of rights it retains in the asset. Typically, this is determined by comparing the present value of the lease payments (in other words, the initial value of the lease liability) with the fair value of the underlying asset (as suggested in Illustrative Example 24 of the standard).

However, when a sale and leaseback transaction only includes payments based on a variable that does not depend on an index or a rate, this approach results in the recognition of a sale and leaseback gain or loss calculated on the entire asset (the proportion of rights retained by the seller-lessee being zero).

This raised the question of whether, in such cases, another approach should be used to determine the proportion of rights retained by the seller-lessee.

The IFRS Interpretations Committee (IFRS IC), to which this question had been submitted, was only able to provide a partial answer, noting that IFRS 16 does not specify a particular method for the subsequent measurement of sale and leaseback transactions. The agenda decision published in the June 2020 IFRIC Update, which only addressed the initial recognition of these transactions (see *Beyond the GAAP no.145, June 2020*), indicated that:

- the seller-lessee could determine the retained proportion of the right to use by comparing, for example (a) the present value of expected payments for the lease (including those that are variable), with (b) the fair value of the transferred asset at the date of the transaction;
- the gain or loss recognised by the seller-lessee was a consequence of its measurement of the right-of-use asset and related only to the rights transferred to the buyer-lessor; and
- even if all the lease payments were variable and did not depend on an index or rate, the seller-lessee recognised a liability at the date of the transaction. The initial measurement of the liability was merely a consequence of how the right-of-use asset was measured (and could therefore include variable payments that did not depend on an index or rate).

At its May 2020 meeting, the IASB decided, on the recommendation of the IFRS IC, to propose amendments to IFRS 16 to clarify how a seller-lessee should subsequently measure the liability arising from a sale and leaseback transaction. This project led to

the publication of an exposure draft in November 2020 (see Beyond the GAAP no.149, November 2020), with a comment period expiring in March 2021.

The amendments that have just been published represent the culmination of the process of clarifying IFRS 16 on sale and leaseback transactions, initiated by the IFRS IC.

### **What changes have been made to the standard?**

Taking into account the comments received on its exposure draft, the IASB has ultimately provided no clarification on how to measure the proportion of the seller-lessee's retained interest in the asset, contrary to the position taken in the exposure draft. In practice, therefore, an entity will need to determine for itself how to measure the retained right to use the asset, so that no gain or loss related to the retained right of use is recognised (the approach proposed in the June 2020 IFRS IC decision agenda being only one possible method).

The amendments are thus limited to modifying the existing sale and leaseback provisions to permit the subsequent measurement of the lease liability to include variable payments that do not depend on an index or rate (in a manner that is consistent with how the entity determined the proportion of retained interest in the asset and how it initially measured the lease liability).

A new paragraph (IFRS 16.102A) clarifies that a seller-lessee:

- shall subsequently measure the lease liability arising from a sale and leaseback transaction in accordance with the general provisions of the standard, but determining the lease payments so that no gain or loss

relating to the retained right of use is recognised (which, in practice, allows variable payments that are not dependent on an index or rate to be included in the subsequent measurement of the lease liability); and

- in the event of a modification that reduces the scope of the lease, any gain or loss arising from the partial or total termination of the right of use will be accounted for in profit or loss as required by the general provisions of the standard (the new provisions do not preclude these).

A new example (IE12, example 25) illustrates the application of these new provisions. Once the proportion of the seller-lessee's retained interest in the asset has been determined (the example does not describe how this was calculated, as the standard is not prescriptive on this issue), the seller-lessee develops an accounting policy to determine the lease payments so that no gain or loss related to the retained right-of-use is recognised. Depending on the circumstances, the seller-lessee could take either of the following two approaches:

- Approach 1—Expected lease payments at the commencement date: the lease payments correspond to the payments expected at the commencement of the lease; or
- Approach 2—Equal lease payments over the lease term: the lease payments reflect equal annual payments over the lease term (these annual payments are deducted from the value of the lease liability, their present value at the seller-lessee's incremental borrowing rate being equal to the lease liability).

In the example, the lease liability is repaid according to the original schedule. Any positive or negative difference between

actual lease payments and those initially expected is recognised in profit or loss. The lease liability is therefore not subsequently revised when expected lease payments or actual lease payments depart from the originally expected schedule.

Finally, the IASB has taken the opportunity to make some slight changes to the wording of one of the examples in the standard (IE11, example 24), in order to make it more readable and understandable.

### **Effective date and transitional arrangements**

The IASB has set the effective date of these amendments for annual reporting periods beginning on or after 1 January 2024. Early application is permitted.

The transitional arrangements state that a seller-lessee shall apply these amendments retrospectively, in accordance with IAS 8, to all sale and leaseback transactions entered into after the date of initial application of IFRS 16 (in most cases, 1 January 2019).

These amendments have still to go through the European endorsement process. They are thus included in EFRAG's endorsement status report (updated to 22 September 2022 and available [here](#)). No date has been announced yet for their endorsement by the European Union.

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## A race against time to finalise draft European Sustainability Reporting Standards

Since 8 August 2022, the end of the public consultation period, the European Financial Reporting Advisory Group (EFRAG) – through the Sustainability Reporting Board (SRB) and its Technical Expert Group (SR TEG) – has entered the home stretch before the draft European Sustainability Reporting Standards (ESRSs) are submitted to the European Commission in mid-November 2022.

Readers will recall that the public consultation was launched on 29 April 2022 (see Beyond the GAAP no.165, April 2022) on the basis of a first set of 13 draft standards including two cross-cutting standards (ESRS 1 and ESRS 2), five standards on environmental issues (ESRS E1 on climate, ESRS E2 on pollution, ESRS E3 on water, ESRS E4 on biodiversity and ecosystems and ESRS E5 on the circular economy), four standards on social issues (ESRS S1 on own workforce, ESRS S2 on workers in the value chain, ESRS S3 on affected communities and ESRS S4 on end consumers) and two standards on governance issues (ESRS G1 on governance, risk management and internal control and ESRS G2 on business conduct).

In its redeliberations, EFRAG must take into account not only the responses to the various public consultation questionnaires – some 750 stakeholders submitted comments – but also the changes that were made to the draft Corporate Sustainability Reporting Directive (CSRD) in the Trilogue (see Beyond the GAAP no.167, June 2022), as part of the political compromise reached at the end of June 2022 between

the European Council, Commission and Parliament. EFRAG had initially worked on draft standards compatible with the April 2021 draft version of the CSRD. This is because the CSRD is the top-level legislation, with the final version due to be published in the Official Journal of the European Union by the end of the year. The ESRSs will be endorsed by the European Commission by delegated act in June 2023 (for this first batch).

### Main lessons of the public consultation and consequences on draft ESRSs

EFRAG's public consultation was organised through a number of questionnaires listing 135 questions in total (respondents did not have to answer all of them, and many did not), many of which were presented as multiple-choice questions. Qualitative comments could also be made to flesh out the answers to the multiple-choice questions. EFRAG engaged an external service provider to assist in the processing of these questionnaires.

An initial summary of the responses (available [here](#)) was presented at a joint meeting of the SRB and SR TEG on 8 September 2022. A final report will be published shortly.

This first review covers the responses to questionnaires 1A, 1B and 1C, which addressed the overall relevance of the exposure drafts (with a strong focus on ESRS 1, the standard on general principles and the counterpart to IFRS S1). A number of main issues have emerged:

- firstly, and not unexpectedly, at this stage the draft standards are thought to be too granular and include too many disclosure requirements (and too many data points in the detail of each disclosure requirement). Significant rationalisation/prioritisation will therefore

be required to enable companies to implement the first ESRs within the ambitious timetable set by the CSRD (i.e. 2024 reporting published at the beginning of 2025 for large listed companies currently subject to the Non-Financial Reporting Directive), and without disproportionate cost. In particular, there was a call for sector-specific disclosure requirements (in particular on environmental issues) that are *de facto* not applicable to all companies to be removed from the first batch of standards and included in the sector-specific standards which EFRAG will subsequently develop;

- the rebuttable presumption of materiality – which allows certain disclosures required by the standards to be omitted, subject to justification – has been very unfavourably received by stakeholders, who are also asking for more practical guidance on how to conduct the double materiality analysis. Since August 2022, this topic has been the subject of much debate within the SR TEG and SRB in an effort to arrive at an approach that satisfies both preparers and users. Discussions have also taken place to identify disclosure requirements that would be mandatory (e.g. on climate), with no possible exemptions;
- alignment with the IFRS standards currently being developed by the ISSB (see ‘Highlights’ above) should be sought wherever possible by avoiding the use of different phrases/terminology for similar concepts (in particular when dealing with the subject of financial materiality, which is common to both standards). Following initial discussions in the SRB and SR TEG, the architecture of the ESRs should be revised to align more clearly with the structure of the TCFD (again, see the

article on the work of the ISSB in this issue);

- the content of some draft standards needs to be reorganised to avoid redundancy (e.g. between ESRs 1 and ESRs 2) and unnecessary complexity in the presentation of disclosure requirements (in particular by reworking what belongs in the body of the standard and what belongs in the application guidance);
- some information has been identified as unavailable or confidential. A review of the scope of what is required on some topics was therefore suggested. In particular, disclosures on the value chain should be more narrowly focused;
- in the case of the draft ESRs E1 on climate (a standard covering the same ground as IFRS S2), in addition to the above and in particular in terms of:
  - reappraising the granularity of the information: for example, with regard to disclosures on the decarbonisation levers applied by the entity;
  - reassessing standards that are sector-specific rather than sector-agnostic: for example, locked-in greenhouse gas emissions; and
  - providing for a phased introduction of disclosures: for example on the potential financial impacts of identified risks and opportunities, which EFRAG should address by proposing that entities provide only qualitative disclosures in the first instance;

stakeholders generally expressed support for the proposals, although concerns were voiced, particularly by preparers, about the cost-benefit ratio of the disclosures. Clarifications and

simplifications are therefore necessary, in particular to avoid giving the impression that ESRS E1 requires action to be taken – for example, to finance carbon capture measures – whereas the standard is simply a reporting standard, designed to ensure transparency on the climate issues facing entities;

- in the case of the other environmental standards, the stakeholders stress, unsurprisingly, that the disclosure requirements cover areas that are much less mature than climate change, and particular vigilance is therefore required in terms of what may ultimately be required of entities; and
- also unsurprisingly, ESRS S1 on own workforce was the best received of all the draft standards on social issues.

The SRB and SR TEG held several meetings during September 2022 to address these issues and to analyse the responses to the public consultation on each of the draft standards.

In particular, the position expressed by the Global Reporting Initiative (GRI), with which EFRAG worked prior to the public consultation, was analysed in detail, not least in order to better reflect the 'impact materiality' component (which accompanies the 'financial materiality' component in a double materiality approach) in the draft standards. For example, the issue of 'just transition' – a transition to a low-carbon economy that takes account of the social implications of an entity's decarbonisation strategy – should be explicitly covered in ESRS E1, but has so far only been addressed in the draft social standards.

The SRB and SR TEG also again discussed the time horizons to be used by entities when identifying and managing impacts, risks and opportunities, in

particular for defining action plans and setting targets. The ranges given in the draft ESRS 1 could be removed so that each entity is free to determine the relevant time horizons in the short, medium and long term. However, sector-specific standards could be more prescriptive to ensure comparability of reporting.

### **Impact of changes in the CSDR on draft ESRSs**

The CSRD will be the legislative text establishing the framework, organisation and content of sustainability reporting disclosures, while ESRSs will enable the practical application of the key principles set out in the CSRD.

Compared with the April 2021 draft text of the CSRD, the political compromise reached at the end of June 2022 places greater emphasis on the fact that European standards must contribute to the process of convergence, at global level, of the reference frameworks governing sustainability reporting, in particular by supporting the work currently being carried out by the ISSB. It may be useful to recall that Beyond the GAAP no.166 of May 2022 presented a comparative analysis of the proposals put forward by EFRAG and the ISSB.

The final text of the CSRD observes that ESRSs should reduce the risk of inconsistency for international entities resulting from different sustainability disclosure requirements, by incorporating the IFRS standards being developed by the ISSB to the extent that these standards are compatible with the EU legal framework and with the objectives of the European Green Deal. The interoperability of the two frameworks, sought by the stakeholders, will thus avoid disproportionate costs to businesses.

EFRAG and the ISSB are therefore now working together to a strict timetable, even on the ISSB side. In practice, the alignment between ESRs and IFRSs should lead to a revision of the structure of the ESRs, initially organised around the three fundamental reporting cycles of strategy, operational implementation and performance measurement, to adhere more closely to the structure of the TCFD, which has been reproduced almost identically by the ISSB. Conversely, the ISSB could bring IFRS S2 closer to ESR E1, following feedback from stakeholders. *A priori*, and from a technical point of view, there is no obstacle to the convergence of the climate standards currently developed by Europe on the one hand and the IFRS Foundation on the other.

Another change made during the Trilogue is that value chain disclosures should be limited to what will be required by the future standard for listed SMEs, so that large entities do not have to request more information from listed SMEs than they have to produce to meet their own regulatory requirements.

In terms of the location of disclosures, ESR 1 will have to take into account the fact that the political compromise reached on the CSRD removes the three options for the presentation of information that were initially foreseen, maintaining just one presentation in a single dedicated section of the management report (under four headings: general information, and disclosures relating to the environment, social aspects and governance). The SRB's September 2022 discussions also noted that the inclusion of information by reference would in principle still be possible.

Turning to the social standards, EFRAG will need to extend ESR S1 to include

disclosures on the measures taken by the entity against violence and harassment in the workplace, and on diversity (gender, age, education, etc.).

The governance aspect of the draft standards should also be impacted by the new draft CSRD. This is because the Trilogue text amends the scope of governance disclosures concerning the role of administrative, management and supervisory bodies to limit them to the role of these bodies in relation to sustainability matters only, together with the composition, expertise and competences of these bodies (or their access to such expertise and competence) to fulfil this distinct role. The content of ESR G1, which dealt with governance in general, should therefore be significantly revised in respect of the governance disclosures on sustainability that were required at that stage in ESR 2.

One last point worth mentioning: in the event that subsidiaries have identified significant risks and impacts that differ from those identified (and therefore presented) at the consolidated level, the group should mention them specifically. This is the 'trade-off' for the confirmation that a subsidiary does not have to publish sustainability reporting at its level when it has been integrated into a group subject to ESRs or equivalent standards (except in the case of large listed subsidiaries).

### **SRB and SR TEG timetable**

A number of SRB and SR TEG meetings are still planned between now and mid-November 2022, and additional meetings may be scheduled.

Once the first batch of draft standards has been finalised, EFRAG will be able to focus on the second batch which will include:

- the draft sector-specific standards, bearing in mind that it was decided in

August 2022 to spread the standardisation work over three years, prioritising the 41 sectors that ESRs should ultimately cover. In practice, EFRAG will first address the following ten sectors: Agriculture and farming, Coal mining, Mining, Oil and gas – Mid to downstream, Oil and gas – Upstream, Energy and utilities, Road transport, Motor vehicles, Textiles, accessories and jewellery, and lastly Food and beverages. At the end of September 2022, EFRAG invited stakeholders with sectoral expertise to assist in the preparation of sector-specific workshops and outreach events in October and November 2022;

- the adapted standard for listed SMEs; and
- the adapted standard for third-country undertakings (i.e. outside the EU).

This second batch will be open for comment in spring 2023, and EFRAG is expected to deliver draft standards to the EC by mid-November 2023.

The SRB is now moving forward without an officially appointed Chair. Such appointment should soon be announced, once the administrative process nominating Patrick de Cambourg is complete. Mr de Cambourg currently chairs the French accounting standard-setter (ANC) and was formerly Chair of the Task Force that prepared the draft ESRs submitted for public consultation last spring. His appointment has already received the necessary political support.

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