Beyond the GAAP

Forvis Mazars' monthly newsletter on financial and sustainability reporting

Contents

The drafting of the present issue was completed on 6 January 2025.

Editorial

Happy New Year from the Beyond the GAAP editorial team! The year 2024 concluded with the publication of targeted amendments to IFRS 9 and IFRS 7, aimed at contracts referencing nature-dependent electricity, often structured as PPAs (Power Purchase Agreements) or VPPAs (Virtual Power Purchase Agreements). These eagerly awaited amendments are detailed in this newsletter.

This newsletter also includes a presentation of the AMF study of the practices and main difficulties encountered by the French banking and insurance industries in fully complying with the requirements of the Taxonomy Regulation.

IFRS Highlights

Draft update of the Due Process Handbook

In December 2024, the Trustees of the IFRS Foundation published a draft update of the Due Process Handbook (which sets out the policies and procedures to be followed by the Foundation's standard-setting bodies) to take account of the creation of the International Sustainability Standards Board (ISSB) in 2021. The Due Process Handbook was last updated in 2020.

The proposed amendments mainly concern the ISSB's standard-setting process, but also address certain International Accounting Standards Board (IASB) and IFRS Interpretations Committee (IFRS IC) processes.

The comment period runs until 28 March 2025.

Jurisdictional consultations on adoption of ISSB standards

The latest news with respect to the jurisdictional consultations on the adoption of a regulatory framework for sustainability reporting based on the ISSB standards are the following:

- **Japan**: the Sustainability Standards Board of Japan (SSBJ) received more than 100 comment letters to its initial consultation on Exposure Drafts of the Sustainability Disclosure Standards released on 29 March 2024, and is currently reviewing the original proposals, with an intention to publish final standards in March 2025. As a result of this exercise, the SSBJ has launched a public consultation on Revised Proposals Related to the Calculation Period for the Reporting of Metrics with comments requested by January 10, 2025;
- **Qatar**: the Qatar Financial Centre Regulatory Authority has published Proposed Amendments to General Rules on Corporate Sustainability Reporting, aligned with IFRS S1 – *General Requirements for Disclosure of Sustainability-related Financial Information* and IFRS S2 – *Climate-related Disclosures*. The comment period runs until 25 March 2025. The reporting requirements will apply to financial services firms designated by the Regulatory Authority.
- **UK**: the UK Sustainability Disclosure Technical Advisory Committee (TAC) has recommended the endorsement of the first two IFRS Sustainability Disclosure Standards. The TAC has recommended minor amendments, including extended transitional relief for ‘climate-first’ reporting from one to two years. The Government will now consider these recommendations and is expected to consult on adoption of the standards in the first half of 2025, with the scope of companies required to comply with standards to be consulted on separately.
- **Canada**: the Canadian Sustainability Standards Board (CDSB) has published the final versions of its ISSB-aligned climate-disclosure standards (CSDS 1 and CSDS 2). These standards are available for voluntary adoption, until their use is mandated by regulatory authorities.

IBC support for adoption of ISSB Standards

The Growth and Emerging Markets Committee (GEM) of the International Organization of Securities Commissions (IOSCO) has created a new network supporting the adoption of ISSB standards.

The network comprises over 30 jurisdictions which are at different stages in working towards adoption, with others expressing an interest in being involved in the future. The focus of the network will be on building capacity for supervision and enforcement of standards, understanding how adoption can be achieved and assessing market readiness.

European Highlights

EFRAG publishes new explanations on the application of ESRS

On 6 December 2024, EFRAG published a fifth set of explanations on the application of European Sustainability Reporting Standards (ESRS) on the Q&A platform launched at the end of last year (see Beyond the GAAP no. 181, 2023).

This is a compilation of the 157 questions tackled since February 2024, organised by standard and disclosure requirement (DR). The Q&A published on 6 December 2024 are officially dated November 2024.

In each case, EFRAG provides the references and extracts from the standards on which its explanations are based in order to guide the reader. The regular publication of explanations is intended to provide support to preparers and other stakeholders engaged in the implementation of ESRS.

Of the 64 questions addressed in the November 2024 batch, 27 relate to environmental standards, 26 to cross-cutting standards, ten to social standards and one to governance.

Some of EFRAG's responses on cross-cutting standards deserve particular attention, including:

- ID 177 (published separately due to its length) which maps the sustainability matters listed in ESRS 1 – *General requirements* paragraph AR 16 to the DRs of the topical standards;
- ID 923 on the transitional provisions applicable to entity-specific disclosures;
- ID 935 on the difference between current and anticipated financial effects;
- ID 1072 on how to document the sustainability expertise and skills of the members of governance bodies, reminding that ESRS do not prescribe behaviour but do require transparency; and
- ID 1297 on the level of disaggregation required under the general principles of ESRS 1 Chapter 3.7.

The list of questions received and categorised as 'already answered' in Appendix III has also been updated. In each case, the list indicates the reference to the already answered question, thus explaining why these questions were rejected.

On 19 December 2024, a new and separate document was published to supplement the November 2024 batch, with explanations dated December 2024. Here, EFRAG addresses five new environmental questions, so that 162 questions have been officially answered at this stage. EFRAG is now expected to wait until spring 2025 before issuing further explanations, i.e. after the publication of the first sustainability statements under ESRS.

Of these five questions, three concern the information to be provided in application of the DR E1-4 on targets relating to climate change mitigation and adaptation. More specifically, these questions have been posed by financial institutions and concern the difficulties in implementing paragraph AR 23 of ESRS E1 – *Climate change*, which states that, where a company has set only one greenhouse gas intensity-emission reduction target, it shall nevertheless publish the associated absolute values for the target year and the interim target year(s). For a bank, emissions in absolute value are essentially linked to financing activities and therefore fall within Scope 3.

EFRAG's overall response is that where loan portfolio targets under Scope 3 Category 15 (Investments) are considered value chain information, a company can refer to the transitional provisions set by ESRS 1, in particular paragraph 133(a). This provision allows a bank, for the first three years in which it publishes information under the ESRS, and in order to take account of the difficulties that entities may encounter in gathering information from actors throughout their value chain, to limit disclosures on the upstream and downstream value chain to information which is available in-house, such as data already available to the undertaking and publicly available information, particularly with regard to disclosures on targets. In practice, EFRAG clarifies that in the particular case where only intensity targets are available, a financial institution may - during the first three reporting years - limit its disclosures on targets covering the value chain to information available in-house, which may include data already collected for Pillar 3 reporting.

EFRAG also indicates that it may, in the future, develop sector-specific provisions to address this issue.

EFRAG publishes adjustments to IG 3 on the list of ESRS datapoints

On 20 December 2024, EFRAG published adjustments to implementation guidance IG 3, listing ESRS datapoints (see Beyond the GAAP no. 188, 2024) to clarify and correct the list originally published at the end of May 2024. At this stage, these limited changes are not included in the Excel file related to IG 3, but are presented in two separate tables:

- the first adds 17 datapoints to IG 3, and removes one datapoint; and
- the second presents adjustments to existing datapoints in IG 3 (change of description, change of reference to the relevant Application Requirement, etc.). 16 datapoints are affected by these adjustments.

These technical adjustments were made in response to questions raised by stakeholders on the Q&A platform (see the previous highlight in this newsletter).

EFRAG plans to provide an updated version of the IG 3 Excel file in spring 2025 after the publication of the first sustainability statements. Further clarifications/corrections may therefore be necessary in light of the issues identified in this first reporting exercise. This serves to emphasise that IG 3 is a tool, useful to preparers in particular, but that the standards take precedence in the event of contradiction between IG 3 and the ESRS. EFRAG also stresses that this Excel file cannot be used as an automatic ESRS compliance check-list, and cannot be decoupled from the materiality assessment to be carried out beforehand.

EFRAG releases the voluntary sustainability reporting standard for SMEs

On 17 December 2024, EFRAG released its technical advice on the voluntary sustainability reporting standard for non-listed SMEs and micro-undertakings (the 'VSME standard'), at the request of the European Commission. Readers will recall that the final version of this text was approved by the Sustainability Reporting Board (SRB) on 13 November 2024 (see Beyond the GAAP no. 193, 2024). This technical advice should in principle be submitted to public consultation as part of the European due process, despite the fact that this standard will not be adopted by means of a delegated act (as not planned by CSRD).

ESMA launches public consultation on amendments to the ESEF regulation

On 13 December 2024, the European Securities and Markets Authority (ESMA) launched a public consultation on amendments to Regulation (EU) 2019/815 on the European Single Electronic Format (ESEF) (deadline for comments: 31 March 2025).

The amendments relate to:

- incorporation of the Regulatory Technical Standards (RTS) applicable to the tagging of (i) disclosures published in accordance with the ESRS Set 1 and (ii) disclosures published in accordance with Article 8 of Regulation (EU) 2020/852 on the European Taxonomy, with initial application in respect of the 2026 financial year for large listed entities and 2027 for other large entities within the scope of the CSRD. The tagging of ESRS sustainability information will be introduced in accordance with a gradual three-stage timetable (each stage lasting two years);
- a revision of the tagging rules for the notes to the consolidated financial statements; and
- amendments to the RTS applicable on the European Single Access Point (ESAP).

After considering the feedback received from stakeholders, ESMA expects to publish a final report in Q3 2025. ESMA's technical advice will then be submitted to the EC with a view to the endorsement of the amendments to the ESEF regulation by means of a delegated regulation.

IASB publishes final amendments to IFRS 9 and IFRS 7 on contracts referencing nature-dependent electricity (PPAs and VPPAs)

In response to the increasingly widespread use of these contracts, the IASB published amendments to IFRS 9 – *Financial Instruments* and IFRS 7 – *Financial Instruments: Disclosures* at the end of last year, designed to help companies to better report their financial effects.

This follows analysis of the feedback received in response to the exposure draft published in May 2024 (see Beyond the GAAP no. 188, 2024) and redeliberations carried out in the second half of the year (see Beyond the GAAP no. 191, 2024, and Beyond the GAAP no. 193, 2024).

In this special feature, we present the content of the new amendments.

Scope

The amendments cover 'contracts referencing nature-dependent electricity', or NDE. This phrase has replaced 'contracts for renewable electricity', which was the terminology used in the May 2024 exposure draft. Stakeholders felt that the previous phrase was unclear and vague.

NDE contracts reference electricity that is subject to variability in the amounts produced as it is dependent on uncontrollable natural conditions, such as electricity generated from wind or solar energy. Thus, electricity generated from biomass or waste recycling does not fall within the scope of the amendments, as the natural resources can be stored, granting control over the source of electricity generation (IFRS 9.BC2.17G).

The amendments cover:

- contracts to buy or sell electricity that will be settled by physical delivery (Power Purchase Agreements or PPAs); and
- swaps that are settled by a net payment in cash of the difference between the contractual fixed price and the variable market price (Virtual PPAs or VPPAs), which are financial instruments.

The amendments specify that an entity may not apply the specific provisions of the amendments on own-use and hedge accounting by analogy to other contracts (IFRS 9.2.3B).

Own-use classification

Readers will remember that IFRS 9 includes an exception for contracts that were entered into and continue to be held for the purpose of the receipt or delivery of a non-financial item in accordance with the entity's expected purchase, sale or usage requirements (the so-called 'own-use' exception).

In the amendments, classification as 'own-use' from the buyer's point of view would be subject to the following three conditions, considered at date of initial recognition of the contract and at each subsequent reporting date:

- the contractual features expose the entity to the risk of taking delivery of more electricity than it requires in any delivery interval. This condition is met even if i) the risk of intermittent overproduction is inherent in the nature of the contract and known from the start (IFRS 9.BC2.18A); and ii) the producer takes on part of the volume risk through caps or floors (IFRS 9.BC2.18D);
- in practice, the design and operation of the market require the entity to immediately resell the excess electricity on the market; and
- the entity is a net purchaser over the contract period, i.e. it buys back or expects to buy back enough electricity to at least offset sales of any excess, within a reasonable amount of time. 'A reasonable amount of time' shall be determined by considering i) the seasonality of the source of electricity and the entity's business cycle, and ii) all reasonable and supportable information, whether past, current, or forward-looking, that is available at the date of the assessment. It may not exceed 12 months. When determining whether it is a net purchaser, the entity shall consider electricity purchased on the same market, which implies that an entity could offset frequent overproduction by one site with

underproduction by another site on the same market (IFRS 9.BC2.18I).

Hedge accounting

The amendments relate to the definition of a hedged item when designating a cash flow hedging relationship (CFH). In this relationship, the hedging instrument is an NDE contract classified as a derivative, either by its nature (VPPA) or because it is a physical PPA that does not qualify as own-use ('failed own-use') and is designated in an all-in-one cash flow hedge.

The amendments stipulate that:

- the hedged item may include a variable nominal amount equal to the variable amount of nature-dependent electricity produced by the generation facility referenced in the hedging instrument; and
- the other hedge accounting requirements of IFRS 9 remain unchanged for these contracts.

Further details on the impacts and practical application of this change in the hedge accounting requirements for these contracts are provided in the Basis for Conclusions (IFRS 9.BC6.661 to 6.683):

- applying the 'highly probable' criterion in the context of a CFH: for an electricity buyer, this criterion is deemed to be met even if the contract covers a very long period (e.g. 25 years, see IFRS 9.BC6.672); for an electricity seller (or a buyer in the context of an all-in-one hedge), this criterion is deemed to be systematically met by nature or design regardless of the quantity of electricity produced, as the cash flows in the contingent hedging relationship are perfectly matched by the hedged cash flows (IFRS 9.BC6.674);
- measuring the hypothetical derivative: this is an exception to the principle that the characteristics of the hypothetical derivative should not simply mirror those of the hedging derivative. However, this applies only to the nominal amount of the derivative, which should be equal to the variable amount of electricity produced by the facility referenced by the contingent hedging derivative (IFRS 9.BC6.676 to 6.681). As a result, any remaining sources of hedge ineffectiveness must be identified and quantified, such as price differences resulting from the timing of production and consumption, or from the use of two geographically different reference markets (IFRS 9.BC6.677).
- introducing an exception to the principle set out in the [March 2019 IFRS IC agenda decision on load following swaps], which states that it is not possible to designate a hedged item as a variable nominal amount, as the future cash flows to be hedged cannot be accurately specified or demonstrated to be highly probable (IFRS 9.BC6.662). However, the agenda decision remains in force for other types of contingent hedging relationship (such as certain currency hedges), as the amendments cannot be applied by analogy to other situations.

Finally, a new illustrative example has been added to the standard to illustrate how hedge accounting should be applied to NDE contracts (Example 19 – IFRS 9.IE 148 to 159).

Disclosures required in the notes

The proposed disclosure requirements are intended to enable users of financial statements to understand the effects of contracts for renewable electricity on the amount, timing and uncertainty of the entity's future cash flows.

For own-use PPAs, an entity shall provide the following disclosures in a single note:

- contractual features that expose the entity to the risk of intermittency (variability depending on the amount of electricity produced by the nature-dependent source) and volume risk (the risk of oversupply of electricity);
- information about unrecognised commitments at the reporting date:
  - the expected cash flows from buying electricity, aggregated into appropriate time bands; and
  - qualitative disclosures about how the entity manages the risk that a contract will become onerous (as defined in IAS 37 – *Provisions, Contingent Liabilities and Contingent Assets*), including the methods and assumptions used; and
- qualitative and quantitative information on how the entity determines whether it is a net purchaser for the reporting period, and more specifically:

- the costs arising from purchases of electricity, distinguishing between the used and unused portions;
- the proceeds arising from sales of unused electricity; and
- the costs arising from subsequent purchases of electricity made to offset sales of unused electricity.

For derivatives designated in hedging relationships, an entity shall present separately the disclosures required by paragraph 23A of IFRS 7, i.e. the contractual features and how they affect the amount, timing and uncertainty of the entity's future cash flows.

Lastly, if an entity that buys electricity discloses information about other contracts within the scope of the amendments (such as VPPAs designated in hedging relationships) in other notes in its financial statements, it must include cross-references to those notes in the required single note.

Effective application and transition

Entities are required to apply the proposed amendments as follows:

- retrospectively for the own-use requirements, in accordance with IAS 8 – *Accounting Policies, Changes in Accounting Estimates and Errors*, but without requiring the entity to present restated comparative information for prior periods. The assessment of whether the own-use exception applies shall be carried out based on the facts and circumstances at the date of initial application of the amendments (not the date when the contract was signed). As a result, the impacts of the amendments will thus be recognised in opening retained earnings for the first period of application. Moreover, at the date of initial application, an entity has the option of designating contracts that were previously classified as derivatives and reclassified as own-use under the amendments as measured at fair value through profit or loss (applying IFRS 9.2.5); and
- prospectively for the hedge accounting requirements. The amendments permit an entity to discontinue an existing hedging relationship in order to designate a new hedging relationship applying the amendments, which could result in hedge ineffectiveness arising from the non-zero value of pre-existing hedging derivatives at the date of initial application (IFRS 7.BC7.109).

Finally, entities are exempt from disclosing, for the current period and for each prior period presented, the quantitative information required by paragraph 28(f) of IAS 8.

The amendments are mandatory for annual reporting periods beginning on or after 1 January 2026. Early application is permitted, subject to adoption by the European Union.

AMF publishes study on 2023 Taxonomy reporting of financial institutions

This study presents an overview of the practices and main difficulties encountered by French banking and insurance firms in fully complying with the requirements of the Taxonomy Regulation.

On 10 December 2024, the French market authority (AMF) published a study (available here) on the Taxonomy reporting of financial institutions. The study presents an overview of the practices and main difficulties encountered by banking and insurance firms in fully complying with the requirements of the Taxonomy Regulation. The analysis was carried out as part of the Finance ClimAct project, with support from the European Union's LIFE programme.

The AMF also notes that the study is simply an overview of practice and does not constitute positions or recommendations that are binding on market participants.

The sample for the banking sector comprised four banks, while the sample for the insurance and reinsurance sector comprised three companies.

The Taxonomy reportings covered by the study were published in 2024 for the 2023 financial period. The AMF reminds readers that, for financial institutions, 2024 was the first year in which they were required to report on the alignment of their exposures or activities. They had to assess alignment with the two climate-related objectives. Financial institutions were also required, for the first time, to report on the eligibility of their exposures or activities for the four other environmental objectives.

Banking sector

Following a brief pedagogical reminder of the various reporting requirements that apply to the banking sector, the AMF's key findings for the sector were as follows:

- the completeness of the disclosures appears generally satisfactory, taking into account that this is the first year of reporting on alignment with the two climate-related objectives. However, a number of elements were missing, and attention should be paid to these in future years. For example, none of the banks in the sample published the key performance indicators (KPIs) on eligibility for the four other environmental objectives in the Taxonomy. The banks cited difficulties in accessing data from their counterparties, who were also required to publish these disclosures for the first time in 2024. The banks in the sample also failed to publish the GAR (Green Asset Ratio) flow KPI. They explained this omission by methodological uncertainties around the methods for calculating this indicator. The AMF notes that the difficulties with GAR flow should be resolved for the next financial period by the clarifications provided in a set of FAQs published by the European Union in draft form in December 2023, and subsequently in the Official Journal of the European Union in November 2024 (see Beyond the GAAP no. 193, 2024).
- despite visible efforts made by the banks, the reporting is still difficult to understand for an investor who is not familiar with the Taxonomy regulation. The AMF notes that the amount and format of templates required by the Article 8 Delegated Act make the presentation of disclosures complex and dense. Faced with this complexity, some banks in the sample took a number of initiatives to improve the readability of their reporting, such as by adding summary tables not required by the regulations, with a primarily pedagogical function. However, the AMF notes that this calls into question the comparability of disclosures, which was the main goal of standardising the presentation format through the use of regulatory templates. The complexity of the reporting is further exacerbated by the use of sometimes very complex concepts, the heterogeneity of contextual information, and differences in the structure of the GAR. The AMF reminds readers that banks are required by Annex XI of the Article 8 Delegated Act to publish contextual information to accompany the quantitative data, specifying the assumptions, sources and limitations;
- the AMF notes that Taxonomy reporting is not yet clearly connected with other ESG information.

The large majority of banks in the sample do not make links between their Taxonomy reporting and other parts of the financial report, such as their CSR policy or strategy, despite the requirements of Annex XI of the Article 8 Delegated Act, which states that financial institutions must describe how their business strategy complies with the Taxonomy Regulation, particularly in terms of the product design processes, and engagement with clients and counterparties. The AMF notes that banks' reporting would be more relevant and useful to readers if clearer links were made with the banks' ESG strategy and policy;

- most of the banks in the panel said they faced difficulties with the availability and reliability of data provided by counterparties, on which they depend to calculate their regulatory KPIs. Some banks said they used data providers to mitigate these difficulties. The AMF notes that while this practice is a priori acceptable, banks must ensure that the data providers do not use estimates, which are prohibited in Taxonomy reporting;
- in this first-time reporting, the GAR levels published by the banks in the sample are low, but in line with the GAR levels of other European banks. Moreover, the AMF points out that the GAR indicator is heavily criticised by the banking industry; and
- some banks published voluntary KPIs, to address the criticisms of the methodology used to calculate the GAR. The European Commission has also encouraged financial institutions to voluntarily publish 'any estimates of Taxonomy-alignment of their exposures covered by the KPIs, but where financial undertakings lack sufficient data and adequate evidence specific to their exposures to prove Taxonomy-alignment'[1]. However, the AMF points out that publishing voluntary KPIs calls into question the comparability of reporting and raises issues of clarity for the reader.

Insurance sector

In the study, the AMF also analyses reporting by insurance and reinsurance companies. As for the banking sector, a brief pedagogical reminder of the various reporting requirements precedes the analysis.

Several findings for the insurance and reinsurance sector are similar to those for the banking sector, notably as regards the complexity of reporting, the limitations in terms of the availability and quality of data needed to calculate KPIs, and the generally satisfactory level of completeness of published information. However, the AMF does identify some findings that are specific to the insurance and reinsurance sector:

- as a reminder, insurance and reinsurance firms must publish one KPI on their exposures and another one on their underwriting activities. To calculate the latter, they assess compliance with the technical screening criteria and minimum safeguards. The companies in the sample explained their analysis of eligibility and alignment for their underwriting activities in a relatively clear and readable way, but information on how the technical screening criteria and minimum safeguards were analysed was heterogeneous and would benefit from further detail; and
- following a clarification provided by the European Commission in the set of FAQs published in the OJEU in November 2024 (and previously published in draft form in December 2023), the companies adjusted the method used to calculate eligible premiums, which led them to be revised downwards.

In future periods, in line with the findings above, the AMF calls on financial institutions to continue working towards greater transparency by clearly indicating the assumptions used, difficulties encountered and reasons for not publishing certain KPIs. The AMF also notes that better connectivity between Taxonomy reporting and other ESG disclosures, particularly on financial institutions' ESG strategy, would improve the overall relevance and usefulness of the reporting for readers.

[1] Set of FAQs published by the European Commission in draft form on 21 December 2023 and in the OJEU in November 2024, Section 1 – Context

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