

PUBLIC STATEMENT

European common enforcement priorities for 2021 annual financial reports

INTRODUCTION FOR MANAGEMENT AND SUPERVISORY BODIES OF ISSUERS

The European Securities and Markets Authority (ESMA) issues its annual Public Statement setting out the European common enforcement priorities for the 2021 annual financial reports of listed companies. ESMA, together with national enforcers, will pay particular attention to these areas when monitoring and assessing the application of the relevant reporting requirements. In addition, enforcers will continue to focus on issues that are material for the individual reports examined. Based on the examinations performed, enforcers will take enforcement actions whenever material misstatements are identified and ESMA will report subsequently on their findings. In addition to these European priorities, enforcers may also set national priorities.

ESMA underlines the responsibility of management and supervisory bodies of issuers as well as the importance of the oversight role of audit committees which is key to ensure the overall internal consistency of the annual financial report and contribute to high-quality annual financial reports.

The following topics are addressed in the common enforcement priorities for IFRS financial statements and non-financial statements and in the other considerations related to Alternative Performance Measures (APMs):

	Priorities related to IFRS financial statements	Priorities related to non-financial statements	Other considerations related to APMs
	<i>Section 1</i>	<i>Section 2</i>	<i>Section 3</i>
➤ Impacts of COVID-19	✓	✓	✓
➤ Climate-related matters	✓	✓	
➤ Expected credit losses	✓		
➤ Taxonomy-related disclosures		✓	

ESMA emphasises the importance of taking into account those topics and the detailed recommendations included in this Public Statement when management and supervisory bodies of issuers undertake their respective responsibilities in relation to the 2021 annual financial reports and of discussing them with their auditors.

Reminder on the application of the European Single Electronic Format (ESEF)

ESMA also reminds issuers that starting from the financial year 2021, all annual financial reports pursuant to Article 4 of the Transparency Directive (TD)¹ shall be prepared in compliance with the European Single Electronic Format, or ESEF² (xHTML or inline XBRL³). Preparers, and most notably first-time preparers, are encouraged to refer to the dedicated page on the ESMA website⁴ to consult guidance material, specifically the ESEF Reporting Manual, to better understand the requirements⁵. In order to ensure usability of files, ESMA draws issuers' attention in particular to Guidance 2.6.1. of the ESEF Reporting Manual, which clarifies that the multiple files which make up an inline XBRL report are expected to be packaged according to XBRL International's Report Package Working Group Note⁶. Failing to do so may severely impair users' ability to consume the content of the report. In addition, ESMA recommends preparers of inline XBRL reports to carefully consider Guidance 1.6.1 of the ESEF Reporting Manual, which provides information on the correct use of positive and negative values in inline XBRL reports, which is an area where ESMA observed frequent errors in 2020 filings. Indeed, issuers need to be aware of the fact that the correct XBRL sign for a fact is not always the same as that used in the financial report, and that XBRL signage needs to be carefully reviewed in order to ensure usability of the reported data.

¹ Directive 2004/109/EC of the European Parliament and of the Council of 15 December 2004 on the harmonisation of transparency requirements in relation to information about issuers whose securities are admitted to trading on a regulated market and amending Directive 2001/34/EC

² Commission Delegated Regulation 2019/815 specifying the harmonised electronic format for issuers' annual financial reporting`

³ All issuers' annual financial reports shall be prepared in xHTML format. In addition, issuers preparing IFRS consolidated financial statements shall mark those up using Inline XBRL

⁴ <https://www.esma.europa.eu/policy-activities/corporate-disclosure/european-single-electronic-format>

⁵ ESMA32-60-254rev ESEF Reporting Manual, 12 July 2021

⁶ <http://www.xbrl.org/WGN/report-packages/WGN-2018-08-14/report-packages-WGN-2018-08-14.html>

SECTION 1: PRIORITIES RELATED TO IFRS FINANCIAL STATEMENTS

1.1. Priority 1: Impacts of COVID-19 pandemic

Longer-term impact of COVID-19

ESMA notes that in several jurisdictions the evolution of the COVID-19 pandemic has been highly volatile in the recent months. For many issuers and sectors, the impact of COVID-19 has been severe and the path to recovery to pre-COVID-19 levels of economic activity may be prolonged. ESMA calls for a careful assessment of the longer-term impacts of COVID-19 on issuers' activities, financial performance, financial position and cash flows. In this regard, ESMA reiterates the message included in its 2020 Public Statement on the European Common Enforcement Priorities⁷ regarding the implications of COVID-19 in financial statements, most notably ESMA's recommendations relating to going concern assumptions, significant judgements, estimation uncertainty, presentation of financial statements and impairment of assets.

In addition, ESMA highlights that, as discussed in the IASB's educational materials *Going concern—a focus on disclosure*⁸, the twelve months from the end of the reporting period referred to in paragraph 26 of IAS 1 is a minimum period. Therefore, as required by paragraph 25 of IAS 1, issuers need to assess and disclose if material uncertainties exist related to events or conditions that may cast significant doubt upon the issuers' ability to continue as a going concern if relevant *beyond* the twelve-month period after the reporting period.

Mindful of the fact that COVID-19 is contributing in some instances to the reconfiguration of trade and supply chains, ESMA reminds issuers to provide full transparency of any material arrangements that take the form of supply chain financing (e.g. management judgements in accordance with IAS 1, presentation in the statements of financial position and of cash flow as well as impacts)⁹. In particular, ESMA also recommends that issuers provide transparent information regarding their liquidity risk as required by paragraphs 39 and B10A to B11F of IFRS 7 *Financial Instruments: Disclosures* and that this information is, as for all disclosures, sufficiently entity-specific. It should be noted that general requirements stemming from paragraphs 31 to 35 of IFRS 7 also apply to liquidity risk and, in particular, that both qualitative and quantitative information is necessary to enable investors to evaluate an entity's exposure to liquidity risk.

Recovery from COVID-19

ESMA expects issuers, in particular those operating in sectors that are severely impacted by the longer-term impacts of COVID-19 (e.g. transportation, hospitality, retail), to disclose information on the judgements, estimates and assumptions that were updated as a result of any recent changes in their economic and financial situation together with the basis for those changes, where this is necessary for an understanding of the financial statements. These include, but are not limited to, the main assumptions used (and respective sensitivity analyses) to determine whether an impairment or reversal of impairment of non-financial assets should be recognised or whether the useful life of non-financial assets should be revised.

ESMA also highlights that the reversal of impairments recognised in the previous periods should be assessed on the basis of paragraphs 109 *et seq.* of IAS 36. ESMA reminds issuers to assess at the end of

⁷ ESMA, [European Common Enforcement Priorities 2020](#)

⁸ IASB, [Going concern—a focus on disclosure](#)

⁹ ESMA highlights that the IFRS Interpretations Committee (IC) agenda decision on supply chain arrangements published in December 2020 clarifies which IFRS requirements apply to these transactions in terms of analysis and classification in the financial statements. The agenda decision emphasises the importance of a distinct presentation in the primary statements, most notably in the statement of financial position and in the statement of cash flows, and the accompanying notes if the impacts are significant.

each reporting period whether there is any indication that an impairment loss recognised in prior periods for an asset other than goodwill may no longer exist or may have decreased. ESMA highlights that in making that assessment, issuers should consider, at a minimum, the internal and external indications as specified in paragraph 111 of IAS 36 and that an impairment loss recognised in prior periods for an asset other than goodwill is reversed if, and only if, there has been a change in the estimates used to determine the asset's recoverable amount since the period in which the last impairment loss was recognised.¹⁰ In accordance with paragraph 116 of IAS 36, an impairment loss is not reversed if an increase of the asset's value in use is exclusively due to the passage of time ('unwinding' of the discount).

Finally, ESMA calls for transparency on the criteria and assumptions used in the recognition of deferred tax assets arising from the carry forward of unused tax losses and unused tax credits due to the COVID-19 pandemic (e.g. analysis of the origin of the losses and nature of convincing evidence required in the specific circumstances).¹¹ In this respect, ESMA draws issuers' attention to its Public Statement¹² setting out expectations regarding the application of the requirements in IAS 12 *Income Taxes* relating to the recognition, measurement and disclosure of deferred tax assets arising from unused tax losses.

Government support measures

Paragraph 39 of IAS 20 *Accounting for Government Grants and Disclosures of Government Assistance* requires disclosure of information related to government assistance including, among other information, the accounting policy adopted for government grants, as well as the methods of presentation adopted in the financial statements (both in the statement of comprehensive income and in the statement of financial position), and the nature and extent of government grants recognised in the financial statements. ESMA expects issuers to include in the financial statements a description of the nature and extent of any significant public support measure received by category (e.g. loans, tax relief, compensation schemes). ESMA also expects issuers to give information on the main characteristics of the support measures (e.g. expected duration, reimbursement and main conditions) as well as on the effects of their termination. Where relevant, ESMA expects issuers to make a link with the going concern assumptions or other planned actions.

1.2. Priority 2: Climate-related matters

Consistency between IFRS financial statements and Non-Financial information

ESMA highlights that issuers and auditors must consider climate risks when preparing and auditing IFRS financial statements to the extent that the effects of those risks are material to those financial statements, even if IFRS Standards do not explicitly refer to climate-related matters. ESMA notes that typically the identification and assessment of climate-related risks may require consideration of a longer-term horizon than the one generally considered for financial risks. In this respect, ESMA notes that investors are increasingly interested in information regarding the impacts that climate-related matters may have on issuers as well as in information on the issuers' impacts on the mitigation of the effects of climate-related matters¹³, especially in light of commitments at international and European levels such as the Paris Agreement¹⁴ and the European Climate Law¹⁵. While some sectors will be more affected than others, it is key

¹⁰ Paragraph 114 of IAS 36

¹¹ Paragraph 35 and following, and paragraph 82 of IAS 12

¹² Public Statement, [Considerations on recognition of deferred tax assets arising from the carryforward of unused tax losses](#)

¹³ See the Sixth Assessment Report of the Intergovernmental Panel on Climate Change (IPCC) on the physical science basis of climate change

¹⁴ https://unfccc.int/sites/default/files/english_paris_agreement.pdf

¹⁵ Regulation (EU) 2021/1119 of the European Parliament and of the Council of 30 June 2021 establishing the framework for achieving climate neutrality and amending Regulations (EC) No 401/2009 and (EU) 2018/1999 ('European Climate Law')

that all issuers consider the climate-related matters holistically in their communications to the market by ensuring consistency in the information disclosed across the management report, the non-financial statement, the financial statements, and, where applicable, the prospectus. For example, as further explained in the sub-section on significant judgements and estimation uncertainty, assumptions underlying forward-looking estimates and valuations of assets and liabilities should take into account any risks and trends identified and addressed by an issuer as part of its strategy. In order to ease investors' access to information on material climate-related matters in financial statements, issuers are encouraged to include all information required to be disclosed by the IFRS Standards on climate-related matters, including those concerning expected credit losses (as further discussed in sub-section 1.3), in one single note or alternatively to provide a mapping of where different notes address climate-related matters. The disclosures should be tailored to the specific circumstances of individual issuers.

Climate risks in IFRS Standards

ESMA draws issuers' attention to the fact that, in November 2020, the IASB published educational material on the effects of climate-related matters on financial statements.¹⁶ This educational material highlights how several IFRS Standards require issuers to consider the effects of climate-related matters when these are material. ESMA expects issuers to take this educational material into account when assessing the impacts and risks of climate change in their financial statements. ESMA also reminds issuers that, in addition to information required by individual IFRS Standards, pursuant to paragraph 112(c) of IAS 1 *Presentation of Financial Statements*, information on climate-related matters needs to be provided in the notes if not presented elsewhere in the financial statements when such information is relevant to an understanding of any of them.

Significant judgements and estimation uncertainty

ESMA highlights the fact that paragraphs 122-124 of IAS 1 require disclosure of the significant judgements (apart from those involving estimations) management has made in the process of applying an issuer's accounting policies and that have the most significant effect on the amounts recognised in the financial statements. In this context, issuers, in particular those belonging to the most affected sectors, need to consider disclosure of management judgements related to climate risks (for example those related to any climate scenarios on which assumptions have been made). Issuers are also required to disclose information in accordance with paragraphs 125-133 of IAS 1 regarding major sources of estimation uncertainty (for example in sensitivity analysis) that have a significant risk of resulting in a material adjustment to the carrying amount of assets and liabilities within the next financial year. In this respect, ESMA expects issuers to disclose in the financial statements how the forward-looking assumptions, estimates and judgements applied in preparing the financial statements are consistent with the information included in the corresponding management report and non-financial statement. In line with paragraph 112(c) of IAS 1, issuers should also clearly explain why apparently significant climate-related risks have not had a material impact on the financial statements.

ESMA expects issuers to consider climate change when assessing whether the expected useful lives of non-current assets and the estimated residual values in IAS 16 *Property, Plant and Equipment* and IAS 38 *Intangible Assets* should be revised.¹⁷ In addition, in accordance with IAS 36 *Impairment of Assets*¹⁸, issuers should, where relevant, (i) assess whether indications exist that non-financial assets are impaired as a result of climate risk or Paris agreement implementation measures, (ii) use assumptions reflecting climate risks and (iii) adapt the sensitivity analysis disclosed to consider climate risks and commitments

¹⁶ IASB, [Educational material: the effects of climate-related matters on financial statements prepared applying IFRS Standards](#)

¹⁷ Paragraphs 51, 73, 76 of IAS 16 and paragraphs 102, 104, 118, 121, 126 of IAS 38

¹⁸ Paragraphs 9-14, 30-33, 134 of IAS 36.

in the assumptions used. For example, IAS 36 highlights that external information about significant changes with an adverse effect on the company, such as significant changes in the environment in which a company operates, is an indication that an asset may be impaired.

Where it may be reasonably expected that climate change will have a significant impact on future expected cash flows for a particular asset or cash-generating unit (CGU), ESMA expects issuers to consider those impacts when making disclosures of assumptions used to determine the recoverable amount of assets or CGUs in accordance with, as applicable, paragraphs 132 and 134 of IAS 36.

In particular, for CGUs containing goodwill or intangible assets with indefinite useful lives, paragraph 134 of IAS 36 requires disclosure of information for each CGU for which the carrying amount of goodwill or intangible assets with indefinite useful lives allocated to that CGU is significant in comparison with the entity's total carrying amount of goodwill or intangible assets with indefinite useful lives. More specifically, paragraphs 134(d) and (e) require disclosures, among other information, for each CGU of each key assumption on which management has based its cash flow projections, or its determination of fair value less costs of disposal, as well as a description of management's approach to determining the value(s) assigned to each key assumption. If a reasonably possible change in a key assumption would cause the CGU's carrying amount to exceed its recoverable amount, paragraph 134(f) of IAS 36 requires disclosure of the value assigned to the key assumption(s), the amount by which the CGU's recoverable amount exceeds its carrying amount (which some refer to as 'headroom'), and the amount by which the value assigned to the key assumption(s) would need to change, after incorporating consequential effects on other variables, in order for the CGU's recoverable amount to be equal to its carrying amount¹⁹. In this respect, the estimations of long-term growth rate may be impacted by different climate change scenarios.

Issuers should carefully consider the requirements in IAS 37 *Provisions, Contingent Liabilities and Contingent Assets*, for example, with regards to contingent liabilities for potential litigation, regulatory requirements to remediate environmental damage, additional levies or penalties related to environmental requirements, contracts that may become onerous, or restructurings to achieve climate-related targets.

ESMA also calls for transparency in the accounting treatment applied regarding carbon and greenhouse gas emission trading schemes. In particular, issuers are encouraged to provide information on their accounting policies and information on how these schemes affect their financial performance and financial position.

Defining materiality

ESMA reminds issuers that the requirements to determine the materiality of financial information provided by paragraph 7 of IAS 1 should be taken into consideration when assessing the need to disclose information about climate risks. Consistently with these requirements, the IASB Practice Statement *Making Materiality Judgements*²⁰, which further supports the implementation of materiality requirements, foresees that when assessing whether or not information is material, issuers should take into account quantitative factors (paragraphs 44 and 45) and qualitative factors (paragraphs 46 to 51), as well as the interaction amongst different factors (paragraphs 52 to 54). In addition, in some circumstances, information on an item could reasonably be expected to influence primary users' decision-making regardless of its magnitude (paragraph 55). This might happen when information about a transaction, other event or condition is highly scrutinised by the primary users of an entity's financial statements.

¹⁹ Similar provisions under IAS 36 paragraph 135 apply when the amount of goodwill or intangible assets with indefinite useful lives are considered on an aggregate basis.

²⁰ IASB, [IFRS Practice Statement 2: Making Materiality Judgements](#)

1.3. Priority 3: ECL disclosures of credit institutions

The 2021 recommendations regarding credit institutions' disclosures on the calculation of expected credit losses (ECL) build upon and further expand some of the common enforcement priorities for the 2020 annual financial reports, taking into account the preliminary results of ESMA's current review of ECL-related disclosures in the 2020 financial statements of a sample of European credit institutions.²¹

Management overlays

It continues to be ESMA's view that when material adjustments (also referred to as 'management overlays') are used in the measurement of ECL, enhanced transparency should be provided by issuers in order to fulfil the overarching objectives and principles of paragraph 35B of IFRS 7 *Financial Instruments: Disclosures*. ESMA observes that such adjustments either take the form of ECL model revisions, including updates of the model inputs ("in-model adjustments"), or are applied outside the primary models ("post-model adjustments"). The following considerations apply in substance to both types of adjustments, although ESMA acknowledges that it may often be difficult to quantify the effect of the in-model adjustments.

To comply with the requirements of paragraphs 35G, 35D and 35E of IFRS 7, ESMA expects issuers to disclose, for each material adjustment, detailed and specific information on its impact on the ECL estimate, the rationale and the methodology applied. These disclosures should be provided at an appropriate level of granularity, for example by explaining to which specific type of products, exposures, sectors or geographic areas the adjustments relate to, if relevant. A corresponding breakdown of the quantitative impact of the adjustments may be appropriate in order to increase transparency and meet the requirements of paragraph 35H of IFRS 7. The rationale should clearly specify the reasons for the adjustment (e.g. to include the latest macroeconomic outlook, or to address model limitations resulting from insufficient inclusion of certain risks). The description of the methodology should include significant inputs and assumptions. Where material, ESMA expects issuers to provide information, in line with the requirements of paragraph 35F(a), on whether the adjustments relate to a specific impairment stage and, if applicable, what impact they have on staging of the underlying instruments. ESMA also recommends that issuers consider how their ECL sensitivity disclosures in the notes to the financial statements can incorporate material management overlays and provide rationale for the chosen method, if relevant.

Issuers should explain, in accordance with paragraph 35G(c) of IFRS 7, any significant changes in methodologies and assumptions from the previous reporting period and the reasons for those changes. This information should enable users to understand the extent of the movements, their nature (i.e. changes in underlying assumptions) and the reasons for the development of adjustments (i.e. incorporation of the post-model adjustments in the core model, if applicable) as it is ESMA's understanding that European credit institutions have used management overlays to a significant extent in 2020.

Significant changes in credit risk (stage transfers)

In accordance with paragraphs 35F and 35G of IFRS 7, ESMA reminds issuers to disclose the basis for the inputs and assumptions and the estimation techniques used to determine whether a significant increase in credit risk (SICR) has occurred for financial instruments since their initial recognition or whether a financial asset is credit impaired. Issuers should explain the quantitative and qualitative factors applied, including the length of the "cure" period, and any material differences in the application of the factors across portfolios. ESMA recommends that issuers disclose any quantitative SICR-thresholds applied, such as probability of default (PD) deterioration triggers. If there are significant differences in thresholds depending on portfolio type, additional explanations are required.

²¹ The final ESMA report with the results of the review is expected to be published by the end of 2021.

If, during the reporting period, any significant relief measures were provided to borrowers by issuers, ESMA expects that issuers explain how these measures have impacted the assessment of SICR. In particular, if the relief measures do not result in a derecognition of the financial instrument, credit institutions should include a description of how they determined SICR or whether these instruments are impaired in these specific circumstances providing, for example, information on related significant judgements, type of (new) indicators applied and the level of assessment (e.g. counterparty, sector, type of financial instruments etc.) at an appropriate level of detail. ESMA reminds that, in line with paragraph 35G of IFRS 7, any significant changes in the assessment of SICR or on whether a financial asset is credit-impaired (i.e. changes in the methodology or significant assumptions) during the reporting period shall be disclosed and explained.

With respect to disclosures required by paragraph 35F(a)(i) of IFRS 7 on the application of the low credit risk expedient, issuers should disclose, where relevant, the main types of transactions or portfolios that are impacted by these expedients, including qualitative and quantitative criteria used to define “low credit risk”.

ESMA emphasises the importance of disclosures required by paragraph 35F(c) of IFRS 7 on whether and how the issuer has applied a collective approach to measuring SICR. If the entity grouped financial instruments according to paragraph B5.5.5 of IFRS 9, issuers are expected to disclose key risk characteristics underlining the grouping approach and how the collective assessment was performed (for example use of “bottom up” or “top down” approach).

Forward-looking information (FLI)

ESMA welcomes explanations on how the impact of the pandemic has been considered in the macroeconomic scenarios in 2020 financial statements of many credit institutions. ESMA encourages issuers to provide detailed explanations in the 2021 financial statements as well. More specifically, when explaining how FLI has been incorporated into the determination of ECL as required by paragraph 35G(b) of IFRS 7, ESMA encourages credit institutions to provide specific disclosures on the main judgements and estimations related to uncertainties that have been taken into account when defining the scenarios and their weight. ESMA recommends that credit institutions disclose quantitative information on the macroeconomic variables considered for each scenario and main geographical areas and/or sectors. ESMA emphasises the importance of providing granular disclosures on the sensitivity analysis (e.g. regarding each scenario) and the quantitative impact of this analysis on the ECL and, where appropriate, on staging.

Transparency on changes in loss allowances, credit risk exposures and collateral

ESMA highlights that the tabular reconciliation of the loss allowance (impairment amount) from the opening balance to the closing balance in accordance with paragraphs 35H and B8E of IFRS 7 should be disaggregated by class of financial instrument and it should separately provide information about the changes in loss allowances for off-balance sheet commitments. Moreover, paragraph B8D of IFRS 7 requires a narrative explanation including an analysis of the reasons for changes in the loss allowance during the period. ESMA highlights that, in order to provide sufficient transparency, reconciliations should be disclosed both at the entity level and for significant portfolios with shared credit risk characteristics. ESMA reminds issuers that paragraph 35I of IFRS 7 requires explanations of how significant changes in the gross carrying amount during the period contributed to changes in the loss allowance. To ensure better transparency, ESMA encourages credit institutions to disclose a joint reconciliation of the loss allowance and the gross carrying amount.

When providing quantitative information on credit risk exposures required by paragraphs 34(a), 35B and 35M of IFRS 7, issuers should consider the requirement of paragraph 35D of IFRS 7 and provide an appropriate level of disaggregation to make significant credit risk concentrations transparent (e.g. PD ranges should be sufficiently narrow to provide useful information about the credit quality of exposures,

particularly for higher risk bands). ESMA considers it useful to provide a breakdown by stages for all levels of disaggregation. To comply with the requirements of paragraph 35C of IFRS 7, quantitative disclosures and the narrative descriptions provided in different parts of the financial statements or of the management report should be clearly linked to each other.

ESMA emphasises that paragraphs 35K and 35D of IFRS 7 require disclosures on credit enhancements to be sufficiently granular to enable users to understand material concentrations of credit risk. Where appropriate, disaggregation of exposures by loan to value (LTV) ranges can be provided.

Effect of climate-related risk on the ECL measurement

ESMA expects credit institutions to disclose whether material climate-related and environmental risks are taken into account in credit risk management, including information about the related significant judgements and estimation uncertainties. More specifically, to meet the objectives of paragraph 35B of IFRS 7, credit institutions should provide explanations, where applicable, on how these risks are incorporated in the calculation of ECL, on any credit risk concentrations related to environmental risks and how those risks affect the amounts recognised in the financial statements. When determining the appropriate level of detail disclosed, credit institutions should take into account materiality considerations as described in sub-section 1.2.

SECTION 2: PRIORITIES²² RELATED TO NON-FINANCIAL STATEMENTS

2.1 Priority 1: Impacts of COVID-19

In its 2020 Public Statement on the European Common Enforcement Priorities²³, ESMA already highlighted areas where disclosures of the implications of COVID-19 could be relevant in relation to social and employee matters, as well as on the business model of issuers.

ESMA notes the continued relevance of the pandemic which impacts the economic activities of issuers and may impair their ability to meet any pre-determined sustainability-related goals in the short and medium term. ESMA therefore recommends that issuers provide transparency on how the consequences of the pandemic are affecting their plans to meet any such sustainability targets and whether any new or adjusted goals have been determined.

Issuers are also encouraged to provide disclosures on how they foresee the development of their business in response to the changing conditions arising from the pandemic, in particular, in relation to any expected structural changes to the way they conduct their business (e.g. re-structuring of supply chains and distribution channels) and arrange the working conditions for their employees.

ESMA also recommends that issuers provide transparency on any material effects that the pandemic might have had on non-financial key performance indicators (KPIs) as well as on any new non-financial KPIs which may have been developed to reflect any long-term effects of the pandemic.

2.2 Priority 2: Climate-related matters

ESMA reminds issuers of the requirements in articles 19a and 29a of the Accounting Directive²⁴ to disclose the policies pursued in relation to non-financial matters and the outcome of those policies. ESMA particularly emphasises the importance of providing transparency on such policies and the related outcomes in the area of climate-related matters. As a way to comply with these requirements, ESMA reminds issuers of the guidance provided by the European Commission in its *Guidelines on reporting climate-related information*²⁵ which, notwithstanding its non-binding nature, is also consistent with the disclosures envisaged by the Task-Force on Climate-Related Financial Disclosures (TCFD).

Following the review of the 2019 European Common Enforcement Priorities²⁶, as summarised in its latest Activity Report²⁷, ESMA noted that in several instances the issuers reviewed did not disclose information specific to climate change and have only generically referred to policies addressing environmental issues, often omitting to provide explanations for any such omissions. ESMA noted that a good practice could be to disclose the reasons to conclude why the disclosures on climate-related matters were not provided.

²² Member States have transposed Articles 19a and 29a of the Accounting Directive with some differences. As a result, a limited number of enforcers can supervise and enforce non-financial information only if it is set out within the management report or published together with it or only have the power to check the *existence* of the non-financial information as opposed to the *content* or do not have any supervisory powers on non-financial information at all. For this reason, the priorities presented in Section 2 may be addressed differently by, or may not apply to, these enforcers.

²³ ESMA, [European Common Enforcement Priorities 2020](#)

²⁴ Directive 2013/34/EU of the European Parliament and of the Council of 26 June 2013 on the annual financial statements, consolidated financial statements and related reports of certain types of undertakings, amending Directive 2006/43/EC of the European Parliament and of the Council and repealing Council Directives 78/660/EEC and 83/349/EEC

²⁵ European Commission, [Guidelines on reporting climate-related information](#)

²⁶ ESMA, [European Common Enforcement Priorities 2019](#)

²⁷ ESMA, [Report on the Activities of European Accounting Enforcers in 2020](#)

ESMA emphasises the importance of disclosing which policies, if any, issuers have put in place to address climate change, both in terms of any identified risks and opportunities that climate-related matters may give rise to for the undertakings' activities as well as on the impact (positive or negative) that the undertaking's actions may have on such matters. Disclosure of such policies should include reference to the most significant transitional risks and physical risks that issuers have identified having a current or future expected material impact on its business model and activities and disclose how those risks are managed and which climate change mitigation or adaptation actions are put in place to address those risks.

ESMA recommends that issuers provide transparency of the process leading to the identification of such risks and on the outcomes of their climate-related policies also by providing specific indicators and explaining how the entity's performance on such indicators is consistent with any pre-defined targets. Issuers should also disclose the progress made towards achieving any such targets. For example, ESMA reminds issuers that disclosures on their greenhouse gas (GHG) emissions are most useful when they are provided by means of an appropriate segmentation (i.e. by country/region of operations or business segment) and when they are contextualised within specific pre-defined targets. Such disclosures would normally be accompanied by qualitative and quantitative explanations of the progress made to achieve those targets as well as quantitative information on how an issuer's emissions' patterns align with the objectives agreed upon in the 2015 Paris Agreement. ESMA emphasises the importance of providing information on scope 1, 2 and, where reliable data is available, scope 3²⁸ emissions at the reporting date, as well as the explanation of their evolution towards the achievement of any pre-set emissions' target and of providing information on the most significant sources of the disclosed GHG emissions.

In ESMA's view, in order to provide information that is useful for investors and other stakeholders to assessing the issuers' performance and position in relation to climate-related matters, the disclosures in this area should not be limited to providing backward-looking information. Rather, ESMA recommends that this information is contextualised in the undertaking's broader strategic orientation and the related implementation plans which should indicate the expected progress to meet any pre-defined targets.

Lastly, ESMA notes that an issuer's strategy, plans, targets and current performance in relation to climate-related matters should be taken into account both in terms of non-financial disclosures as well as financial information. In particular, ESMA emphasises the importance of providing the necessary information in the non-financial statements to enable users to understand the financial consequences of the issues arising from climate-related matters. In this context, ESMA highlights the importance of ensuring consistency and connectivity between the information provided within the non-financial statements in relation to climate-related matters with the information provided in the financial statements, including the judgements made and estimates which should duly consider any financial implications of climate-related matters. Priority 2 in Section 1 further describes ESMA's recommendations in relation to climate-related topics for IFRS financial statements.

2.3 Priority 3: Disclosures relating to Article 8 of the Taxonomy Regulation

ESMA reminds issuers of the disclosure obligations set out in Article 8 of the Taxonomy Regulation in relation to the taxonomy alignment of the economic activities which they undertake. ESMA emphasises the importance of issuers' preparedness to discharge such obligations²⁹acknowledging that the assessment of taxonomy eligibility and alignment is likely to require progressive adjustments.

²⁸ European Commission, [Guidelines on reporting climate-related information](#)

²⁹ European Commission, [Regulation \(EU\) 2020/852 \(Taxonomy Regulation\)](#); European Commission, [Climate Delegated Act](#), European Commission, [Final Delegated Act](#) on disclosures pursuant to Article 8 of the Taxonomy Regulation

In particular, ESMA notes that the classification regime envisaged by the Taxonomy Regulation for the classification of economic activities as environmentally sustainable envisages six environmental objectives for two of which – climate change mitigation and climate change adaptation – the Commission has developed technical criteria that, at the time of drafting this text, are undergoing the scrutiny period by European co-legislators. While in the Commission’s final delegated act on the Article 8 disclosures the first application of these disclosure requirements is subject to simplified reporting obligations for a predefined transition period, ESMA encourages issuers to use the additional time available to properly set their internal reporting systems to comply with the requirements.

ESMA notes that the assessment of the degree of alignment of an issuer’s economic activities with the taxonomy criteria and the disclosure of the related information may require collection of data that may not always be readily available to issuers. ESMA, therefore, encourages issuers to put in place the necessary preparations to ensure a timely and correct application of the relevant requirements.

ESMA and European enforcers will continue to monitor the developments in this area and the application of the disclosure requirements foreseen by Article 8 of the Taxonomy Regulation as further specified by the related delegated acts once they are incorporated into European law.

SECTION 3: OTHER CONSIDERATIONS RELATED TO ALTERNATIVE PERFORMANCE MEASURES (APMs)

In the 2020 ECEP, ESMA highlighted the importance of providing relevant and transparent information on the impacts of COVID-19. For this purpose, ESMA issued Q&A #18 which provides guidance³⁰ on how issuers should present the impact of the pandemic on their operations and should comply with the Guidelines on APMs.³¹

Given the persistence of the COVID-19 pandemic, ESMA calls for caution when adjusting APMs used and/or when including new APMs solely with the objective of depicting the impacts that COVID-19 may have on their financial performance. ESMA notes that, at this point, it is more likely that the impacts of COVID-19 rather represent a general development that has been induced by the pandemic than the result of a one-off event. Therefore, ESMA considers that, in most cases, these impacts should not necessarily be presented separately in APMs but in the accompanying narrative information. Nevertheless, ESMA reminds issuers that Q&A #18 aims for issuers to improve their disclosures and include a narrative in their disclosures, financial reports and/or prospectuses rather than to adjust existing APMs or include new ones.

ESMA notes that some of the issuers reviewed used APM labels that could lead to confusion with commonly accepted financial aggregates such as “EBITDA”. ESMA recalls that APMs disclosed should be given meaningful labels reflecting their content and basis of calculation in order to avoid conveying misleading messages to users. For example, issuers or persons responsible for the prospectus should not use the term ‘EBITDA’ if items other than interest, taxes, depreciation, and amortisation are adjusted from the net result (Adjusted EBITDA).

In addition, ESMA also highlights that APMs presented by issuers should be neutral. In this respect, ESMA recalls that Q&A #17 notes that presenting biased APMs which are adjusted to exclude only one-off losses (e.g. impairment losses) but include one-off gains of the same nature (e.g. reversal of impairments or grants) may violate the principles set out in articles 4 and 5 of the Transparency Directive relating to fair review of the development and performance of the business and the position of the issuer.

ESMA highlights that the guidance issued on the APM Guidelines will be enforcers’ main reference point when examining APMs in ad hoc disclosures published under the Market Abuse Regulation, in management reports or additional periodic financial information published in accordance to the Transparency Directive as well as in prospectuses published pursuant to the Prospectus Regulation.

³⁰ ESMA32-51-370 Questions and answers – ESMA Guidelines on Alternative Performance Measures (APMs), 17 April 2020

³¹ ESMA/2015/1415 Guidelines – ESMA Guidelines on Alternative Performance Measures, 5 October 2015