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ESMA enforcement priorities for 2020

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European regulator highlights priorities for 2020 financial statements prepared under IFRS® Standards

Highlights

- Main areas of focus – COVID-19 impacts on presentation, impairment of assets and leases
- Other areas of focus – Non-financial information and alternative performance measures
- Other issues – Brexit and the European Single Electronic Format
- Find out more

"The economic effects and heightened uncertainty arising from COVID-19 will be key challenges for companies in preparing 2020 annual reports. ESMA is calling for transparency in reporting the impacts of the pandemic – other regulators are likely to echo this call."

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The European regulator, ESMA[1], has issued a **statement** highlighting the areas that European national securities regulators will be focusing on when reviewing listed companies' 2020 annual reports. The aim is to promote the consistent application of IFRS Standards and EU-specific reporting requirements.

Given the severe impact of the COVID-19 coronavirus pandemic, ESMA's key priority is transparent and timely disclosure of information on the effects of the pandemic on a company's financial performance, position and cash flows. ESMA also stresses the importance of non-financial information disclosures, with a renewed focus on social, employee and climate change matters.

Although the topics included in the statement are those deemed by ESMA to be most relevant at a European level, regulatory bodies outside Europe are also likely to focus on the same topics. These topics are not exhaustive, however, and national regulators may have additional areas of focus.

Main areas of focus

Presentation of COVID-19 impacts

ESMA emphasises the need for transparent, company-specific disclosures that enhance the users' understanding of, and confidence in, the company's financial statements.

1. European Securities and Markets Authority

Going concern

ESMA highlights the importance of providing sufficiently detailed disclosures on the company's assessment of its ability to continue as a going concern when such an assessment involves significant judgement. Preparers are expected to consider all available information about the future – which is at least, but not limited to, 12 months from the reporting date. The level of detail would depend on the company's specific facts and circumstances.

Preparers should disclose material uncertainties related to events or conditions that may cast doubt on the company's ability to continue as a going concern and, even if management concludes that there are no material uncertainties, disclose significant judgements made in reaching the conclusion (a 'close call' scenario). ESMA expects the assumptions used in the going concern assessment to be consistent with those used in other areas of the company's financial statements – e.g. IFRS 7 *Financial Instruments: Disclosures information* about exposures to liquidity and other financial risks.

For more information, see our article on **COVID-19 going concern considerations**.

Significant judgements and estimation uncertainty

Preparers are expected to explain how COVID-19 has affected significant judgements and estimation uncertainty – e.g. the assumptions underlying the impairment of assets, the recoverability of deferred tax assets and fair value measurements. Given the current market conditions, ESMA strongly recommends that companies provide information about the sensitivity of carrying amounts to the methods, assumptions and estimates underlying their calculations.

COVID-19 presentation

ESMA calls for caution regarding any separate presentation of the COVID-19 impacts in the income statement because of their pervasiveness. Instead, it encourages preparers to disclose in the notes qualitative and quantitative information about impacts, including the methodology applied in their determination. It expects companies to choose a presentation that is not misleading and provides a clear and unbiased picture of the areas of the financial statements affected by COVID-19.

Preparers are also reminded to provide adequate cross-references if the information on the impact is disclosed in multiple notes to the financial statements.

For more information, see our article on **COVID-19 income statement impacts**.

IAS 36 *Impairment of Assets*

The recoverability of non-financial assets is a continuing concern. The adverse impact of COVID-19 may have resulted in the triggering of one or more impairment indicators in IAS 36. Consistent with its **previous statement** on half-yearly reports, ESMA continues to highlight the need to consider the effects of the COVID-19 pandemic in assessing any indicators of impairment for non-financial assets.

ESMA reminds preparers that an impairment test performed for the last interim reporting period does not replace the requirement to perform another when there is an indication of impairment. It emphasises that the scale of reasonably possible changes in the key assumptions used in impairment testing may be larger than usual. It also reminds preparers that the annual impairment test for a cash-generating unit (CGU) to which goodwill has been allocated is performed at the same time every year.

Application of IAS 36	Specific issues for preparers to consider
Measurement of the recoverable amount of assets	– Modelling multiple future scenarios when estimating the future cash flows of a CGU. Alternatively, further adjusting the discount rate to reflect the additional uncertainty (provided that the cash flows have not already been adjusted for the same risk). – Updating any assumptions used in previous periods to reflect the latest available information. – Giving greater weight to external evidence when determining cash flow projections. – Excluding cash flows from future uncommitted restructurings or asset enhancements in calculating value in use (VIU).

Disclosure	Meaningful disclosure of:
	– how uncertainty was factored into impairment testing;
	– the estimates and key assumptions used (including any changes during the year) – e.g
	  - if and when a return to pre-crisis cash-flow levels is realistic; and
	  - the time horizon considered in post-COVID-19 scenarios; and
	– the sensitivity of recoverable amounts to significant changes in key assumptions affected by COVID-19.

For more information, see our article on **non-financial assets**.

IFRS 9 *Financial Instruments* and IFRS 7

IFRS 9 for credit institutions

ESMA expects preparers to reflect the significant uncertainty affecting the economic environment in the measurement of expected credit losses (ECL) in an unbiased way. Companies are reminded to use all reasonable and supportable information, including economic forecasts, that is available without undue cost and effort.

Financial instruments risk disclosures

Adequate disclosure of risks arising from financial instruments, in particular liquidity risk and sensitivities to market risks, is essential. ESMA highlights that COVID-19 may have given rise to new significant financial risks – e.g. new liquidity risks arising from debt renegotiations – that did not exist before, or that were not previously considered significant.

Application of IFRS 7	Providing disclosures on:
Liquidity risk	– quantitative liquidity risk based on information provided to management; – the maturity analysis of financial liabilities and, if necessary, of financial assets used to manage liquidity risk; – supply chain financing or reverse factoring transactions;

Application of IFRS 7	Providing disclosures on:
Other financial risk management considerations	– how financial risks arise and how they are managed; – the specific objectives, policies and processes put in place to address those risks; – financial risk concentrations, including how they are measured; – details of forbearance or payment moratoria from lenders;
Credit institutions	– the approach to ECL measurement, especially any changes; – underlying information and assumptions used in ECL measurement – e.g. changes in macro-economic scenarios, the rationale and methodology underlying post-model adjustments and the specific risks that they capture; – the nature of changes in the loss allowance – e.g. changes due to sale, write-off or modification; – granular information on credit risk exposures, quality and concentrations, separately explaining those linked to COVID-19; – support measures granted to debtors and their effects – e.g. the impact on the assessment of significant increases in credit risk and the extent to which such measures have mitigated credit risk; and – sensitivity analyses of ECL calculations and staging.

For more information, see our suite of articles on the **impact of COVID-19 on financial instruments**.

IFRS 16 *Leases*

Application of IFRS 16	Providing disclosures on:

Lessee	– how companies have applied the practical expedient that provides relief to lessees when accounting for COVID-19-related rent concessions;
	  - concessions to which the practical expedient has been applied;
	  - the nature of the leases and/or concessions to which it has been applied, if it has not been applied to all eligible concessions;
	– depreciation and expenses – e.g. variable lease payments recognised in the income statement;
	– future cash flows not reflected in lease liabilities;
	– additional information on the impact of COVID-19;

Application of IFRS 16	Providing disclosures on:
Lessor	– the nature of rent concessions granted; – the accounting policy adopted for such concessions; and – the requirements of other standards for assets subject to operating leases.

For more information, see our article on **COVID-19 rent concessions**.

Other areas of focus

Non-financial information

Given the pervasive impact on companies' activities relating to non-financial matters, ESMA calls for transparency on the consequences of COVID-19 and the mitigating actions taken.

Topics	Providing disclosures on:
Social and employee matters	– inclusion and diversity, the fight against racism and inequality; – employee health and safety issues around workplaces, remote working and supply and contract chains;
Climate change risk	– measures to prevent and mitigate the consequences of climate change; – physical and transition risks related to climate change and any mitigating measures;
Business model and value creation	– the company's strategy and its implementation to give an understanding of the business model and its relationship with non-financial matters; – how the business model impacts, and is impacted by, non-financial matters; and – the resilience of the business model to the pandemic, including but not limited to: - the receipt of any government support; - changes in demand for products or services; and - changes in the value of assets.

Alternative performance measures

ESMA reminds preparers of the requirements in **its guidelines on alternative performance measures** (APMs), which are aimed at promoting the usefulness and transparency of these measures. ESMA also highlights its **guidance released in April 2020** to help preparers apply these guidelines in the current environment.

Other issues

ESMA also highlights the following areas.

– **Brexit** – companies are expected to monitor negotiations and to disclose the impact of Brexit on their activities and their financial and non-financial information. Visit the KPMG Brexit homepage to find out more about the impacts on your business.

- **European Single Electronic Format (ESEF)** – listed companies are reminded that the new requirements are effective for calendar 2020 year ends. However, in the context of COVID-19, the EU Council has proposed allowing member states to postpone implementation by one year.

Find out more

In addition to the guidance referred to above, the 2020 editions of our **guides** to annual financial statements include a **COVID-19 supplement**, **illustrative disclosures** and a companion **disclosure checklist**. With **Insights into IFRS**, our **web tool** on newly effective standards and our **COVID-19 financial reporting resource centre**, these form part of your reporting toolkit for the year end.

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