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ESMA enforcement priorities for 2021

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"Companies may face new challenges in preparing their 2021 annual reports. ESMA expects them to provide relevant and consistent information on climate-related matters in all parts of the report, and transparency in their reporting of the impacts of, and recovery from, the COVID-19 pandemic."

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Priorities for financial and non-financial information in 2021 annual reports

Highlights

- **Providing information on climate-related matters**
- **Transparent disclosure of impacts of COVID-19 pandemic**
- **Expected credit losses (ECL) disclosures of credit institutions**
- **Other issues**
- **Find out more**

The European regulator, ESMA[1], has issued a **statement** highlighting the areas that European national securities regulators will focus on when reviewing listed companies' 2021 annual reports. The aim is to promote the consistent application of IFRS® Standards and EU-specific reporting requirements.

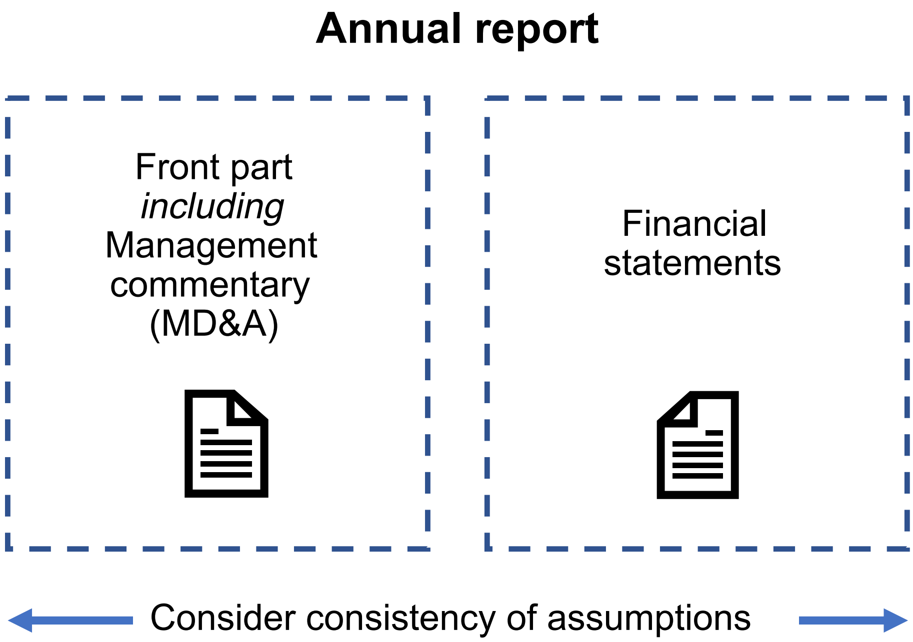
In view of growing demand from investors, ESMA stresses the importance of financial and non-financial information on climate-related matters. But with the COVID-19 pandemic ongoing, another key priority is transparent disclosure of information on the effects of the pandemic on a company's financial performance, position and cash flows, based on a careful assessment of its longer-term impacts. ESMA also calls for enhanced transparency regarding ECL measurement for credit institutions.

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. However, these topics are not exhaustive and national regulators may have additional areas of focus.

Providing information on climate-related matters

ESMA expects preparers to report material information on climate-related matters in their annual reports. It emphasises the need for consistency between information disclosed in the front end of their annual reports (e.g. in the management commentary or MD&A) and their financial statements.

1. European Securities and Markets Authority.



ESMA priorities related to the front end of the annual report

ESMA reminds preparers of the need to provide useful information to investors and stakeholders, particularly in relation to climate-related matters, and believes that good-practice disclosures in the front end would include:

- identified risks and opportunities and how these are addressed and managed;
- specific indicators, pre-defined targets and quantitative and qualitative explanations of the progress made towards these targets (e.g. greenhouse gas emissions), linking them to the company's broader strategy and plans;
- information on financial consequences arising from climate-related matters, which is expected to be consistent with corresponding disclosures in the financial statements (see below); and
- reasons why no information on climate-related matters is provided if such information is omitted.

ESMA priorities related to financial statements

ESMA expects information on climate-related risks in financial statements to be disclosed to the extent that the effects of those risks are material. When assessing the need to disclose information about climate-related risks, preparers should consider the guidance on materiality in IAS 1 *Presentation of Financial Statements*[2] and IFRS Practice Statement 2 *Making Materiality Judgements*. When assessing materiality, preparers also need to consider whether users of the financial statements might scrutinise information about transactions, events or conditions.

When assessing the impacts and risks of climate change, ESMA expects preparers to consider the **educational material** published by the International Accounting Standards Board[3]. See also our **Climate change financial reporting resource centre**.

2. Paragraph 7.
3. *Educational material: the effects of climate-related matters on financial statements prepared applying IFRS Standards*, November 2020.

Topic	ESMA's expectations on information to provide on climate-related matters
Presentation	– Present all disclosures related to climate-related risks in a single note, or alternatively map to the relevant notes – Tailor the information disclosed to the specific circumstances of each preparer – Present information that is not presented elsewhere in the financial statements but is relevant to users' understanding, as required by paragraph 112(c) of IAS 1 – Explain why apparently significant climate-related risks have not had a material impact on the financial statements – Disclose significant management judgements (e.g. climate-related scenarios underlying the assumptions used) – Disclose major sources of estimation uncertainty (e.g. in sensitivity analysis) – Explain the consistency between the forward-looking assumptions, estimates and judgements applied in the financial statements and the information in the front end – Disclose transparent information on the impact of carbon and greenhouse emissions trading schemes on financial performance and position, including the accounting policies used
Non-current assets	– (Re)assess expected useful lives of non-current assets and their estimated residual values. See also our **article** on this topic
Impairments of non-financial assets	– Identify indications of impairment resulting from climate-related risks – Reflect climate-related risks in key assumptions used and sensitivity analyses – Disclose the impact of climate change on the key assumptions used to determine the recoverable amount of an asset or cash-generating unit (CGU). See also our **article** on this topic
Provisions and contingencies	– Disclose contingent liabilities and recognised provisions for environmental damage caused, litigation, levies and penalties related to climate-related matters, onerous contracts and restructurings to achieve climate-related targets

Transparent disclosure of impacts of COVID-19 pandemic

ESMA priorities related to the front end of the annual report

ESMA re-emphasises[4] the need for transparency on how COVID-19 is impacting a company's economic activities, its business model (e.g. supply chain) and its non-financial KPIs (e.g. sustainability-related goals).

4. In its 2020 statement, ESMA highlighted areas where disclosures of the implications of COVID-19 could be relevant (e.g. social and employee matters or business model and value creation): see our previous **article**.

ESMA priorities related to financial statements

ESMA's recommendations from its **2020 statement** on the COVID-19 pandemic impacts remain valid – including those relating to going concern assumptions, significant judgements, estimation uncertainty, presentation of financial statements and impairment of assets. In addition, ESMA stresses the need for companies to provide relevant information on how they are recovering from COVID-19. It highlights the following areas for preparers to consider.

Topic	ESMA's expectations on transparent disclosure of COVID-19 impacts
Going concern	– Assess and disclose whether material uncertainties related to events or conditions that may cast doubt on the company's ability to continue as a going concern exist, if relevant **beyond** the 12-month period after the reporting date. See also our **article** on this topic
Supply chain financing	– Provide full transparency on supply chain financing arrangements and their impacts, including their classification in the balance sheet and the statement of cash flows, and the significant judgements involved – Provide transparent and company-specific information on liquidity risk under the requirements of IFRS 7 *Financial Instruments: Disclosures*, because these arrangements often give rise to liquidity risk
Disclosure on judgements and estimates	– Disclose information on changes in judgements, estimates and assumptions – e.g. the assumptions used (and respective sensitivity analyses) to determine whether an impairment or reversal of impairment of non-financial assets is recognised or whether the useful life of non-financial assets needs to be revised
Impairment of non-financial assets	– Assess carefully for indications of an impairment reversal – Reverse an impairment if, and only if, there has been a change in the estimate of the recoverable amount of the asset or CGU since recognising the last impairment loss. ESMA reminds preparers that an impairment loss is not reversed if an increase in the asset's value in use is exclusively due to the passage of time (i.e. 'unwinding' the discount). See also our **article** on this topic
Deferred tax assets	– Disclose the criteria and assumptions used when recognising deferred tax assets from unused tax losses/credits (e.g. convincing evidence). ESMA draws attention to its **statement**[5] on this issue
Government assistance	– Disclose information on significant government assistance received, including a description of: - the nature and extent of assistance by category (e.g. loans, tax relief, compensation schemes)

5. *Considerations on recognition of deferred tax assets arising from the carry-forward of unused tax losses*, 15 July 2019.

Topic	ESMA's expectations on transparent disclosure of COVID-19 impacts
	- its main characteristics (e.g. expected duration, reimbursement, main conditions) and effects of its termination - the related accounting and presentation policies – Consider the fact that the cessation of government assistance may impact the going concern assessment

ECL disclosures of credit institutions

ESMA's 2021 recommendations for credit institutions consider the preliminary results of its current review of ECL-related disclosures in the 2020 financial statements of a sample of European credit institutions. Its final report is expected by the end of 2021. ESMA's key expectations relating to disclosures on calculating ECL are as follows.

Topic	ESMA's expectations on ECL disclosures of credit institutions
Management overlays	– Disclose for each material adjustment detailed and specific information on its impact on the ECL estimate, the rationale and the methodology applied (including significant inputs and assumptions and the impact on staging where applicable)
Significant changes in credit risk/stage transfers	– Disclose the basis for the inputs, assumptions and the estimation techniques used to determine whether there is a significant increase in credit risk (SICR) of financial instruments since initial recognition or whether a financial asset is credit-impaired – Disclose details on whether and how a collective approach to measuring SICR has been applied
Forward-looking information	– Explain the main judgements and estimations related to uncertainties when explaining how forward-looking information has been incorporated into the determination of ECL, including how the impact of the pandemic has been considered in macroeconomic scenarios
Transparency on changes in loss allowances, credit risk exposures and collateral	– Provide a tabular reconciliation of the loss allowance, disaggregated by class of financial instrument, and narrative explanation, including an analysis of the reasons for changes – Provide an appropriate level of disaggregation in credit risk exposure information to make significant credit risk concentrations transparent – Provide granular disclosures on credit enhancements to enable users to understand material concentrations of credit risk
Effect of climate-related risk on the ECL measurement	– Explain how material climate-related and environmental risks are considered in credit risk management and incorporated in the calculation of ECL

Other issues

ESMA highlights the following areas.

Alternative performance measures

ESMA reminds preparers of the requirements in its **guidelines** on **alternative performance measures** (APMs) and the related **Q&A** that are aimed at promoting the usefulness and transparency of these measures. ESMA re-emphasises the need to:

- exercise caution when adjusting, labelling and/or creating new APMs to depict COVID-19 impacts;
- use meaningful labels for APMs (e.g. using 'EBITDA' for an adjusted EBITDA figure is misleading); and
- present neutral and unbiased APMs (e.g. not overly positive).

European Single Electronic Format

ESMA reminds preparers in the EU that the new requirements are effective for calendar 2021 year ends and all annual financial reports need to be prepared in compliance with the European Single Electronic Format (ESEF). See relevant guidance in the *ESEF Reporting Manual*.

Article 8 of the EU Taxonomy Regulation

ESMA also reminds preparers that the new requirements will come into effect from 2022 and they need to make necessary preparations to comply with the forthcoming disclosure requirements – e.g. updates to the internal reporting systems may be necessary.

Find out more

In addition to the guidance referred to above, the 2021 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 resource centres on the financial reporting impacts of **COVID-19** and **climate change**, these form part of your reporting toolkit for the year end.

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