CHAPTER 1

Enforcement Priorities for 2024 Corporate Reporting

This article aims to:

Summarise the important considerations for financial reporting for management of the companies, audit committees and auditors.

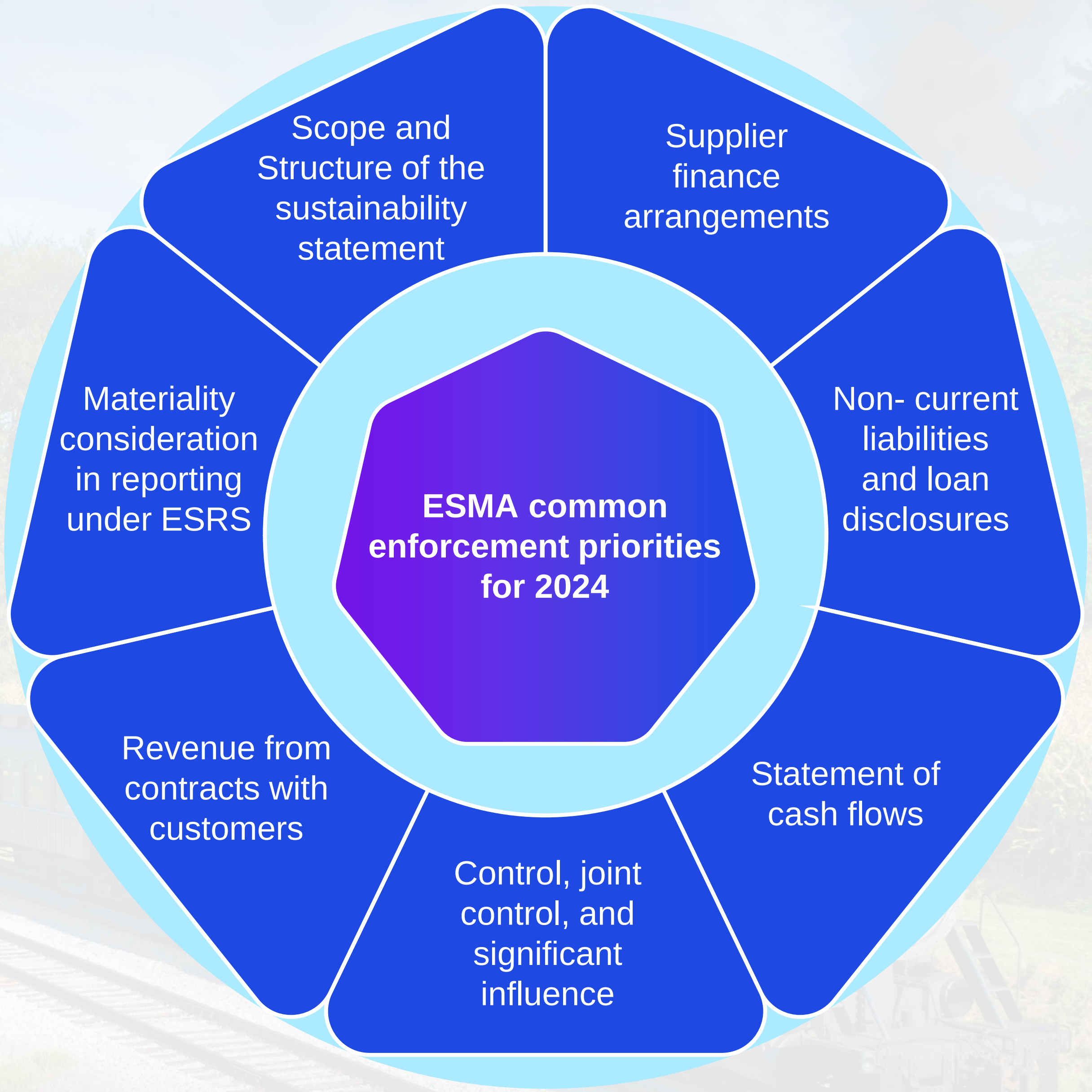
Introduction

The European Securities and Markets Authority (ESMA) has released its annual Public Statement outlining the European Common Enforcement Priorities (ECEP) for the 2024 annual financial reports of issuers trading on European Economic Area (EEA) regulated markets. ESMA, along with national enforcers in the EEA, will focus on these priorities when reviewing the application of relevant reporting requirements. They will also address other entity-specific issues and take enforcement actions if material misstatements are found, with ESMA reporting on their findings. Additionally, national priorities may be set by enforcers.

ESMA emphasises the responsibility of management and supervisory bodies of issuers, highlighting the importance of audit committees in ensuring the internal consistency of annual financial reports, supervising internal controls, and contributing to high-quality reports. Issuers, auditors, and supervisory bodies are urged to consider the topics and recommendations in the Public Statement when preparing, auditing, and supervising the 2024 annual financial reports, taking into account their materiality and relevance to the issuer's operations.

Key areas considered

ESMA considered topics from IFRS financial statements, sustainability statements, and annual financial reports. In this article, we have highlighted important IFRS financial statements and sustainability statements enforcement priorities.



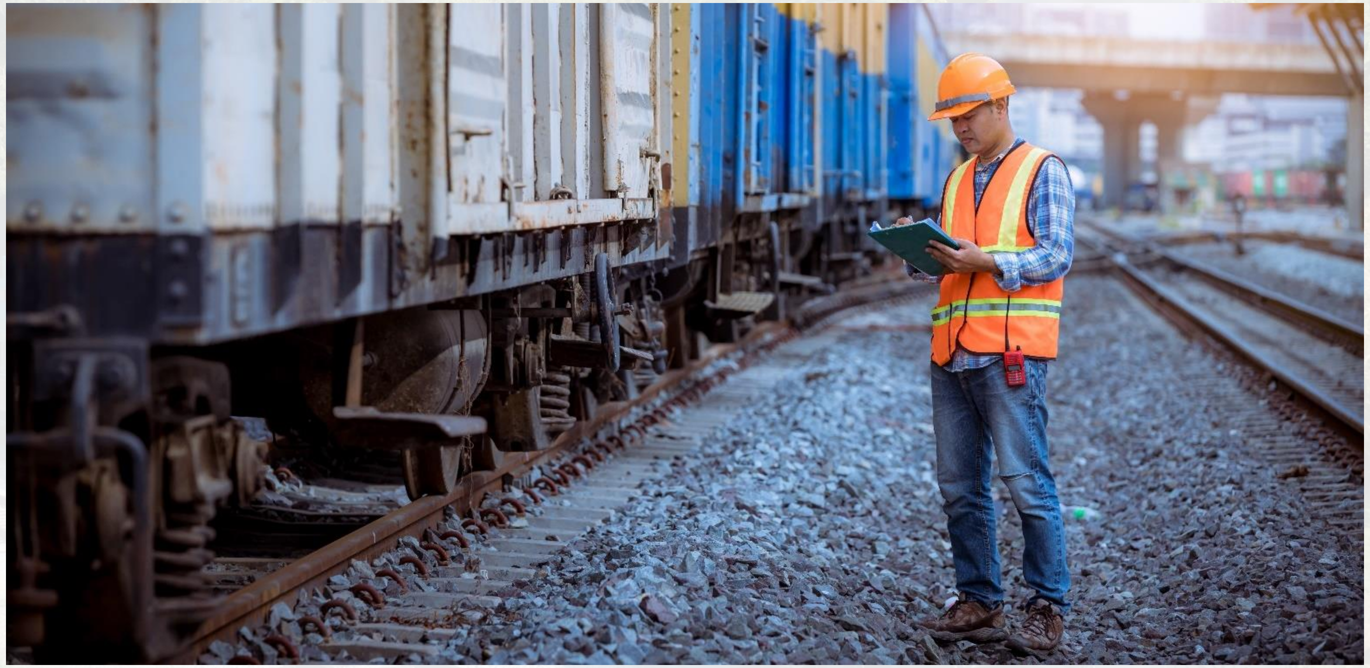
Priorities related to IFRS financial statements

Liquidity considerations

1. **Supplier Finance Arrangements (SFA):** Liquidity risk disclosures are important, focusing on new IAS 7, *Statement of Cash Flows* requirements for Supplier Finance Arrangements (SFA). Issuers must identify all material SFAs and disclose terms, conditions, and non-cash changes. Specific information on financial liabilities and payment due dates must be provided. Explanatory information is needed for wide payment ranges. Access to SFAs should be considered under IFRS 7 liquidity risk disclosures (IFRS 7, *Financial Instruments: Disclosures*).
2. **Clarifications on non-current liabilities and loan disclosures:** ESMA has issued a reminder to issuers regarding the clarifications and new disclosures under IAS 1, *Presentation of Financial Statements* related to non-current liabilities with covenants, as well as the disclosures required by IFRS 7 concerning loans payable. These reminders are particularly relevant in cases of defaults, breaches, or renegotiations of loan agreements. Paragraph 76ZA of IAS 1, mandates the disclosure of information that helps users of financial statements understand the risk that liabilities could become repayable within twelve months after the reporting period. This is crucial when issuers classify liabilities arising from loan arrangements as non-current, and when the right to defer settlement of those liabilities is subject to compliance with covenants within 12 months after the reporting period.
3. **Statement of cash flows:** ESMA also highlights several requirements where enforcers have previously identified non-compliance:
   - **Cash flows presentation:** Cash flows in the Statement of Cash Flows (SCF) must be presented on a gross basis. Non-cash transactions cannot be included in the SCF, and material non-cash transactions related to investing and financing must be disclosed elsewhere in the financial statements.
   - **Bank borrowings:** Bank borrowings are generally considered financing activities. However, bank overdrafts that are repayable on demand and form an integral part of an entity's cash management can be included as a component of cash and cash equivalents. Banking facility arrangements should be presented as financing activities unless there is frequent fluctuation between negative and positive balances.
   - **Transparency in accounting policies:** Issuers must be transparent about their accounting policies and judgements regarding the classification of cash flows, such as interest, dividends, cash flows from leases, and other complex or infrequent transactions, as well as components of cash and cash equivalents.

Accounting policies, judgements, significant estimates

1. **General remarks:** ESMA emphasises that disclosures of material accounting policies, judgements, and sources of estimation uncertainty should be entity-specific and consistent with other information within the financial statements. Issuers should avoid merely repeating IFRS requirements to prevent boilerplate disclosures that obscure relevant information. They should clearly disclose the judgements that have the most significant effect on the amounts recognised in the financial statements and the assumptions about the future that have a significant risk of resulting in material adjustments to the carrying amount of assets and liabilities within the next financial year. Additionally, issuers should assess and explain how estimation uncertainty is affected by significant current developments, such as macroeconomic, technological, social, climatic, and geopolitical factors.
2. **Control, joint control, and significant influence:** ESMA highlights that determining whether an issuer controls an entity or has significant influence over an investee often requires significant judgement. This is especially true when factors other than voting rights need to be considered. These factors include special rights under contracts, specific legal regimes, legal provisions limiting capital involvement, and temporary circumstances like holding options on the investee's equity. Issuers should adhere to the requirements of paragraphs 7-9 of IFRS 12, *Disclosure of Interests in Other Entities*, and provide clear and detailed disclosures about the significant judgements made when assessing control, joint control, and significant influence.
3. **Revenue from contracts with customers:** ESMA notes that assessing whether long-term contracts meet the definition of a contract with a customer may require significant judgement, and issuers should disclose these judgements. For long-term contracts, there is often uncertainty regarding revenues and costs, and issuers should ensure forecasts are reasonable and supportable. For onerous contracts, the present obligation should be recognised as a provision. ESMA also highlights the need for disclosures under IAS 37, *Provisions, Contingent Liabilities and Contingent Assets*, including uncertainties about the amount and timing of outflows of economic benefits. When another party is involved in providing goods or services, the recognition of revenue depends on whether the issuer acts as principal or agent, requiring significant judgement. ESMA emphasises the importance of disclosing the amount and timing of revenue expected from existing contracts and providing reconciliations of remaining performance obligations. Issuers should comply with ESMA Guidelines on Alternative Performance Measures when including backlog measures in the management report.



Priorities related to sustainability statements

Materiality consideration in reporting under ESRS

Conducting a thorough materiality assessment is crucial for determining the information to be disclosed in the sustainability statement under European Sustainability Reporting Standards (ESRS). ESMA recommends following EFRAG's Implementation Guidance on Materiality Assessment. Detailed disclosures on the assessment process are essential for users to understand the steps taken to reach materiality conclusions. This includes information on activities, business relationships, geographies, and stakeholders considered. The sustainability due diligence process and stakeholder engagement are key aspects of the materiality assessment. ESMA emphasises the importance of transparency and the need to comply with mandatory disclosure requirements, even if the related topics are not found to be material. Issuers must also provide explanations for any omitted disclosures and include a content index for easier navigation.

Scope and structure of the sustainability statement

The sustainability statement must align with the financial statements, using the same scope of consolidation for both. It should cover material impacts, risks, and opportunities (IROs) related to the value chain. Transitional reliefs for value chain information are available for the first three years, but issuers must explain efforts to obtain necessary information. The structure of the sustainability statement is prescribed, with options for incorporation by reference. Issuers should ensure compliance with ESRS requirements and facilitate access and understanding of the information. Connections to other parts of corporate reporting must be clear, with references to corresponding financial statement information.

Conclusion

In conclusion, ESMA's enforcement priorities for 2024 emphasise the importance of transparency, accuracy, and compliance in both financial and sustainability reporting. Issuers must ensure that their disclosures are entity-specific, consistent, and provide a clear understanding of their financial position and sustainability practices. By adhering to these priorities, issuers can enhance the quality of their reports, build trust with stakeholders, and contribute to a more transparent and accountable financial market.

In the Indian context, the Securities and Exchange Board of India (SEBI) has also been emphasising the importance of transparency and accuracy in corporate reporting. Indian companies are required to comply with the Indian Accounting Standards (Ind AS), which are converged with IFRS. SEBI has been proactive in ensuring that companies provide detailed disclosures on financial and sustainability matters, similar to the requirements set by ESMA. Indian companies should take note of ESMA's enforcement priorities and align their reporting practices to meet global standards, thereby enhancing their credibility and attractiveness to international investors.