

## PUBLIC STATEMENT

### European common enforcement priorities for 2018 annual financial reports

The European Securities and Markets Authority (ESMA) issues its annual Public Statement defining the European common enforcement priorities and highlighting other considerations for 2018 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 all respective requirements. Enforcers will continue to focus on material issues that are relevant for an individual issuer examined. Based on examinations performed, enforcers will take corrective actions whenever material misstatements are identified and ESMA will report subsequently on their findings. In addition to the European common enforcement priorities, enforcers might set additional national enforcement priorities focusing on other relevant topics.

The common enforcement priorities for 2018 year-end, outlined in Section 1 of this Statement are:

1. Specific issues related to the application of IFRS 15 *Revenue from Contracts with Customers*;
2. Specific issues related to the application of IFRS 9 *Financial Instruments*; and
3. Disclosure of the expected impact of implementation of IFRS 16 *Leases*.

ESMA selected these topics based on the anticipated significant changes that the new requirements have introduced. Furthermore, in light of their continuing relevance, ESMA and enforcers will continue to assess relevant issues monitored in previous years. Finally, ESMA highlights financial reporting consequences of Argentina being classified as a hyperinflationary economy under IFRS as of 1 July 2018.

ESMA highlights the importance of issuers being specific in their disclosure in their financial reports and providing informative description and explanation of the issues that are relevant to the understanding of the entity's financial performance and financial position.

In addition to the common enforcement priorities outlined above, ESMA highlights specific requirements relating to the sections of the annual financial report other than the financial statements. As outlined in Section 2 of this Statement, these include the requirements with regards to:

- the disclosures of non-financial information with particular focus on: environmental and climate change-related matters, explanation as to why certain policies were not pursued; and key-performance indicators relating to non-financial policies; and
- specific aspects of the ESMA Guidelines on Alternative Performance Measures (APMs), namely the definition and explanation of APMs and the principle of prominence.

Finally, ESMA highlights the importance of disclosures on the impact of the decision of the United Kingdom to leave the European Union (Brexit). ESMA reminds issuers to closely follow the impact that Brexit negotiations will have on their activities. ESMA notes that the details of the exit scenario might become clearer by the date the 2018 annual financial reports are authorised for issue and thus issuers should provide sufficient transparency on its impact on their exposures and activities as well as risks and sources of estimation uncertainty and the way these are managed based on the specific circumstances of individual issuers.

## SECTION 1: PRIORITIES RELATED TO IFRS FINANCIAL STATEMENTS

### 1. Application of IFRS 15

The year 2018 is the first year in which IFRS 15 was mandatorily applied by all entities. In light of the importance of revenue for financial reporting, IFRS 15 changes the main notions and principles of revenue recognition, even if the quantitative impact is not material at the date of transition. Consequently, irrespective of the significance of the impact, entity-specific accounting policies should be clear as to how the IFRS 15 principles apply to the entity's revenue streams.

ESMA also reminds issuers of the importance of disclosing the entity-specific transition impact accompanied by explanations for each significant effect having material impact on financial position and performance. ESMA also reiterates that issuers need to provide transparency on the transition method applied. In this respect, when the modified retrospective method is used in accordance with paragraph C3(b) of IFRS 15, paragraph C8 of IFRS 15 requires additional disclosures for reporting periods that include the date of initial application. These include the amount by which each financial statement line item is affected in the current reporting period by the application of IFRS 15 as compared to the previously applied requirements and an explanation of the reasons for significant changes.

#### *Identification and satisfaction of performance obligation*

ESMA reminds issuers that the application of the new requirements set out in paragraphs 22-30 of IFRS 15 for identifying performance obligations may require unbundling of contracts (e.g. in the telecommunication and media industries) and thus might lead to different revenue recognition patterns, in timing and/or amount, that need to be clearly explained. Furthermore, application of the new requirements on satisfaction of performance obligation and transfer of control of the goods or services to the customer, set out in paragraphs 31-38 of IFRS 15 might lead to a change in the pattern of revenue recognition from point in time to over time and vice versa (e.g. in the real estate and construction industries). Should that be the case, ESMA highlights the need for additional transparency in this respect and appropriate explanation of the drivers of such change.

ESMA reminds issuers of the criteria to assess whether a performance obligation is satisfied over time in accordance with paragraph 35 of IFRS 15. In particular, one of those criteria<sup>1</sup> states that revenue can only be recognised over time if the entity's performance does not create an asset with an alternative use to the entity and the entity has an enforceable right to payment for performance completed to date.<sup>2</sup> In this respect, the decisions of the IFRS Interpretations Committee (IFRS IC) in March 2018<sup>3</sup> provide additional insight on application of these criteria to different specific fact patterns. ESMA encourages issuers to assess whether these agenda decisions have any impact on their assessment of application of IFRS 15 as these agenda decisions articulate the underlying thinking of paragraph 35 of IFRS 15 and, hence, can inform how to apply IFRS 15 to other fact patterns.

#### *Principal versus agent assessment*

ESMA recalls that the fundamental principle behind revenue recognition is the transfer of control. Paragraph B35 of IFRS 15 highlights that an entity acts as a principal if it controls the goods or services before it transfers

---

<sup>1</sup> paragraph 35(c) of IFRS 15

<sup>2</sup> paragraphs 36 and 37 of IFRS 15

<sup>3</sup> <https://www.ifrs.org/news-and-events/updates/ifric-updates/march-2018/>

the goods or services to a customer and paragraph B37 of IFRS 15 provides some indicators for the analysis. The assessment whether the entity is an agent or principal needs to be made with this fundamental principle in mind, depending on the contractual arrangements and can be complex and highly judgemental. Therefore, ESMA reiterates the importance of the disclosures of significant judgements and assumptions in this respect, as required by paragraph 123 of IFRS 15, in particular as the IFRS 15 analysis can lead to a different conclusion than the previous accounting treatment.

#### *Allocation of transaction price to multiple performance obligations*

In case of several performance obligations within a contract, paragraphs 73-80 of IFRS 15 require an allocation of the transaction price to each performance obligation on a relative stand-alone selling price basis. Hence, ESMA highlights the importance of considering all information and maximising the use of observable inputs as required in paragraph 78 of IFRS 15. Even if a stand-alone selling price is not observable in the market, the issuer shall maximise the use of observable inputs and apply estimation methods consistently.

#### *Presentation of contract assets and contract liabilities upon transition*

ESMA reminds issuers of IFRS 15 requirements related to presentation and disclosure of contract assets and contract liabilities. In particular, the disclosure requirements of paragraph 118 of IFRS 15 entail both quantitative and qualitative explanation of the significant changes in the contract asset and the contract liability balances during the reporting period. ESMA notes that users of financial statements need to understand the relationship between the revenue recognised in a reporting period and the changes in the balances of the entity's contract assets and contract liabilities to assess the nature, amount, timing and uncertainty of revenue and cash flows arising from an entity's contracts with customers. Finally, ESMA also notes that contract assets are subject to the expected credit loss model and respective disclosures.

#### *Disaggregation of revenue*

ESMA underlines the requirements of paragraph 114 of IFRS 15 with regards to the disclosure of the revenue disaggregated into categories that depict how the nature, amount, timing and uncertainty of revenue and cash flows are affected by economic factors. In particular, while the level of disaggregation depends on the facts and circumstances that pertain to the entity's contracts with customers, such disaggregation should be sufficient for users to understand the main drivers in revenues. In this context, issuers are reminded to consider carefully information about revenue provided by the entity for other purposes (referred to in paragraph B88 of IFRS 15) as well as the examples of categories provided in paragraph B89 of IFRS 15. This could imply disaggregation of revenue in a further detail than previously required (e.g. in accordance with *IFRS 8 Operating Segments*).

#### *Disclosure objectives of IFRS 15 and Disclosure of significant judgements*

Disclosure objectives articulated by paragraph 110 of IFRS 15 require issuers to disclose sufficient information to enable users of financial statements to understand the nature, amount, timing and uncertainty of revenue and cash flows arising from contracts with customers. This might require issuers to provide more granular information in the financial statements than disclosed previously. For example, ESMA highlights that the scope of the disclosure of remaining performance obligations required in paragraph 120 of IFRS 15 is extensive and issuers might have to provide additional information. In this respect, ESMA notes that Illustrative Example 42 shows that any backlog disclosure should be accompanied by sufficient explanations.

As the application of IFRS 15 relies on the analysis of the individual contractual relationships with its customers, issuers should provide sufficient transparency of the significant judgements made and key assumptions used. When providing such disclosures, ESMA expects issuers to describe and explain the rationale for the significant judgements made. Paragraph 123 of IFRS 15 includes a general requirement to disclose the judgements, and changes in the judgements, made in applying IFRS 15 that significantly affect the determination of the amount and timing of revenue from contracts with customers. ESMA notes that disclosure of some of the significant judgements is explicitly required.<sup>4</sup> At the same time, ESMA is of the view that some of the other common significant judgements that might need to be disclosed include judgements on identification of separate performance obligations (e.g. for warranty or maintenance phases that might be of particular relevance in the retail industry) and treatment of upfront fees and pre-production costs (e.g. in the construction or outsourcing industries).

Finally, ESMA also draws issuers' attention to the disclosure requirements of paragraphs 127-128 of IFRS 15 on disclosure of judgements made in determining the amount of the costs incurred to obtain or fulfil a contract with a customer, the amortisation methods and related impacts recognised in the reporting period.

## 2. Application of IFRS 9

With regards to the initial application of IFRS 9, ESMA highlights that IFRS 7 *Financial instruments: Disclosures* contains a detailed set of disclosure requirements for the period that includes the date of initial application of IFRS 9 in order to meet the objectives of IFRS 7.<sup>5</sup> These include the requirements to disclose:

- i. reclassifications of financial assets and financial liabilities upon the initial application of IFRS 9;
- ii. a reconciliation of the closing impairment allowances under IAS 39 *Financial Instruments: Recognition and Measurement* to the opening impairment allowances under IFRS 9 disaggregated by measurement category.

Disclosure of further disaggregation of such reconciliations (at least by class of financial assets as identified in accordance with paragraph 6 of IFRS 7) together with a narrative explanation of the main drivers of the impact, including the impact on performance, may be relevant depending on circumstances.

While credit institutions are expected to be most significantly impacted by IFRS 9, this standard is applicable to all issuers. ESMA expects issuers to provide relevant, material and entity-specific disclosures, taking into account the importance of financial instruments in their business operations. ESMA reminds issuers that the new impairment model, subject to certain simplifications also applies to trade receivables, contract assets and lease receivables. Where appropriate, issuers shall disclose the eventual changes made to accounting policies due to IFRS 9 implementation, such as to policies on modification/de-recognition and write-off of financial assets.

### *Presentation of interest revenue*

ESMA highlights the March 2018 IFRS IC agenda decision<sup>6</sup> on application of paragraph 82(a) of IAS 1 which requires issuers to present separately, the amount of interest revenue calculated using the effective interest

---

<sup>4</sup> e.g. paragraphs 124-125 of IFRS 15 on disclosure of determining the timing of satisfaction of performance obligations and paragraph 126 of IFRS 15 on determining the transaction price and the amounts allocated to performance obligations

<sup>5</sup> paragraphs 42I to 42S of IFRS 7

<sup>6</sup> Agenda Decision, Presentation of interest revenue for particular financial instruments, IFRIC Update, March 2018

method for financial assets that are subsequently measured at amortised cost or fair value through other comprehensive income in accordance with paragraphs 4.1.2 or 4.1.2A of IFRS 9. ESMA also notes that paragraph 82(ba) of IAS 1 requires to include a specific line item in the profit or loss with impairment losses (including reversals of impairment losses or impairment gains) determined in accordance with IFRS 9.

#### *Hedge accounting*

ESMA reminds issuers of the new disclosures required by IFRS 7 in relation to hedge accounting<sup>7</sup> which apply to all issuers, including those which choose not to apply the hedge accounting requirements of IFRS 9 but continue to apply the hedge accounting requirements in IAS 39. The disclosures should be transparent and proportionate to the impact and significance of the exposure to the risks from the hedge items and be disaggregated by risk category on the basis of the risks hedged for accounting purposes.

#### ***Specific considerations related to application of IFRS 9 for credit institutions***

ESMA highlights the importance of transparent disclosure of the initial application of IFRS 9 by credit institutions who should explain in detail the nature and drivers of the impact on financial position, performance as well as accounting equity. Where applicable, ESMA encourages disclosure of the impact on applicable prudential ratios, including use of any transitional arrangements on these ratios in the financial statements.<sup>8</sup> In the context of cooperation between accounting enforcers and prudential supervisors, ESMA welcomes the ongoing initiatives undertaken by the European Banking Authority (EBA) to monitor the implementation of IFRS 9 by the European banking sector from the prudential perspective.

The new expected credit loss (ECL) model is dependent on entity-specific assumptions, methods and inputs. ESMA considers that taking into account the requirements of paragraphs 35D, 35F and 35G of IFRS 7, material assumptions are required to be disclosed and the disclosure should be sufficiently disaggregated in line with internal credit risk management strategies and, as appropriate, based on different type of products or geographical markets. Furthermore, in addition to the IFRS 7 specific disclosure requirements, ESMA highlights that the general disclosure requirements on judgments and sources of estimation uncertainty (including in some case sensitivity of carrying amounts to methods and assumptions) in IAS 1 are also applicable to the new ECL model, when relevant. ESMA also reminds credit institutions of the requirements of paragraph 35F(b) of IFRS 7 with regards to disclosure of the definitions of default applied, including the reasons for selecting those definitions and encourages credit institutions to describe to which extent those definitions align to the definition of default used for regulatory purposes, where appropriate.

#### *Significant Increase in Credit Risk (SICR)*

ESMA considers that credit institutions should disclose their approach to setting the criteria for identifying SICR for material portfolios, and provide material judgements related to the SICR assessment in accordance with paragraphs 35F(a) and 35G(a)(ii) of IFRS 7. In this respect, ESMA considers that the disclosures should provide sufficient transparency on the qualitative (e.g. type of event or measures taken, backstop criteria such as forbearance etc.) and quantitative factors (e.g. indicators used, setting of thresholds, extent to which issuer

---

<sup>7</sup> paragraphs 21A to 24F of IFRS 7

<sup>8</sup> As a reference, see also EBA Guidelines on disclosure requirements of IFRS 9 transitional arrangements (EBA/GL/2018/01) for disclosure of the IFRS 9 transitional arrangements in the Pillar III reports

relies on the 30-days past due backstop, etc.) taken into account in the determination of SICR by the entity. In addition, factors taken into account in assessing the reversal of SICR, including the use of ‘*probation*’ or ‘*cure*’ periods, if any, should be disclosed. Furthermore, ESMA also highlights that SICR might need to be assessed at portfolio level<sup>9</sup> and the way such a portfolio approach is used should be explained.

#### *Incorporating forward looking information into ECL models*

ESMA considers that credit institutions should be specific when disclosing how they determine ECL, including key factors and assumptions used in the ECL calculation as required by paragraphs 35D and 35G(a)(i) of IFRS 7, disaggregated by type of instruments, portfolios or geographical markets. ESMA highlights the need to take into account forward-looking information when determining the probability-weighted estimate of credit losses. Furthermore, issuers are reminded that disclosures need to comply with paragraph 35G(b) of IFRS 7 regarding the approach to incorporating forward-looking information in the ECL calculation, including use of macroeconomic information (comprising quantification of the macroeconomic variables used) and the way this information has been incorporated in the ECL model. ESMA reminds credit institutions that in order to comply with IFRS 9 it might be necessary to use multiple scenarios to determine ECL as required by paragraph 5.5.17(a) of IFRS 9.<sup>10</sup>

#### *Reconciliations*

Disclosures provided by credit institutions should be sufficient to enable users to understand factors giving rise to the credit losses, and their significant movements. Paragraph 35H of IFRS 7 requires a reconciliation of the loss allowance from the opening to closing balance, and paragraph 35I of IFRS 7 requires an explanation of how significant changes in the gross carrying amount of financial instruments during the period contributed to changes in the loss allowance. ESMA emphasises that an appropriate level of detail is expected in relation to the type of changes presented in these reconciliations, including all relevant qualitative and quantitative information. For example, if the respective gross flows are significant, ESMA considers that the amount of transfers from 12-month ECL to lifetime ECL (and from stage 2 to stage 3) and vice versa should be disclosed separately, accompanied by the amounts of write-offs, and other de-recognition events as well as the impact of new lending or purchases of financial assets.

#### *Credit-impaired financial assets*

ESMA notes that a number of credit institutions reported a material impact from the initial application of IFRS 9 on the measurement of credit-impaired financial assets. ESMA reiterates the message from its 2017 public statement,<sup>11</sup> urging issuers with material amounts of credit-impaired loans to evaluate critically whether their estimate of the expected cash flows from the credit impaired loans and where relevant from the related collateral or from sale of these loans are realistic and unbiased, in accordance with the new IFRS 9 ECL model.

#### *Consideration of sale of loan scenario in ECL calculation*

ESMA also reminds issuers that IFRS 9 requires that cash flows expected from the sale of defaulted loans should be included in the measurement of expected credit losses, if selling the loan is one of the recovery

---

<sup>9</sup> paragraph B5.5.1 of IFRS 9, exemplified by Illustrative Example 5

<sup>10</sup> The scenarios should consider different risk scenarios, including e.g., where relevant, risks related to the repricing of risk premia and increasing interest rates as identified by the September 2018 Joint Committee Report on Risk and Vulnerabilities in the EU Financial System

<sup>11</sup> Public Statement, European Common Enforcement Priorities for 2017 IFRS financial statements, 27 October 2017, ESMA32-63-340



methods that the entity reasonably expects to pursue in a default scenario and provided such expectations are clearly evidenced, and supported, by its intention and ability to sell. Should that be the case, inclusion of the recovery sale proceeds in the measurement of expected credit losses would be appropriate for financial instruments in all three stages.<sup>12</sup>

#### *Solely Payments of Principal and Interest test (SPPI)*

With regards to the classification and measurement of financial assets, ESMA highlights that the SPPI (solely payments of principal and interest) test needs to be applied on an instrument-by-instrument basis. When analysing the contractual characteristics of the instrument, different factors might be relevant in assessment of the SPPI criterion and might require judgement. In particular, issuers should be careful when assessing instruments with non-recourse features, which should be analysed based on the 'look-through' approach,<sup>13</sup> considering whether the payments under the financial asset represent compensation for the time value of money and credit risk of the borrower or if they represent a different type of cash flows. Furthermore, ESMA considers that when material, judgements on application of SPPI criteria shall be disclosed.

#### ***Specific considerations related to application of IFRS 9 for insurance undertakings/conglomerates***

ESMA notes that the amendments to IFRS 4 Insurance Contracts<sup>14</sup> permit a reporting entity whose activities are predominantly connected with insurance to continue to apply IAS 39 rather than IFRS 9 until 2021. As required by paragraph 39C of IFRS 4 ESMA expects issuers using the temporary exemption from IFRS 9 to provide relevant and appropriate information on assumptions and judgements made when determining that they fulfil the qualifying requirements of paragraph 20D of IFRS 4. ESMA also highlights the additional disclosures needed based on paragraphs 39E and 39G of IFRS 4.

ESMA recalls that the Commission Regulation<sup>15</sup> allows the use of the temporary exemption option for consolidated financial statements of banking-led financial conglomerates with regards to legal entities in the insurance sector, subject to certain conditions. ESMA expects that issuers benefiting from this option explicitly disclose why the conditions of this Commission Regulation apply to them and how the option is being applied. Particularly, ESMA highlights the importance of disclosing the amount of financial assets for which the temporary exemption from the application of IFRS 9 is applied as well as the nature and extent of significant restrictions on the use of the group's assets subject to the transfer ban. ESMA highlights that enforcers will closely scrutinise the compliance of issuers using the temporary exemption with the conditions authorising its use. Furthermore, ESMA reminds issuers that for those entities in the group that are not eligible for the temporary exemption, full disclosure on initial application of IFRS 9 should be provided.

### **3. Disclosure related to the expected impact of implementation of IFRS 16**

IFRS 16 will replace the requirements in IAS 17 *Leases* and related interpretations, and will become mandatorily applicable from 1 January 2019. ESMA highlights the need for high-quality implementation of IFRS 16

---

<sup>12</sup> See December 2015 Meeting Summary of Transition resource Group for Impairment of Financial Instruments (paragraphs 19-24)

<sup>13</sup> paragraph B4.1.17 of IFRS 9

<sup>14</sup> Amendments to IFRS 4: Applying IFRS 9 *Financial Instruments* with IFRS 4 *Insurance Contracts* issued in September 2016

<sup>15</sup> Commission Regulation (EU) 2017/1988 of 3 November 2017 (OJ L 291, 9.11.2017, p. 72–83)

and communication of its expected impact on the financial statements in the period of their initial application, as required by IAS 8 *Accounting Policies, Changes in Accounting Estimates and Errors*.

ESMA expects that entity-specific quantitative and qualitative disclosures about the application of IFRS 16 will be provided in accordance with paragraph 30 of IAS 8. As the 2018 annual financial statements will be published after the requirements in IFRS 16 become effective, ESMA expects that issuers will have substantially completed their implementation. Therefore, ESMA expects that the impacts of the initial application of the new standard will be known or reasonably estimable at the time of the preparation of the 2018 accounts and thus should be disclosed. In ESMA's view, such disclosure should include sufficiently disaggregated information on accounting policy choices expected to be applied, including those relating to the transition approach and the use of practical expedients. When explaining the impacts, issuers expected to be significantly impacted by the new standard are encouraged to consider what information would enable analysts and other users to update their models.

Paragraph 31 of IAS 8 states that issuers should consider disclosing the nature of the impending changes in accounting policy. When providing these disclosures, ESMA recommends that issuers focus on disclosing a concise entity-specific description of the changes introduced by IFRS 16 and the judgements and choices the entity has made thus enabling users to assess the impacts. In ESMA's view, this description should include, for example considerations such as the nature and characteristics of contract types, and, where significant judgement was involved, the main assumptions used in the determination of right of use assets and lease liabilities (such as assessment whether a contract contains a lease in line with paragraphs 9-11 of IFRS 16, determination of lease terms in accordance with paragraphs B34-B41 of IFRS 16 and discount rates as well as consideration of separation of the service and lease components of a contract).

ESMA notes that once IFRS 16 is applied disclosures required by Appendix C of the standard relating to the initial application and chosen method of transition will need to be provided. Particularly, ESMA reminds issuers that when applying the simplified transition approach issuers are required by paragraph C12(b) of IFRS 16 to explain any difference between operating lease commitments disclosed applying IAS 17 and lease liabilities recognised as at the date of application of IFRS 16 and that, in accordance with paragraph C7 of IFRS 16, comparative information cannot be restated. If restated comparative information is presented in the financial communication, outside of the financial statements, it will fall under the scope of the *ESMA Guidelines on APMs*.

ESMA also encourages disclosure, where material, of assumptions and judgments used in estimating the discount rate used in determining the present value of the remaining lease payments and in recognising the right-of-use assets upon transition in accordance with paragraph C8 of IFRS 16.

Finally, ESMA expects that, based on the 2018 accounts, users will try to make a link between minimum lease payments for operating leases disclosed based on the requirements of IAS 17 and IFRS 16 impacts; hence, issuers are encouraged to explain these differences.





## SECTION 2: TOPICS RELATED TO OTHER PARTS OF THE ANNUAL REPORT

### ***Non-financial information***

ESMA reminds issuers<sup>16</sup> of the requirements in Article 19a of the Accounting Directive<sup>17</sup> as transposed in the law of the Member State. Those requirements aim at improving transparency on aspects relating, at a minimum, to environmental, social and employee matters, respect for human rights, anti-corruption and bribery matters (hereafter '*non-financial information*'). ESMA highlights that the required disclosures shall reflect relevant, material and entity-specific information. The European Commission's Guidelines on non-financial reporting<sup>18</sup> (the 'EC Guidelines') include principles that may assist issuers in providing disclosures that fulfil the relevant requirements on non-financial information. In addition, in order to improve comparability and promote a better understanding of the disclosures provided, ESMA reminds issuers of the requirement to disclose any specific disclosure framework based on which, partly or in full, disclosures of non-financial information have been provided. In this respect, ESMA recalls that the EC Guidelines indicate that companies may choose to use widely accepted, high quality international, EU-based or national reporting frameworks and that, when doing so, disclosure of the framework(s) used enhances clarity and comparability of the information provided.

### ***Environmental matters***

Taking into account the increasing relevance of sustainability matters relating to the environment also in the context of the European Commission's Action Plan on Financing Sustainable Growth,<sup>19</sup> ESMA particularly highlights the requirements in Article 19a of the Accounting Directive to disclose a description of the policy addressing environmental matters which ESMA considers should include climate change-related matters. These disclosures shall include information on the due diligence processes implemented, together with an indication of the outcome of those policies. In this respect, ESMA notes that issuers shall also provide disclosure of any related non-financial key performance indicators (KPIs) that are relevant to an issuer's particular business in relation to the application of this policy.

ESMA also highlights that, in fulfilling the requirement to disclose the impact of environmental matters, issuers should disclose, as also recommended in the EC Guidelines, information on both the actual and potential impacts relating to environmental matters. Furthermore, ESMA notes that Article 19a of the Accounting Directive requires issuers to provide information on the principal risks related to environmental matters, which should include also climate change related aspects, stemming from the issuer's operations, or which may be linked to its business relationships and products or services. In this respect, ESMA highlights that the EC Guidelines clarify that issuers are expected to disclose relevant information on both the impacts of their operations on the environment and how environmental matters may affect the company's development, performance or position. For example, issuers may need to consider whether, as a consequence of climate change,

---

<sup>16</sup> Article 19a of the Accounting Directive is applicable to '*Large undertakings which are public-interest entities exceeding on their balance sheet dates the criterion of the average number of 500 employees during the financial year.*' According to local transposition measures other entities may also be this scope of these requirements.

<sup>17</sup> Directive 2013/34/EU, amended by Directive 2014/95/EU, as transposed in the individual members states. The considerations in the rest of this document, where relevant, also apply to non-financial statements included in a separate report and to consolidated non-financial statements prepared in accordance with Article 29a of the Accounting Directive.

<sup>18</sup> [https://eur-lex.europa.eu/legal-content/EN/TXT/?uri=CELEX:52017XC0705\(01\)](https://eur-lex.europa.eu/legal-content/EN/TXT/?uri=CELEX:52017XC0705(01))

<sup>19</sup> Communication from the Commission to the European Parliament, the European Council, the Council, the European Central Bank, the European Economic And Social Committee and the Committee of the Regions Action Plan: Financing Sustainable Growth COM/2018/097 final, available at: <https://eur-lex.europa.eu/legal-content/EN/TXT/?uri=CELEX:52018DC0097>

other risks such as those arising from technological obsolescence or from the potentially abrupt need to shift from a carbon-intensive to a low-carbon technology, may have a particular impact on their business model.

ESMA notes that the impact of environmental matters, including climate change, may have adverse consequences of an operational as well as of a financial nature. Consequently, issuers shall provide disclosures addressing information on both of those aspects in the non-financial statement and in the management report explaining the relevance of these risks as well as any actions being implemented to mitigate them. Particularly, ESMA notes that when disclosing the financial consequences of climate change, issuers may consider, amongst the different frameworks available to issuers, the recommendations and methodology developed by the Task Force on Climate-Related Financial Disclosures (TCFD).<sup>20</sup>

#### *Explanation of the rationale for not developing and pursuing certain policies*

Article 19a of the Accounting Directive, as also recalled by the EC Guidelines, requires to disclose a clear explanation of the reasons as to why an issuer has decided not to pursue any of the policies on environmental, social and employee matters, respect for human rights, anti-corruption and bribery matters, irrespective of the fact that the issuer may deem these matters material. ESMA highlights that this disclosure is applicable irrespective of the fact that an issuer may be applying Article 19a for the first time. ESMA also notes that although the issuer may have decided not to pursue a specific policy on those matters, other reporting requirements still apply such as the disclosure of principal risks related to those matters.

#### *Disclosure of non-financial KPIs*

ESMA considers that it is important that issuers disclose the reasons why certain KPIs were deemed relevant to explain the impact of an issuer's actions to pursue the policies related to the non-financial matters disclosed. In providing these explanations, issuers may apply the principles contained in the EC Guidelines in relation to the disclosure of KPIs which highlight, amongst other aspects, that an issuer is expected to select KPIs which it deems most useful in monitoring and assessing progress in pursuing the relevant policies and supporting comparability across companies and sectors. With the objective of improving the relevance of the KPIs disclosed, ESMA also highlights that issuers may also consider presenting and explaining the KPIs in relation to the issuer's strategic targets and benchmarks to improve the relevance of the information provided.

In addition, ESMA highlights that it is important, in line with the principles of the EC Guidelines to provide full disclosure on the methodology adopted and the perimeter of activities being covered by the non-financial reporting. ESMA expects that the perimeter of the KPIs disclosed is consistent with metrics actually used by the issuer in its internal management and risk assessment processes and that any changes in the perimeter from one year to another and the related impact are clearly explained.

#### **Alternative Performance Measures**

ESMA reminds issuers of the requirements in paragraph 20 of the ESMA Guidelines on APMs. This paragraph requires issuers to disclose definitions of the APMs used and their components as well as the basis of calculation adopted, including details of any material hypotheses or assumptions used. Particularly, ESMA highlights that APMs or components of APMs should not be mislabelled as 'non-recurring' or similar terminology, and thus for example items that affected past periods and will affect future periods are rarely considered as non-

---

<sup>20</sup> <https://www.fsb-tcfid.org/>



recurring. Where such labels are used, as indicated in paragraphs 21 to 25 of the ESMA Guidelines, ESMA expects that issuers provide entity specific disclosures.

ESMA also notes that with the introduction of new accounting standards (in particular IFRS 9, IFRS 15 and IFRS 16), APMs may be subject to changes either because issuers need to recalculate them by reference to new components or amounts or because new APMs will replace previous APMs. ESMA points out that, in accordance with paragraphs 41 to 44 of ESMA Guidelines on APMs, issuers should provide disclosures that enable investors to understand the extent of and rationale for any changes to the APMs used. For example, when disclosing the definition of measures such as 'organic growth', in line with Question 15 of ESMA's Questions and Answers document<sup>21</sup> issuers should highlight in the reconciliation, the different significant elements such as the perimeter, change and the application of the new requirements in IFRS 15.

ESMA also reminds issuers of the requirements in paragraphs 33 and 34 of the ESMA Guidelines on APMs to explain why they believe that an APM provides useful information regarding financial position, cash-flows or financial performance, as well as the purposes for which they decided to use a specific APM.

Finally, ESMA urges issuers to pay particular attention to the requirements in paragraph 35 of its Guidelines and the guidance provided for in Question 9 of ESMA's Questions and Answers document<sup>22</sup> concerning the presentation of APMs together with IFRS figures or measures. ESMA highlights that APMs included in the management annual and half year reports and in ad-hoc disclosures should not be displayed with more prominence, emphasis or authority than measures directly stemming from financial statements.

---

<sup>21</sup> [https://www.esma.europa.eu/file/21236/download?token=-jY\\_oH39](https://www.esma.europa.eu/file/21236/download?token=-jY_oH39)

<sup>22</sup> [https://www.esma.europa.eu/sites/default/files/library/esma32-51-370\\_gas\\_on\\_esma\\_guidelines\\_on\\_apms.pdf](https://www.esma.europa.eu/sites/default/files/library/esma32-51-370_gas_on_esma_guidelines_on_apms.pdf)