

PUBLIC STATEMENT

European common enforcement priorities for 2019 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 2019 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 relevant requirements. In addition, enforcers will continue to focus on issues that are material for the 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 these European priorities, enforcers might set additional national priorities focusing on other topics.

The common enforcement priorities related to IFRS financial statements for the 2019 year-end, outlined in Section 1 of this Statement are:

1. specific issues related to the application of IFRS 16 *Leases*;
2. follow-up of specific issues related to the application of IFRS 9 *Financial Instruments* for credit institutions and IFRS 15 *Revenue from Contracts with Customers* for corporate issuers; and
3. specific issues related to application of IAS 12 *Income Taxes* (including application of IFRIC 23 *Uncertainty over Income Tax Treatments*).

ESMA selected these topics based on the significant changes that these new requirements introduced and their importance for European capital markets. As in previous years, ESMA highlights the importance for issuers to present entity-specific information in their financial reports and provide informative description and explanation of the issues that are relevant to the understanding of the entity's financial performance and financial position.

ESMA highlights potentially significant implications of transition from one interest rate benchmark rate to another on financial reporting and the importance of timely disclosure of its consequences. In September 2019, the International Accounting Standards Board (IASB) published amendments to IFRS 9¹ addressing various hedge accounting issues in the period leading up to the replacement of an existing interest rate benchmark. ESMA encourages issuers to prepare for the timely implementation of these amendments and closely monitor development in the endorsement process in the European Union. ESMA also notes that the IASB plans to address in due course other financial reporting issues arising at the time when an existing interest rate benchmark is replaced.

In Section 2 of this Statement, ESMA draws issuers attention to the following specific requirements relating to the sections of the annual financial report other than the financial statements:

1. the disclosures of non-financial information focusing on: environmental and climate change-related matters, key-performance indicators, the use of disclosure frameworks and supply chains; and

¹ Amendments to IFRS 9 (and IAS 39): Financial Instruments - Interest Rate Benchmark Reform, IASB, September 2019

2. specific aspects related to the application of the ESMA Guidelines on Alternative Performance Measures (APMs) to measures modified or included as a result of the new accounting standards.

Additionally, the Commission Delegated Regulation specifying the harmonised electronic format for issuers' annual financial reporting (the European Single Electronic Format) was published² on 29 May 2019 and will apply to annual financial reports containing financial statements for financial years beginning on or after 1 January 2020. ESMA expects issuers to undertake all the necessary steps to ensure compliance with the new requirements on a timely basis. To support implementation, ESMA has published information on its website designed to help issuers to understand the requirements.³

Finally, ESMA highlights, as in past years, the importance of closely monitoring Brexit negotiations and of providing disclosures on what impact the decision of the United Kingdom to leave the European Union (Brexit) will have on issuers' activities and their financial information.⁴

SECTION 1: PRIORITIES RELATED TO IFRS FINANCIAL STATEMENTS

1. Application of IFRS 16 Leases for lessees

2019 is the first year in which IFRS 16 is mandatorily applied by all entities. In order to foster its consistent application, ESMA recommends that issuers monitor closely the discussions at the IFRS Interpretations Committee (IFRS IC) and highlights some of the recent IFRS IC agenda decisions. ESMA encourages issuers to assess whether these decisions have any impact on their application of IFRS 16 and, where applicable and relevant, provide specific information in their accounting policies, increase the level of transparency of the significant judgements made and/or disclose the potential impacts.

Lease term

ESMA acknowledges that the determination of the lease term is one of the aspects that require the use of judgement, notably when the lease contract does not contain specific clauses regarding the termination, cancellation or renewal of the lease. In this regard, ESMA points out the recent IFRS IC tentative agenda decision⁵ on lease terms and the link between lease terms and the period of depreciation of non-removable leasehold improvements. ESMA urges issuers potentially impacted by this agenda decision to closely monitor the forthcoming discussions of the IFRS IC. ESMA also expects issuers to provide sufficient disclosure on judgements made when determining the lease term in order to meet the disclosure objectives set out in IFRS 16 and comply with the requirements in paragraphs 122 and 125 of IAS 1 *Presentation of Financial Statements*.

Discount rate

A lessee shall measure the lease liability, discounting the lease payments using the interest rate implicit in the lease. If that rate cannot be readily determined, the lessee should use its incremental borrowing

² OJ L 143, 29.5.2019, p. 1–792, https://eur-lex.europa.eu/eli/reg_del/2019/815/oj

³ <https://www.esma.europa.eu/policy-activities/corporate-disclosure/european-single-electronic-format>

⁴ https://www.esma.europa.eu/sites/default/files/library/esma32-63-503_esma_european_common_enforcement_priorities_2018.pdf

⁵ Lease Term and Useful Life of Leasehold Improvements <https://www.ifrs.org/news-and-events/updates/ifric-updates/june-2019/>

rate. This may require adjustments to take into account the specific terms and conditions of a lease and to reflect the interest rate that the lessee would pay to borrow (i) over a similar term to the lease term, (ii) with a similar security (collateral), (iii) the amount needed to obtain an asset of a similar value to the right-of-use asset and (iv) in a similar economic environment. ESMA also highlights the recent IFRS IC discussion⁶ on the issue and reminds issuers to consider the objective set out in IFRS16 when determining the incremental borrowing rate.

Presentation & Disclosures

ESMA notes that issuers that are lessees shall disclose information in the notes that, together with the information included in the primary financial statements, enables users to assess the effect that leases have on the financial performance, cash flows and financial position,⁷ by providing qualitative and quantitative entity-specific disclosures (e.g. the nature of the leases and their main characteristics)⁸ and the significant judgements and assumptions made when applying IFRS 16.⁹ These judgements may include, in particular, determining the lease liability (e.g. lease term, discount rate used) as well as assessing whether a contract meets the definition of a lease under IFRS 16. Furthermore, ESMA highlights disclosure requirements related to low-value leases, short-term leases and carrying amounts of right-of-use assets by class of underlying assets in accordance with paragraph 53 of IFRS 16 and to sale and lease-back transactions in accordance with paragraph B52 of IFRS 16.

IFRS 16 requires changes in the presentation of the primary financial statements and more information to be disclosed in the notes. Issuers shall present right-of-use assets and lease liabilities separately from other assets and liabilities in the statement of financial position or disclose them separately. In addition, issuers shall present the interest expense on lease liabilities as a component of finance costs separate from the depreciation charges for right-of-use assets. With regard to the statement of cash-flows, cash payments for the principal portion of the lease liability shall be classified within financing activities while payments for short-term leases, low-value assets and variable amounts not included in the measurement of the lease liability shall be classified within operating activities.¹⁰ In relation to the interest portion of lease payments, ESMA calls for transparency regarding how these amounts are presented in the cash-flow statement e.g. in the accounting policies disclosure.

Impairment of right-of-use assets

In accordance with paragraph 33 of IFRS 16, issuers shall apply IAS 36 *Impairment of Assets* to determine if a right-of-use asset is impaired. Thus, the impairment test may need to be adapted to take into consideration the specificities of lease accounting when calculating the cash-flows for the purpose of determining the recoverable amount. In this regard, in addition to the disclosures required by IAS 36,¹¹ ESMA encourages issuers to provide information on how the methodologies, inputs and assumptions used for carrying out their impairment tests have changed, for instance in determining the carrying

⁶ <https://www.ifrs.org/news-and-events/updates/ifric-updates/september-2019/#7>

⁷ Paragraph 51 of IFRS 16

⁸ Paragraph 59 of IFRS 16

⁹ Paragraphs 122-126 of IAS 1 Presentation of financial statements

¹⁰ Paragraph 50 of IFRS 16

¹¹ Paragraph 134 of IAS 36

amount and the value in use of the CGU that includes the right-of-use asset as well as the treatment of lease liabilities in the impairment test.

Transition

In relation to the transition disclosures, issuers should disclose (i) whether they have elected to apply IFRS 16 retrospectively to each prior reporting period presented or whether they have applied the modified retrospective approach and (ii) which practical expedients set out in paragraph C10 of IFRS 16 they have used.¹²

Finally, ESMA reminds issuers that the right-of-use asset recognised by a lessee at the date of initial application for leases previously classified as operating leases under IAS 17 may differ from the lease liability under the modified retrospective method¹³ (for example, when any prepaid or accrued lease payments exist before the date of initial application). If the modified retrospective approach has been applied, ESMA reminds issuers to provide the information required by paragraph C12 of IFRS 16 regarding the incremental borrowing rate applied to lease liabilities and explain any difference between the operating lease commitments disclosed when applying IAS 17 and the lease liabilities recognised under IFRS 16.

2. Follow up of application of IFRS 9 and IFRS 15

ESMA's expectations on the implementation and application of IFRS 9 and IFRS 15 which were included in the 2018 ECEP statement¹⁴ continue to be valid. Enforcers will continue to focus on their application and on the understandability of disclosures during the examinations of the financial statements. This is especially so in the case of financial institutions (IFRS 9) and particularly impacted industries in the corporate sector (IFRS 15).

ESMA highlights the need to further improve the quality, consistency and coherence of information provided in the 2019 financial statements compared to the 2018 financial reporting period, building on (i) experience from the first year of application, (ii) the information needs of users and (iii) developing market practice.

Application of IFRS 9 by credit institutions

Determination of the expected credit losses (ECL) and forward-looking information

ESMA notes that the introduction of the new impairment model had significant impact on the financial statements of credit institutions. ESMA notes that issuers' estimate of credit losses should be unbiased and probability-weighted based on a range of possible outcomes.¹⁵ Furthermore, this estimate should take into account forward-looking information that is reasonable, supportable and available without undue cost or effort.¹⁶

¹² Paragraphs C5(b) and C13 of IFRS 16

¹³ Paragraph C8(b) (ii) of IFRS 16

¹⁴ https://www.esma.europa.eu/sites/default/files/library/esma32-63-503_esma_european_common_enforcement_priorities_2018.pdf

¹⁵ Paragraph 5.5.17 of IFRS 9

¹⁶ See also paragraphs B5.5.41-B5.5.43 of IFRS 9

Measuring ECL requires the estimate of expected cash shortfalls to reflect the cash flows expected from collateral and other credit enhancements that are an integral part of the contractual terms and are not recognised separately by the entity.¹⁷ ESMA also highlights the March 2019 agenda decision of the IFRS IC¹⁸ regarding presentation of amounts in the statement of profit or loss when a credit-impaired financial asset is subsequently cured (i.e. related to the difference between interest on gross carrying amount and interest revenue recognised in the period the financial asset was credit-impaired) as reversal of impairment losses.

Significant increase in credit risk (SICR)

Issuers are reminded to carefully assess at each reporting date whether the credit risk has increased significantly since initial recognition as required by paragraph 5.5.9 of IFRS 9. Because of the relationship between the expected life and the risk of a default occurring, the change in credit risk cannot be assessed simply by comparing the change in the absolute risk of a default occurring over time.¹⁹ Furthermore, the thresholds for determining whether there has been a SICR should faithfully represent the development of the credit risk of a financial instrument and not unduly delay ECL recognition. ESMA also notes that a given change, in absolute terms, in the risk of a default occurring will be more significant for a financial instrument with a lower initial risk of a default occurring compared to a financial instrument with a higher initial risk of a default occurring.²⁰

Transparency about the ECL allowance

ESMA reminds credit institutions of the requirements in paragraph 35G of IFRS 7 *Financial Instruments: Disclosures* to provide sufficient disclosures to enable users of financial statements to evaluate the ECL recorded and to understand the assumptions used and judgements made in estimating the ECL as well as changes therein from the prior period. ESMA considers that issuers should ensure an appropriate level of information is provided about ECL, including movements in ECLs during the period disaggregated by stage. ESMA encourages issuers, where practicable, to provide clear and transparent reconciliation of the disclosed information to the amounts presented in the financial statements and provide links between relevant disclosures to enable proper understanding of the relationships between individual disclosures. ESMA calls on credit institutions to further improve the quality and transparency of disclosures in the financial statements and enhance appropriate internal controls over financial reporting to ensure the quality and reliability of information provided in the financial statements.

ECL disclosures: disaggregation

ESMA considers that, to meet the disclosure objectives of IFRS 7 and IAS 1, issuers should improve the granularity and disaggregation of disclosures on credit risk exposures and ECL and provide them by stage. So that important differences between financial instruments are not obscured, disaggregation by class (e.g. by type of counterparty, geographical area, type of products or significant concentration of credit risks) is required by paragraph B3 of IFRS 7. In relation to the type of changes presented in the reconciliations of ECLs and gross carrying amounts, ESMA highlights the importance of clear labels on

¹⁷ See paragraph B5.5.55 of IFRS 9 and IFRS IC discussion: <https://www.ifrs.org/news-and-events/updates/ifric-updates/march-2019/#7>

¹⁸ <https://www.ifrs.org/news-and-events/updates/ifric-updates/march-2019/#8>

¹⁹ Paragraph 5.5.11 of IFRS 9

²⁰ Paragraph B5.5.9 of IFRS 9

the movements and relevant categories (e.g. avoid combining changes that are different in nature) accompanied by explanations.

ECL disclosures: qualitative and quantitative disclosures

ESMA highlights the importance of providing both qualitative and quantitative information regarding the ECL models (e.g. key assumptions, parameters). Providing only qualitative disclosures about ECL models is not sufficient to enable users to understand the nature and extent of the risks arising from financial instruments.

Furthermore, ESMA expects improvement in disclosure on application of the SICR criteria on financial instruments in accordance with paragraph 35F(a) of IFRS 7 (and disaggregate them by class) and explanations as to how forward-looking information is incorporated in determining ECLs in line with paragraph 35G of IFRS 7. Improvements in ECL disclosures can entail providing information on the (i) number of scenarios used and their weights, (ii) scenarios including macro-economic parameters assumed in each scenario used, (iii) way the relevance and reliability of forecasts have been assessed and (iv) outcomes of any evaluations of the performance of the forecasts applied (e.g. benchmarking techniques).

ECL disclosures: sensitivity analysis

ESMA highlights the importance of performing and, where relevant, disclosing sensitivity analyses of staging and calculation of ECL that is representative of the credit risk profile of financial instruments. In line with the requirements of paragraph 129 of IAS 1 and paragraph 1 of IFRS 7, ESMA expects sufficient information on the sensitivity to changes in assumptions and parameters that involve significant judgement and/or estimation uncertainty to be disclosed in order to enable users to evaluate the nature and extent of risks arising from financial instruments. Examples of disclosures that an entity can make include: (i) the sensitivity of the ECL (including staging) to assumptions and parameters underlying ECL calculation (including such as use of different scenarios and their weights) and (ii) the reasons for the sensitivity. ECL sensitivity disclosures should reflect material variations, if any, across classes of financial instruments.

Application of IFRS 15 by corporate issuers

ESMA notes that the introduction of IFRS 15 changed the way issuers and users of financial information apply and analyse the recognition of revenue, even where it did not have a significant quantitative effect on the amount of revenue recognised. ESMA acknowledges the efforts made by issuers in implementing IFRS 15 and in providing information in the first set of annual financial statements prepared under the new standard. However, given the prominence of revenue in the financial statements and its importance in reflecting the activities of the issuer, ESMA is of the view that the disclosures provided by entities should be further improved. This is of particular importance in industries where revenue recognition is subject to significant assumptions and judgements.

Accounting policies on revenue recognition

ESMA is of the view that the disclosure on accounting policies of the issuer needs to be detailed, entity-specific and consistent with the information provided in the other parts of the annual financial report.

Users should be able to understand the revenue recognition policies and practices for material revenue streams.

Disclosure of significant judgements and estimates

ESMA expects issuers to provide adequate information on the significant judgements and estimates made, such as regarding the identification of performance obligations and the timing of their satisfaction, whether the issuer is a principal or an agent under the contract, the determination of the transaction price (including the judgements related to variable consideration) and the allocation to the performance obligations identified (and notably the amount allocated to the remaining performance obligation).²¹

When providing disclosures on the timing of the satisfaction of performance obligations in accordance with paragraph 124 of IFRS 15, it might be important to disclose judgements made in determining that the conditions for recognition of revenue over time in paragraph 35(c) of IFRS 15 are met.

Disaggregation of revenue

ESMA highlights the need to disaggregate recognised revenue into categories that depict how the nature, amount, timing and uncertainty of revenue and cash flows are affected by economic factors.²² ESMA expects that when considering the level of (dis)-aggregation, issuers should take into account both their activities and the needs of users. For instance, in some cases additional information routinely disclosed to users outside of the financial statements (such as those in investors' presentations) may indicate the need for additional disaggregation of revenue in the notes to the financial statements in order to meet the disclosure objective of IFRS 15. Furthermore, sufficient information should be disclosed to enable users of financial statements to understand the relationship between the disclosure of disaggregated revenue and revenue information that is disclosed for each reportable segment. In some cases, disclosures of certain revenue streams below the segment level may be necessary to satisfy the disclosure objective of IFRS 15.²³

Contract balances

ESMA also notes that issuers should present the contract balances (contract assets and liabilities) in the statement of financial position in accordance with paragraphs 116-118 of IFRS 15 and provide qualitative and quantitative explanations of any significant changes in these contract balances.

Consequences of IFRS IC discussions

ESMA highlights the discussions of the IFRS IC on implementation and application issues related to IFRS 15²⁴ (e.g. costs to fulfil a contract, over time transfer of constructed goods, compensation for delays and cancellations in the airline industry, etc), which should be taken into account by impacted issuers.

²¹ See in particular paragraphs 123-128 of IFRS 15

²² paragraphs 114-115 and B87-B89 of IFRS 15

²³ See discussion in paragraphs BC338-BC340 of IFRS 15

²⁴ <https://www.ifrs.org/supporting-implementation/supporting-materials-by-ifrs-standard/ifrs-15/#agenda>

3. Specific aspects of application of IAS 12

Deferred tax assets arising from carry-forward of unused tax losses

ESMA draws issuers' attention to the recently published Public Statement²⁵ setting out expectations regarding the application of the requirements in IAS 12 by issuers relating to the recognition, measurement and disclosure of deferred tax assets arising from unused tax losses.

Amendments to IAS 12 stemming from 2015-2017 Annual Improvements

ESMA reminds issuers that the new paragraph 57A of IAS 12 requires an issuer to recognise the income tax consequences of dividends as defined in IFRS 9 when it recognises a liability to pay a dividend. According to this pronouncement, the income tax consequences of dividends are more directly linked to past transactions or events that generated distributable profits, rather than to distributions to owners. However, the existing principle that the issuer shall recognise the income tax consequences of dividends where the entity originally recognised those past transactions or events remains unaltered. ESMA also reminds issuers of the disclosure requirements in paragraph 81(a) of IAS 12 related to items that are charged or credited directly to equity.

ESMA notes that paragraph BC67 to IAS 12 highlights that issuers do not apply paragraph 57A to the income tax consequences of all payments on financial instruments classified as equity, but only when an issuer determines payments on such instruments are distributions of profits (i.e. dividends). ESMA expects issuers with material balances of financial instruments classified as equity, that trigger payments having income tax consequences, to disclose clearly where such income tax consequences are accounted for.

Application of IFRIC 23

ESMA highlights the need for increased transparency about uncertainty over income tax treatments. ESMA notes that IFRIC 23 applies from 1 January 2019 to the determination of taxable profit (tax loss), tax bases, unused tax losses, unused tax credits and tax rates, when there is uncertainty over income tax treatments. It also highlights the corresponding disclosure requirements on the assumptions and estimates made. As the determination of whether there is uncertainty over income tax treatments can be subject to significant judgement, ESMA expects issuers to provide sufficient transparency regarding the judgements made in accordance with paragraph 122 of IAS 1 and about the accounting policies used for the recognition and measurement of uncertain income tax treatments. These disclosures include, in particular, disclosure on whether an issuer considered uncertain tax treatments collectively or separately, whether it used the most likely amount or the expected value when determining the effect of uncertainty for the uncertain tax treatments as well as any changes in judgements, methods and assumptions from the previous period. Furthermore, if the uncertain income tax treatment is considered a major source of estimation uncertainty, the impacted carrying amount should be disclosed in accordance with paragraphs 125-129 of IAS 1.

²⁵ Public Statement, Considerations on recognition of deferred tax assets arising from the carryforward of unused tax losses, ESMA32-63-743, 15 July 2019, https://www.esma.europa.eu/sites/default/files/library/esma32-63-743_public_statement_on_ias_12.pdf

One of the underlying principles of IFRIC 23 is to assume that the taxation authority will examine any amounts it has the right to examine and will have full knowledge of all relevant information when doing so.²⁶ Consequently, this assumption should be reflected in the tax balances recognised.

Finally, ESMA draws attention to the recent discussions of the IFRS IC²⁷ on presentation of assets and liabilities related to these uncertain tax treatments in the statement of financial position. As uncertain income tax positions meet the definition of income taxes in IAS 12, an issuer shall present uncertain tax liabilities/assets as current tax liabilities/assets or deferred tax liabilities/assets when applying IAS 1.

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

1. Non-financial information

General aspects

On the basis of the evidence from the review of the non-financial statements of European issuers (both presented in their management reports or separately),²⁸ ESMA wishes to reiterate some general principles with the aim of promoting improvements in the quality of public reporting of non-financial information.

Material information

In accordance with Articles 19a and 29a of the Accounting Directive, the objective of the disclosures included in the non-financial statement is to provide the information necessary for an understanding of the development, performance, position and impact of the issuer's activity in relation to non-financial matters.

This disclosure objective, as further explained in paragraph 3.1 of the European Commission's non-binding Guidelines on non-financial reporting (hereinafter the 'Guidelines'),²⁹ complements the concept of materiality in the Accounting Directive to reflect a 'double materiality perspective', with consideration of both the impact of the non-financial matters on the issuer, including any dependencies, and the impact of the issuer on non-financial matters. ESMA recommends that issuers pay particular attention to this double materiality perspective when preparing the non-financial disclosures in order to ensure that all material information with respect to the above-mentioned disclosure objective is provided.

In addition, ESMA encourages issuers to explain how they have determined what is material when preparing the non-financial statement as this may improve the communication between issuers and users of non-financial statements. Particularly, ESMA believes that to enable users to understand the materiality assessment performed, issuers should consider disclosing how the following aspects were taken into account: (i) the information needs of different stakeholders and their relative importance; (ii) the selection of relevant time horizons; and (iii) the probabilities associated with financial and non-financial impacts.

²⁶ paragraph 8 of IFRIC 23

²⁷ <https://www.ifrs.org/news-and-events/updates/ifric-updates/june-2019/#5>

²⁸ Report, Enforcement and Regulatory Activities of European Accounting Enforcers in 2018, ESMA32-63-672, 27 March 2019 https://www.esma.europa.eu/sites/default/files/library/esma32-63-672_report_on_enforcement_activities_2018.pdf

²⁹ [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))

Completeness of disclosures

Paragraph 3.3 of the Guidelines clarifies that by selecting material disclosures, an issuer is expected to provide a comprehensive picture of its activities, performance and impact in the reporting year. In this respect, ESMA reminds issuers that they should ensure that the material disclosures address as a minimum each non-financial matter referred to in the Accounting Directive. For each of those matters, the required disclosures include the description of the business model and of the non-financial policies pursued, the related due diligence processes, outcomes of those policies and the principal risks identified. ESMA also emphasises that the Guidelines recommend that issuers provide these disclosures as a concise set of information and avoid non-material disclosures.

Furthermore, ESMA reminds issuers that they shall consider the material information relating to the activities of the group, including all the subsidiary undertakings, when preparing the consolidated non-financial statement.

Balance and accessibility

The non-financial statement may result in misleading information if it focuses on matters for which 'good news' can be conveyed and disregards or gives less prominence to other matters for which information is less positive. Therefore, ESMA recommends that for all non-financial matters addressed, issuers should provide a balanced depiction of the performance, position and impact of their activity, including of how those matters affect the concerned issuers.

ESMA highlights that when, in exceptional circumstances, the disclosure of certain information is deemed to be seriously prejudicial to an issuer's commercial position, this fact should not prevent an issuer from providing a fair and balanced understanding of the issuer's development, performance, position and impact of its activity. In this respect, paragraph 3.4 of the Guidelines recommends that relevant information may be provided in broader terms that still convey useful information to investors and other stakeholders.

Moreover, in order to enable a user's understanding of the issuer's performance, position and impact of its activity in relation to the non-financial matters, ESMA believes that the accessibility of non-financial statements should be improved by allowing users to better understand where within the management report (or, where applicable, within the separate non-financial statement), the relevant non-financial disclosures have been included. In this respect, ESMA notes the good practice of some issuers of providing a high-level mapping of where the relevant non-financial information can be found.

Specific topics

Together with the above-mentioned principles, ESMA also recommends that issuers consider the following specific areas when preparing their non-financial statements.

Environmental matters and climate change

ESMA reminds issuers of the continued relevance of matters relating to the environment and, particularly, of the challenges posed by climate change. In this respect, ESMA urges issuers to provide information in line with the objective set out in the Accounting Directive on: (i) the consequences of their activities and of the use of their products and services by customers for climate change and the envi-

ronment; and (ii) how they are impacted by the consequences of climate change and other environmental matters. As referred to above, this reflects the double materiality perspective that was introduced by the Non-Financial Reporting Directive.

ESMA draws the attention of issuers to the recommendations on the contents and key performance indicators³⁰ on climate-related disclosures included in the European Commission's non-binding Guidelines on non-financial reporting relating to climate-related information (hereinafter the 'Supplement to the Guidelines').³¹ ESMA notes that these recommendations are aligned with those of the Task-Force for Climate Related Financial Disclosures (TCFD) and, therefore, they may also help issuers in providing a relevant depiction of the financial consequences of climate change, thereby also improving the integration between financial and non-financial disclosures.

Disclosure of relevant Key Performance Indicators (KPIs)

ESMA reminds issuers that the Accounting Directive requires the inclusion of 'relevant KPIs' in the non-financial statement. In this respect, ESMA recommends that issuers select KPIs that are: (i) entity-specific; and (ii) consistent with those used internally for steering the business and for determining executive remuneration.

ESMA also considers that, in order to provide relevant information, disclosures of KPIs should be complemented by information on any progress made with reference to previous reporting periods and any relevant pre-determined internal or external targets which may enable users effectively to assess the issuer's performance. Moreover, ESMA recommends that issuers disclose the definition and methodology used to determine the KPIs, as well as an explanation as to why the disclosed KPIs were deemed to be relevant.

Use of disclosure frameworks

ESMA reminds issuers that, according to the Accounting Directive, issuers relying on national, Union-based or international frameworks shall specify which frameworks they have relied upon. Particularly, ESMA believes that clarity on the extent of use of any disclosure frameworks used may provide useful information, for example, by disclosing whether they have been complied with in full or in part and by explaining which disclosures were prepared by using the adopted frameworks and why.

Furthermore, ESMA also recommends that, when an issuer makes reference to the adoption of certain frameworks that set out specific sustainability targets,³² the disclosures are most useful if they explain how the issuer's activities contribute to those goals and the progress made towards their achievement.

Supply chains

ESMA reminds issuers that, when assessing the non-financial information to be provided, the Accounting Directive requires the consideration of business relationships as part of the disclosure of principal risks relating to the non-financial matters. In this respect, ESMA recommends that issuers carefully assess whether their involvement in supply chains may give rise to material information to be disclosed. According to the Guidelines this would include information needed for a general understanding of an

³⁰ Paragraph 3.5 of the Supplement provides a list of KPIs that are aligned with the TCFD recommendations

³¹ [https://eur-lex.europa.eu/legal-content/EN/TXT/?uri=CELEX:52019XC0620\(01\)](https://eur-lex.europa.eu/legal-content/EN/TXT/?uri=CELEX:52019XC0620(01))

³² Such as the Sustainable Development Goals: <https://www.un.org/sustainabledevelopment/sustainable-development-goals/>

issuer's supply chain and of how relevant non-financial matters are considered in managing the supply chain.

2. Alternative performance measures

ESMA acknowledges that, as a result of the implementation of IFRS 16, some issuers have modified or included new alternative performance measures (APMs) in their communication documents (e.g. ad-hoc disclosures, prospectuses or management reports). ESMA points out that, in accordance with paragraphs 41 to 44 of the 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 and the reconciliation of measures such as EBITDA,³³ EBITDAR,³⁴ CAPEX,³⁵ net debt or free-cash flow, issuers should highlight the different significant elements/components that have changed due to the application of IFRS 16.³⁶ In addition, ESMA notes that APMs should not be displayed with more prominence than, and should be consistent with, measures directly stemming from financial statements.³⁷

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 the financial position, cash flows or financial performance, as well as the purposes for which they decided to use a specific APM.

³³ Earnings before interest, tax, depreciation and amortisation

³⁴ Earnings before interest, tax, depreciation, amortisation and rent costs

³⁵ Capital expenditure

³⁶ Paragraphs 138 to 140 of the Bases for Conclusions of IFRS 16

³⁷ Paragraphs 35 and 36 of the APM Guidelines