European Securities and Markets Authority

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PUBLIC STATEMENT

European common enforcement priorities for 2020 annual financial reports

The European Securities and Markets Authority (ESMA) issues its annual Public Statement defining the European common enforcement priorities for 2020 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 the relevant requirements. In addition, enforcers will continue to focus on issues that are material for the individual issuers examined. Based on examinations performed, enforcers will take 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 2020 year-end, outlined in Section 1 of this Statement related to the application of the following standards:

- IAS 1 *Presentation of Financial Statements*;
- IAS 36 *Impairment of Assets*;
- IFRS 9 *Financial Instruments* and IFRS 7 *Financial Instruments: Disclosures*; and
- IFRS 16 *Leases*.

The common enforcement priorities related to non-financial statements[1] for the 2020 year-end,[2] outlined in Section 2 of this Statement, are:

- Impact of the COVID-19 pandemic on non-financial matters;
- Social and employee matters;
- Business model and value creation; and
- Risk relating to climate change.

In Section 3 we also set out brief considerations on the application of the ESMA Guidelines on Alternative Performance Measures (APM) in relation to COVID-19.

In setting this year's priorities, ESMA has focused on the need to provide adequate transparency regarding the consequences of the COVID-19 pandemic which, due to its pervasive nature, are expected to affect several areas of the 2020 annual financial reports published by issuers. This Statement builds upon and further expands on some of the recommendations

[1] Member States have transposed Articles 19a and 29a of the Accounting Directive with some differences. As a result, a limited number of enforcers can supervise and enforce non-financial information only if it is set out within the management report or published together with it or only have the power to check the *existence* of the non-financial information as opposed to the *content* or do not have any supervisory powers on non-financial information at all. For this reason, the priorities presented in Section 2 may be addressed differently by, or may not apply to, these enforcers.

[2] These priorities refer also to the case in which the information required for the non-financial statement is prepared as a separate report in accordance with paragraph 4 of Articles 19a and 29a of the Accounting Directive.

already provided in ESMA's Public Statement[3] on the implications of the COVID-19 outbreak on the calculation of expected credit losses (ECL) in accordance with IFRS 9 issued in March 2020, as well as, on ESMA's May 2020 Public Statement[4] on the implications of the COVID-19 outbreak on the half-yearly financial reports. Since this latter Statement, ESMA, together with national enforcers, conducted a fact-finding exercise whose preliminary evidence contributed to the recommendations in this year's priorities. ESMA will report on the fact-finding exercise in its next Activity Report.

Given the complexities of the current environment, ESMA further underlines the responsibility of management and supervisory bodies of issuers as well as the importance of the oversight role of audit committees which is key to ensure the overall internal consistency of the annual financial report and contribute to high-quality annual financial reports.

Additionally, ESMA reminds issuers that, starting from the financial year 2020[5], annual financial reports pursuant to Article 4 of the Transparency Directive (TD)[6] shall be prepared in compliance with the European Single Electronic Format, or ESEF[7]. ESMA highlights that the entire annual financial report, i.e. including *ad minima* the audited financial statements, the management report and responsibility statement, shall be prepared in xHTML format. In addition, issuers preparing IFRS consolidated financial statements shall mark those up using Inline XBRL, starting with the primary financial statements for financial years beginning on or after 1 January 2020. ESMA draws issuers' attention to the information published on the dedicated page on its website to help issuers better understand the requirements,[8] as well as to various support materials[9] published by the IFRS Foundation, in particular, the Preparers' Guide.[10]

Finally, ESMA highlights, that following the United Kingdom's departure from the European Union on 31 January 2020, the EU and the UK have entered a transition period that is currently planned to last until 31 December 2020. As in past years, it remains important to closely monitor Brexit negotiations and to provide disclosures on what impact the decision of the UK to leave the European Union will have on issuers' activities and their financial and non-financial information.[11]

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[3] ESMA32-63-951 Public Statement – *Accounting implications of the COVID-19 outbreak on the calculation of expected credit losses in accordance with IFRS 9*, 25 March 2020

[4] ESMA32-63-972 Public Statement – *Implications of the COVID-19 outbreak on the half-yearly financial reports*, 20 May 2020

[5] In the context of COVID-19, the Council has proposed to amend the Transparency Directive, to provide Member States with the option to postpone, by one year, the requirement for listed companies to prepare all annual financial reports in ESEF for financial years beginning on or after 1 January 2020. As it is still uncertain whether this postponement will actually materialise, ESMA encourages issuers to continue to prepare for the ESEF obligation starting from the financial year 2020.

[6] Directive 2004/109/EC of the European Parliament and of the Council of 15 December 2004 on the harmonisation of transparency requirements in relation to information about issuers whose securities are admitted to trading on a regulated market and amending Directive 2001/34/EC

[7] Commission Delegated Regulation 815/2019 specifying the harmonised electronic format for issuers' annual financial reporting

[8] https://www.esma.europa.eu/policy-activities/corporate-disclosure/european-single-electronic-format

[9] For general IFRS Taxonomy resources, please visit: https://www.ifrs.org/issued-standards/ifrs-taxonomy/#resources

[10] https://cdn.ifrs.org/-/media/feature/resources-for/preparers/xbrl-using-the-ifrs-taxonomy-a-preparers-guide-january-2019.pdf?la=en

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

SECTION 1: PRIORITIES RELATED TO IFRS FINANCIAL STATEMENTS

Application of IAS 1 *Presentation of Financial Statements*

Going concern assumptions

In the current environment, the effects of the COVID-19 pandemic increase the uncertainty on the outlook for individual businesses as well as for the economy at large. Hence, transparency is necessary to further promote investors' confidence. In this context, ESMA highlights, especially for those issuers whose liquidity conditions are most significantly impacted by COVID-19, the importance of providing sufficiently detailed disclosures on their ability to continue as a going concern when this assessment requires significant judgement. In doing so, ESMA reminds issuers of the need to take into account all available information about the future, which is at least, but is not limited to, twelve months from the end of the reporting period, as indicated in paragraph 26 of IAS 1. The level of detail of such considerations should be adapted to each situation.

In particular, in accordance with paragraph 25 of IAS 1, ESMA reminds issuers to disclose material uncertainties related to events or conditions that may cast significant doubt upon the entity's ability to continue as a going concern Such material uncertainties may stem, for example, from reduced market demand for products or services, disruptions to supply chains, over-reliance on temporary public support measures, restricted access to financial resources or other changes to financial arrangements. Since the COVID-19 pandemic may have affected various aspects of issuers' businesses differently in different sectors, ESMA also highlights the importance of providing entity-specific disclosures.

ESMA notes that issuers which have made significant judgements in reaching the conclusion that there are no material uncertainties in relation to going concern shall provide disclosures on any such judgements, pursuant to paragraph 122 of IAS 1, and as highlighted also by the IFRS Interpretations Committee in its July 2014 Agenda Decision.[12] For instance, the issuers could disclose the feasibility and effectiveness of any planned mitigation initiatives, such as public support measures or new access to financial resources.

ESMA reminds issuers that enforcers may request, during their examinations, the information supporting their assessment of going concern and assess its consistency with other information presented and disclosed in the financial statements, including the diclosures required by IFRS 7 about exposures to liquidity and other financial risks.

Significant judgements and estimation uncertainty

In addition to the going concern assessment, ESMA notes that due to COVID-19, the range of reasonably possible assumptions underlying judgements and estimates in other areas of financial statements may be wide. This situation may impair the ability of investors to make informed decisions on the basis of the reported figures. Therefore, it is particularly important

[12] The IFRS Interpretations Committee in July 2014 noted that: "*the disclosure requirements of paragraph 122 of IAS 1 would apply to the judgements made in concluding that there remain no material uncertainties related to events or conditions that may cast significant doubt upon the entity's ability to continue as a going concern*" (https://cdn.ifrs.org/-/media/feature/supporting-implementation/agenda-decisions/ias-1-disclosure-requirements-relating-to-assessment-of-going-concern-jul-14.pdf)

that issuers provide sufficiently detailed disclosures about the judgements that management has made in the process of applying the entity's accounting policies that have the most significant effect on the amounts recognised in the financial statements, as required by paragraph 122 of IAS 1. ESMA also emphasises the importance of disclosures about the major sources of estimation uncertainty that have a significant risk of resulting in a material adjustment to the carrying amounts of assets and liabilities within the next financial year, in accordance with paragraph 125 of IAS 1.

In this context, issuers are strongly recommended to provide information about the sensitivity of carrying amounts to the methods, assumptions and estimates underlying their calculations, as noted in paragraph 129 of IAS 1.

In general, in identifying areas for which disclosure of significant judgements and major sources of estimation uncertainty is required, it is important that issuers take into account items relating to their business model, financial position, performance and cash flows which have raised particular concerns or discussions in the management, administrative or supervisory bodies, including the audit committee and with the external auditors. In identifying such areas, issuers should also ensure consistency with major risks disclosed in other areas of the financial statements and the annual financial report, as well as reflect consistency with areas identified as key audit matters.

ESMA also highlights that it is important to explain how COVID-19 affected such significant judgements and the degree of uncertainty in estimations and how, in turn, this impacted different items in the financial statements. For example, market price volatility due to COVID-19 may be associated with multiple valuations in the financial statements, from inventories to financial instruments. Similarly, the uncertainties regarding the future development of the business in the medium and long term may have an impact on the reliability of business plans, thus requiring particular caution in assessing the assumptions underlying the impairment of assets (see further, in the section relating to IAS 36) and the recoverability of deferred tax assets. Valuation uncertainty may also affect the measurement of investment properties, other items in the financial statements to which fair value measurement applies and the accounting for employee-benefits.

Presentation of COVID-related items in the financial statements

ESMA calls for caution regarding any separate presentation of the impacts of the COVID-19 pandemic in the profit or loss statement. Due to the pervasiveness of such impacts, a separate presentation may not faithfully represent an issuer's current and future overall financial performance and be misleading to users' understanding of the financial statements. In light of these considerations, ESMA encourages issuers to disclose qualitative and quantitative information on the significant impacts of COVID-19 and the methodology applied for their determination, in a way that provides a clear and unbiased picture of the multiple areas affected by COVID-19. Issuers could consider providing such disclosures in a single note or, if the impacts are explained in multiple notes, provide clear cross-referencing amongst the relevant notes.

Application of IAS 36 *Impairment of Assets*

As already highlighted by ESMA in its Public Statement[13] relating to the half-yearly financial reports, issuers should carefully consider the effects of the COVID-19 pandemic in assessing any indications of impairment for non-financial assets, in accordance with paragraph 9 of IAS 36. ESMA notes that, when an impairment test is triggered or when it is required as part of the annual impairment test, this test cannot be replaced by the one already performed for the last interim reporting period. In particular, ESMA reminds issuers that paragraph 96 of IAS 36 requires the annual impairment test for a cash-generating unit to which goodwill has been allocated to be performed at the same time every year and that generally all hypotheses and assumptions should be re-assessed and, where necessary, updated for the annual test.

It continues to be ESMA's view that the adverse impact of COVID-19 provides a strong indication that one or more of the impairment indicators in IAS 36 have been triggered for many issuers.

In particular, ESMA highlights that the recoverable amount of goodwill, intangible assets and tangible assets, such as property plant and equipment, may be impacted by the deterioration of the economic outlook in one or more sectors. From the measurement perspective, in order to reflect the increased level of uncertainty, issuers should consider modelling multiple possible future scenarios when estimating the future cash flows of a cash-generating unit, if it provides more relevant information to depict the possible future economic developments. ESMA also notes that, while the outlook on the future economic conditions remains uncertain, issuers are expected to update any assumptions used in previous interim periods to reflect the latest available information and evidence. ESMA recommends that issuers disclose how the assumptions and measurements have changed, if at all, compared to the last annual and interim reporting.

Alternatively, when calculating the recoverable amount based on value in use, the additional uncertainty may be taken into account by further adjusting the discount rate, provided that the cash flows have not been already adjusted for the same risk, as provided for in paragraphs 55 to 57 of IAS 36. In any case, ESMA believes that issuers should also provide transparency as to how uncertainty was factored into the impairment testing.

In addition, ESMA underlines that, as required by paragraph 33 of IAS 36 for the determination of value in use, when determining cash flow projections[14] based on reasonable and supportable assumptions, greater weight shall be given to external evidence. ESMA also reminds issuers that such projections should reflect the asset in its current condition. Accordingly, they should not reflect cash inflows and outflows expected to arise from a future restructuring to which the entity is not yet committed or from improving or enhancing the asset's performance, as required by paragraph 44 of IAS 36.

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[13] ESMA32-63-972 – Public Statement - *Implications of the COVID-19 outbreak on the half-yearly financial reports* – 20 May 2020

[14] ESMA notes that the recommendations in this paragraph may also be helpful when cash flow projections are used to determine the fair value less costs to sell to determine the recoverable amount in accordance with IAS 36.

In this context, ESMA reminds issuers to provide adequate transparency of the estimates and key assumptions (and changes therein during the year) underlying the impairment assessment, as required by paragraphs 134(d) and 134(e) of IAS 36. For instance, in the current context, issuers should focus on the operational and financial hypothesis and ESMA expects issuers to explain: (i) if and when they consider the return to pre-crisis cash-flow levels realistic; and (ii) what time horizon was considered in relation to post-COVID-19 scenarios.

ESMA highlights that, in accordance with paragraph 134(f) of IAS 36, detailed disclosure of the sensitivity of the recoverable amounts of cash-generating units (CGU) to significant changes in key operational and financial assumption(s) affected by COVID-19 may be required. For instance, the change of the time horizon considered for the expected timing to return to pre-crisis levels of economic activity may be required. ESMA emphasises that the current uncertain economic situation and the difficulty of forecasting may suggest that the scale of reasonably possible changes in the key assumptions used in impairment testing will be larger than usual.

Finally, ESMA also reminds issuers of the disclosure requirements in relation to the impairment test that are applicable in accordance with paragraph 135 of IAS 36. ESMA emphasises that even when the disclosure requirements in paragraph 134 and 135 of IAS 36 do not apply, issuers should consider the disclosure of assumptions and sensitivities in relation to the impairment test in accordance with paragraph 129 of IAS 1.

Application of IFRS 9 *Financial Instruments* and IFRS 7 *Financial Instruments: Disclosures*

General considerations relating to risks arising from financial instruments

ESMA highlights the importance of fulfilling the disclosure objective in paragraph 1 of IFRS 7 and, to this end, of preparing the required disclosures in relation to risks arising from financial instruments and, in particular, those relating to liquidity risk and the sensitivities to market risks. ESMA emphasises that the pandemic may have given rise to new significant financial risks that did not exist before or which were not as significant. Events and transactions that might reveal liquidity risk include, for example, new significant amounts of debt, debt renegotiations, new financial arrangements or the breach of debt covenants. ESMA emphasises the importance that, where relevant, these disclosures are based on information used for the internal reporting to key management personnel.

ESMA reminds issuers to disclose how financial risks arise and how they are managed, taking into account the specific objectives, policies and processes put in place to address those risks. Issuers shall also disclose the financial risk concentrations including quantitative information required by paragraph 34(c) and B8 of IFRS 7 and information on how such concentrations are measured. Such qualitative disclosures shall accompany quantitative information, in order to enable users of financial statements to get an overall picture of the nature and extent of risks arising from financial instruments, as required by paragraph 32A of IFRS 7.

ESMA reminds issuers of the disclosure requirements in paragraphs 39 and B10A to B11F of IFRS 7 relating to liquidity risk. In particular, it is important to disclose a sufficiently detailed maturity analysis of the financial liabilities as well as, where relevant, of the financial assets used to manage liquidity risk.

ESMA also highlights that, in the context of liquidity risk disclosures, issuers should provide transparency of any arrangements that take the form of supply chain financing or, more specifically, reverse factoring transactions which may give rise to liquidity risks.[15] ESMA reminds issuers that the general disclosure requirements in paragraphs 33 to 35 of IFRS 7, as well as the specific requirements in paragraphs 39 and B11F of IFRS 7 apply to such arrangements.

ESMA also reminds issuers which have benefitted from forbearance or payment moratoria measures that this fact should be clearly disclosed, along with the features of any such measures to enable users to understand any risks that may stem from their discontinuation.

Specific considerations related to application of IFRS 9 for credit institutions

ESMA reminds issuers that when measuring expected credit losses (ECL) in accordance with IFRS 9, issuers shall reflect in an unbiased way the significant uncertainty that characterises the current economic environment by taking into account all reasonable and supportable information about past events, current conditions and forecasts of future economic conditions that is available without undue cost and effort, as required by paragraph 5.5.17 of IFRS 9. In the current context and most notably when ECL models are subject to changes in response to changing circumstances, issuers should pay particular attention to the specific disclosure requirements on their approach to measuring ECL, in accordance with paragraph 35F of IFRS 7.

ESMA highlights the importance of providing the disclosures required by paragraph 35G of IFRS 7, most notably the information and assumptions underlying the measurement of ECL. This information includes the macro-economic scenarios considered and any changes compared to scenarios used in the projections for the previous year and for the last interim reporting. ESMA also notes that when post-model adjustments (also referred to as 'management overlays') are used in the estimate of ECL, in line with paragraph 35B of IFRS 7, transparency should be provided on the rationale and methodology underlying these adjustments, their impact on the ECL estimate and the specific risks they aim at capturing which were not, in full or in part, factored in the ECL model.

ESMA reminds issuers to explain, in accordance with paragraphs 35H of IFRS 7, the changes in loss allowance by classes of financial instruments compared to the previous period. In line with paragraph 35I of IFRS 7, ESMA also notes that issuers shall explain how significant changes in the gross carrying amount of financial instruments contributed to changes in the loss allowance. In providing this disclosure, ESMA encourages issuers to explain the nature of the change occurred, for example highlighting any changes due to sale or write-off of financial instruments, as required by paragraph 35I(c) and any modifications (e.g. those arising from some payment *moratoria*) that do not result in derecognition, as required by paragraph 31I(b) of IFRS 7.

[15] See the IFRS IC's Tentative Agenda Decision on Supply Chain Financing Arrangements—Reverse Factoring in the June 2020 IFRIC update, available here: https://www.ifrs.org/news-and-events/updates/ifric-updates/june-2020/#1.

ESMA also highlights the importance of providing disclosures as required by paragraphs 35M and B8H of IFRS 7 on credit risk exposures and on the related risk concentrations. In particular, issuers should provide granular information on their exposures and their quality by, for example, instrument type, sectors and geographies and indicate where, across the different categories identified, risk concentrations may exist. In doing so, ESMA emphasises the importance of providing separate explanation of any exposures, concentrations and any significant variations linked to COVID-19 as well as to other specific factors or events.

ESMA recommends that, in line with the requirements in paragraphs 35F, 35I and B8A of IFRS 7, credit institutions disclose the basis on which support measures, for example debt moratoria, have been granted to borrowers or debtors and their effects in the financial statements. In particular, it is important to explain whether and how such measures have impacted the assessment of significant increase in credit risk, the definition of credit-impaired assets and its practical implementation in the banking sector. ESMA also reminds issuers that paragraph 36 of IFRS 7 also requires the disclosure of information on the financial effect of credit enhancements and the extent to which it has mitigated credit risk.

In line with paragraph 1 of IFRS 7 and paragraph 129 of IAS 1 and as already highlighted by ESMA in its 2019 Public Statement on the European Common Enforcement Priorities[16], it is important to perform and, where relevant, disclose the sensitivity analyses of staging and calculation of ECL that is representative of the credit risk profile of 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); (ii) the reasons for the sensitivity; and (iii) the methodology used to calculate such sensitivity. ECL sensitivity disclosures should reflect material variations, if any, across classes of financial instruments.

Application of IFRS 16 *Leases*

ESMA notes that paragraph 60A of IFRS 16 requires specific disclosures by lessees which have applied the IASB's amendment[17] providing relief to lessees when accounting for rent concessions[18].

ESMA emphasises that lessors which have granted rent concessions, particularly in sectors for which the impact of the COVID-19 pandemic has been most severe, should provide adequate disclosures reflecting the risks that the current market conditions may result in significant changes in the assets subject to operating lease agreements. ESMA highlights that IFRS 16

[16] https://www.esma.europa.eu/sites/default/files/library/esma32-63-791_esma_european_common_enforcement_priorities_2019.pdf

[17] International Accounting Standards Board, *Covid-19-Related Rent Concessions – Amendment to IFRS 16* – May 2020

[18] The amendments were endorsed in the EU with Commission Regulation (EU) 2020/1434 of 9 October 2020 amending Regulation (EC) No 1126/2008 adopting certain international accounting standards in accordance with Regulation (EC) No 1606/2002 of the European Parliament and of the Council as regards International Financial Reporting Standard 16

requires the application of the disclosure requirements of IAS 16, IAS 36, IAS 38, IAS 40 and IAS 41 for assets subject to operating leases.

More in general, ESMA reminds lessees to disclose the information required by paragraph 53 of IFRS 16 in relation to expenses and depreciation charges which impact the statement of profit or loss for the reporting period, including separately disclosing those relating to variable lease payments not included in the measurement of lease liabilities and those stemming from exemptions in IFRS 16 (e.g. short-term or low-value asset leases).

ESMA also highlights the importance of the disclosures required for lessees by paragraph 58 of IFRS 16 in relation to the maturity analysis of lease liabilities and by paragraph 59 in relation to future cash outflows to which the lessee is potentially exposed that are not reflected in the measurement of lease liabilities, including exposures arising from variable lease payments, extension and termination options, residual value guarantees and leases not yet commenced to which the lessee is committed.

ESMA also recommends that lessees carefully consider the disclosure of additional information as indicated in paragraph B48 of IFRS 16 which, particularly in the context of the COVID-19 pandemic, may complement the information already available to users of financial statements on the impact of the pandemic on an issuer's financial position, performance and cash flows. Such information is likely to be relevant to users of financial statements if it helps them to understand (i) the flexibility provided or particular restrictions imposed by lease contracts, (ii) the sensitivity of reported information to key variables, and (iii) the exposure to other risks arising from leases including, for example, liquidity risks, deviations from industry practice, unusual or unique lease terms and conditions that affect a lessee's lease portfolio.

Finally, for both lessees and lessors, ESMA emphasises the importance of providing clear disclosures on the accounting policy applied when accounting for any relief measures granted or benefitted from.

SECTION 2: PRIORITIES[19] RELATED TO NON-FINANCIAL STATEMENTS

2.1 Impact of the COVID-19 pandemic on non-financial matters

ESMA notes that the COVID-19 pandemic has had a pervasive impact on issuers' activities in relation to the non-financial matters addressed by Articles 19a and 29a of the Accounting Directive (i.e. environmental, social and employee matters, respect for human rights, anti-corruption and bribery matters).

When issuers prepare their non-financial statements, ESMA therefore calls on them to pay particular attention to providing transparency on the consequences of, and the mitigating actions taken in relation to, the pandemic. ESMA also encourages issuers to carefully assess how the different non-financial matters have been impacted.

2.2 Social and employee matters

In its report on enforcement and regulatory activities of European enforcers in 2019,[20] ESMA highlighted a need for improved disclosures relating to social matters. In this regard, ESMA notes that issues of inclusion and diversity may have attracted particular attention from users of corporate disclosure, in light of recent calls from different parts of the civil society to ensure equality and to fight racism. To the extent necessary for an understanding of the development, performance, position and impact of its activity, an issuer should therefore provide disclosures on these issues and offer information on how they are addressed as part of the issuer's policies concerning its employees, including employees in the issuer's supply and contract chains, customers and other relevant stakeholders. ESMA also highlights the importance of disclosing any progress made by the issuer in the area of social and employee matters.

ESMA notes that health crises such as the COVID-19 pandemic further increase the relevance of providing transparency on employee-related matters, especially regarding health and safety. In the context of COVID-19, relevant topics include the extensive use of remote working arrangements as well as strategies to bring employees back to the workplace while ensuring compliance with health and safety rules and management of employees, whether direct or in the supply and contract chains, who had to continue working in close physical contact during the pandemic.

In this context, ESMA recommends that issuers should provide disclosures of the policies they have put in place towards their employees, including whether these policies are permanent (for example, a new right for employees to work remotely a certain proportion of the time). ESMA further recommends that issuers should explain how those policies are put into action.

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[19] Member States have transposed Articles 19a and 29a of the Accounting Directive with some differences. As a result, a limited number of enforcers can supervise and enforce non-financial information only if it is set out within the management report or published together with it or only have the power to check the *existence* of the non-financial information as opposed to the *content* or do not have any supervisory powers on non-financial information at all. For this reason, the priorities presented in Section 2 may be addressed differently by, or may not apply to, these enforcers.

[20] ESMA32-63-846 Report – *Enforcement and regulatory activities of European enforcers in 2019*, 2 April 2020

Issuers are also encouraged to disclose how they measure progress towards any targets that they have established, for example, a safe return to the workplace for all employees by a certain date following the COVID-19 pandemic.

ESMA also recommends that issuers disclose the criteria based on which any other key performance indicators on social and employee policies are provided.

Additionally, ESMA notes that the increased use of home-working arrangements has triggered considerations regarding the resilience of IT infrastructures and the ability to prevent and manage cyberattacks. In this respect, ESMA encourages issuers to provide disclosure on how these matters have been addressed, the preventive policies that have been put in place and the outcomes of these actions.

ESMA reminds issuers that, as for all non-financial matters, disclosures relating to social and employee matters should be fact-based and provide evidence of concrete behaviours and actions (for example, any programmes put in place for the benefit of employees and the wider public to promote health and safety measures in the context of the pandemic and the related outcomes). The purpose is to enable users of non-financial statements to assess how issuers have addressed or plan to address the relevant topics. ESMA also emphasises the importance of presenting these disclosures in a way that makes the information accessible to users. Issuers should provide a balanced presentation of the facts without overly emphasising either positive or negative aspects. Users should be able to clearly identify the policies adopted by the issuer, the actions taken to put those policies in place and the related outcomes.

2.3 Business model and value creation

ESMA observes that Articles 19a and 29a of the Accounting Directive require issuers to provide a brief description of their business model. ESMA emphasises that in order to enable users of non-financial statements to get an understanding of the business model and its relationship with and implications for the non-financial matters, issuers are expected to provide information about their strategy together with its implementation. Issuers are also expected to explain how the business model impacts on, and is being impacted by, the non-financial matters, taking into account their short-, medium- and long-term goals / objectives.

ESMA considers that it would be helpful if issuers were to disclose their definition of value creation and to explicitly mention, if relevant, the disclosure framework which provided this definition. ESMA notes that the European Commission's non-binding Guidelines on non-financial reporting[21] indicate that a company's business model describes how an entity generates and preserves value through its products or services and provides an overview of how a company operates and the rationale of its structure by describing how it transforms inputs into outputs through its business activities.

[21] Communication from the Commission – *Guidelines on non-financial reporting (methodology for reporting non-financial information)*, OJ C 215, 5 July 2017, p. 1-20 (please refer to paragraph 4.1)

As highlighted in the Guidelines, ESMA reminds issuers that the business model “is a matter-of-fact” and therefore issuers are expected to provide a clear, understandable and factual explanation of its functioning as well as its expected future development.

In this context, when issuers describe their business model, ESMA encourages them to include appropriate disclosures relating to their business environment and the main trends and factors that may affect their future development. ESMA also encourages issuers to explain how their process of value creation is linked to objectives relating to the non-financial matters. These disclosures could cover, among other topics, the creation of value for shareholders and for the communities within which the issuer operates. Furthermore, issuers are expected to highlight and explain when material changes to their business model and their value creation ability have taken place in the reporting year, for example as a consequence of actions taken by the issuer to manage physical and / or transition risks related to climate change.

It is important for users of non-financial statements to understand the degree of resilience of an issuer’s business model to the consequences of exceptional events such as the COVID-19 pandemic. The use of government support, the increase or decrease in the demand for certain products or services, the disruption of value chains and, more generally, substantial changes in the value of assets and the emergence of impairments may have a significant impact on business models.

Therefore, ESMA emphasises the need to provide disclosures on the impact of the pandemic on the business model and value creation over the short, medium and long term and on the policies put in place to address the non-financial matters. This can for example be contingency plans and employment measures as a consequence of the decreasing demand for products or services. ESMA observes that it may be particularly important to ensure a link between the issuer’s non-financial and financial disclosure in this area. This can be done, for example, by highlighting how the financial performance and position of the issuer have been impacted for the reporting year and how this can be put into the context of the ability of the issuer to continue creating value over time.

ESMA also believes that the presentation of the business model may be facilitated by means of schematic illustrations which may then serve as a map to guide users through the disclosures relating to the different aspects of the business model.

2.4 Risk relating to climate change

As in its 2019 common enforcement priorities,[22] ESMA continues to emphasise the relevance of environmental matters and in particular the measures adopted by issuers to prevent and mitigate the negative consequences associated with climate change and with the risk of an increase in world average temperatures above 1.5 degrees.

[22] ESMA32-63-791 Public Statement – *European common enforcement priorities for 2019 annual financial reports*, 22 October 2019

ESMA therefore reminds issuers of the need to disclose, where material, both physical and transition risks related to climate change as well as any measures put in place to prevent such risks from materialising and to mitigate their effects. In their planning processes, issuers should consider how risks and opportunities connected to climate change may evolve. As such, ESMA advises issuers to provide their risk disclosures with reference to different time horizons to reflect the varying uncertainty relating to the short, medium and long term and the potential business implications under different conditions. Issuers may for example choose to prepare disclosures in this area based on the European Commission's guidelines on reporting climate-related information.[23]

ESMA encourages issuers to explain risks associated with climate change and the related mitigating actions put in place in the context of their business models, environmental policy and any objective and targets that they are pursuing in this area. The explanations should serve also to contextualise disclosures on the degree to which pre-set targets can be achieved and to explain any uncertainty surrounding them.

[23] Communication from the Commission – *Guidelines on non-financial reporting: Supplement on reporting climate-related information*, OJ C 209, 20 June 2019, p. 1-30 (please refer to paragraphs 3.1 and 3.4)

SECTION 3: OTHER CONSIDERATIONS RELATED TO ALTERNATIVE PERFORMANCE MEASURES (APMs)

ESMA reminds issuers of the guidance[24] it has provided on applying its Guidelines on APMs[25] in the context of the COVID-19 pandemic. This guidance provides indications to issuers on how they should present the impact of the pandemic on their operations for the purpose of complying with the Guidelines on APMs. In addition, the guidance will be enforcers' main reference point when examining APMs in ad hoc disclosures published under the Markets Abuse Regulation, in management reports or additional periodic financial information published under the Transparency Directive and in prospectuses published under the Prospectus Regulation.

Furthermore, ESMA encourages issuers to be mindful of the findings presented in its 2019 report on the use of APMs and the compliance with the Guidelines on APMs.[26] Notably, issuers should take account of the recommendations provided in section 5.4 thereof.

[24] ESMA32-51-370 Questions and answers – *ESMA Guidelines on Alternative Performance Measures (APMs)*, 17 April 2020 (please refer to Q&A 18)

[25] ESMA/2015/1415 Guidelines – *ESMA Guidelines on Alternative Performance Measures*, 5 October 2015

[26] ESMA32-334-150 Report – *On the use of Alternative Performance Measures and on the compliance with ESMA's APM Guidelines*, 20 December 2019