European Securities and Markets Authority

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PUBLIC STATEMENT

European common enforcement priorities for 2022 annual financial reports

INTRODUCTION FOR MANAGEMENT AND SUPERVISORY BODIES OF ISSUERS

The European Securities and Markets Authority (ESMA) issues its annual Public Statement setting out the European common enforcement priorities (ECEP) for the 2022 annual financial reports[1] of issuers admitted to trading on EEA regulated markets.

ESMA, together with national enforcers, will pay particular attention to these areas when monitoring and assessing the application of the relevant reporting requirements. In addition, enforcers will continue to focus on issues that are material for the individual reports examined. Based on the examinations performed, enforcers will take enforcement actions whenever material misstatements are identified and ESMA will report subsequently on their findings. In addition to these European priorities, enforcers may also set national priorities.

ESMA underlines the responsibility of management and supervisory bodies of issuers as well as the importance of the oversight role of audit committees (i) to ensure the overall internal consistency of the annual financial report, (ii) to implement and supervise internal controls, including those to prevent and mitigate cybersecurity risks and (iii) ultimately to contribute to high-quality annual financial reports.

The following topics are addressed in the ECEP for IFRS financial statements and non-financial statements and in the other considerations related to Alternative Performance Measures (APMs) and European Single Electronic Format (ESEF):

	Priorities related to IFRS financial statements *Section 1*	**Priorities related to non-financial statements** *Section 2*	**Other considerations related to APMs and ESEF** *Section 3*
➢ Climate-related matters	✓	✓	
➢ Russia's invasion of Ukraine	✓	[2]	[3]
➢ Macroeconomic environment	✓		
➢ Taxonomy-related disclosures		✓	[3]
➢ Reporting scope and data quality		✓	
➢ Identification of APMs and reconciliations			✓
➢ Block tagging on ESEF			✓

[1] As defined by Article 4 of Directive 2004/109/EC (Transparency Directive or TD).
[2] The impacts of Russia's invasion of Ukraine are also addressed in the priorities related to non-financial statements within the priorities on climate-related matters and reporting scope and data quality.
[3] Sections 1 and 2 include specific considerations regarding APMs.

ESMA emphasises the importance of these topics and the detailed recommendations included in this Public Statement when management and supervisory bodies of issuers undertake their respective responsibilities in relation to the 2022 annual financial reports and discuss them with their auditors.

Treatment of climate-related risks across the annual financial report

Issuers shall pay particular attention to climate-related matters and their effects when providing a balanced and comprehensive analysis of the development and performance of the undertaking's business and of its position together with a description of the principal risks and uncertainties that it faces.[4] In particular, issuers should consider whether the degree of emphasis placed on climate-related matters in the management report and the non-financial information is consistent with the extent of disclosure on how the risks and opportunities arising from climate matters have been reflected in the judgements and estimates[5] applied in the financial statements.

Enforcers may challenge, for instance, issuers' disclosed commitments to reach targets related to climate risks in order to identify and prevent potential greenwashing. Notably, enforcers may require further explanations to be disclosed[6] and/or supporting evidence to be provided to ensure the consistency and coherence of the steps planned, actions taken, and milestones foreseen with (i) the targets and commitments disclosed and with (ii) the related information on the financial impacts of such targets and commitments disclosed in the management report and in the financial statements.

Insurance Contracts

ESMA calls for transparency in the implementation of IFRS 17 *Insurance Contracts* and refers to ESMA's expectations and recommendations regarding the disclosures in the 2022 annual financial statements as outlined in ESMA's statement published in May 2022.[7] In this context, with regards to financial conglomerates, ESMA points out that the consolidation requirements of IFRS 10 *Consolidated Financial Statements* shall be applied consistently to intragroup transactions to ensure a correct application of the IFRS 17 requirements in the group financial statements. This applies, for example, to cases where non-insurance group entities (e.g., bank subsidiaries) distribute insurance products and charge distribution fees to insurance subsidiaries (in such cases, the contractual service margin (CSM) at the financial conglomerate's level will often differ from the CSM at the level of the insurance subsidiaries).

[4] Article 19 and 29 of Directive 2013/34/EU of the European Parliament and of the Council.
[5] Paragraphs 122-133 of IAS 1 *Presentation of Financial Statements*.
[6] Paragraph 112 (c) of IAS 1.
[7] ESMA, Public Statement, *Transparency on implementation of IFRS 17 Insurance Contracts,* 13 May 2022.

SECTION 1: PRIORITIES RELATED TO IFRS FINANCIAL STATEMENTS

1.1. Priority 1: Climate-related matters

Consistency between IFRS financial statements and non-financial information

ESMA reminds issuers and auditors to consider climate-related matters when preparing and auditing IFRS financial statements to the extent that the effects of those matters are material,[8] even if IFRS Accounting Standards do not explicitly refer to climate-related matters.[9] ESMA notes that the recommendations and requirements regarding climate-related matters included in the 2021 ECEP[10] remain relevant (such as the requirements related to significant judgements and estimation uncertainty, useful lives of assets, expected credit losses (ECL) and carbon and greenhouse gas (GHG) emission trading schemes), and thus, enforcers will continue to assess issuers' adherence to these recommendations and requirements with respect to the 2022 annual financial statements.

As highlighted in the introduction to this Public Statement, consistent treatment of climate-related matters across the annual financial report is a key element to prevent the risk of greenwashing. ESMA underlines that issuers shall ensure consistency between (i) the judgements and estimates[11] applied in the financial statements and the related uncertainties (including information related to the carrying amount of assets or liabilities at risk of material adjustment due to climate change in line with paragraph 125(b) of IAS 1) and (ii) the information disclosed with regards to climate-related risks and uncertainties in the management report and the non-financial statement.

Boilerplate disclosures stating that climate-related matters have been considered (for instance, in impairment tests) without further explanation as to how and to what extent it affects (or does not affect) financial statements should be avoided. Where issuers have concluded, in particular in highly exposed sectors, that no material financial impact from climate-related matters on their operations and/or in the measurement of their assets and liabilities is expected, ESMA expects those issuers to disclose the assessments performed, judgements made and the time horizon used to reach such a conclusion. Disclosures should be tailored to the specific circumstances of individual issuers.

Finally, to ease investors' access to information on material climate-related matters in financial statements, ESMA reaffirms its 2021 recommendation and encourages issuers to include all information required to be disclosed under IFRS Accounting Standards on climate-related matters in one single note, or alternatively, to provide a mapping of where different notes address climate-related matters.

Impairment of non-financial assets

As a reminder, ESMA expects issuers, in applying IAS 36 *Impairment of Assets,*[12] *to,* where relevant, (i) assess whether indications exist that non-financial assets may be impaired, for example, as a result of measures to prevent or mitigate climate-related risks, including those consistent with the objectives of contributing to the Paris agreement, (ii) use assumptions reflecting climate-related matters and (iii) adapt the sensitivity analysis disclosed to consider climate-related risks and commitments in the assumptions used. Significant changes in the market (such as a decrease in demand for goods and services) or in the regulatory environment in which the asset operates, or changes to the issuer's plans for the asset as a result of climate commitments are examples of external or internal indicators of impairment linked to climate-related risks that should be considered in line with paragraph 12 of IAS 36.

[8] IASB, *IFRS Practice Statement 2: Making Materiality Judgements,* 14 September 2017.
[9] IASB, *The effects of climate-related matters on financial statements prepared applying IFRS Standards,* November 2020.
[10] ESMA, Public Statement, *2021 European Common Enforcement Priorities,* 29 October 2021.
[11] Paragraphs 122-133 of IAS 1.
[12] Paragraphs 9-14, 30-33, 134 of IAS 36.

ESMA notes that the recoverable amount of cash-generating units (CGUs) may be impacted by (i) decreases in expected revenues related to changes in customer behaviours (for example, in favour of cleaner industries or greener products) and/or (ii) anticipated costs and capital expenditures to meet the issuer's or local commitments to achieve net zero emissions by 2050 or sooner, including but not limited to the replacement of fossil fuel energy through more sustainable energy alternatives. ESMA notes, however, that paragraph 44 of IAS 36 does not permit the inclusion of cash flows expected to arise from improvements or enhancements to an asset's performance when calculating the asset's value in use. Where anticipated climate-related impacts such as on weather (e.g., drought, flooding) are identified, ESMA expects issuers to ensure that these aspects are factored in when calculating the expected cash flows used in the determination of the recoverable amount.

ESMA notes that while climate-related risks may affect to a more limited extent short-term cash flow projections, they may have material implications in the medium and long-term. Therefore, ESMA expects that, in industries highly dependent on fossil fuel energies, long term or terminal growth rates used in cash flow projections beyond the period covered by budget forecasts are steady, declining or even negative.[13]

Where material, ESMA also expects issuers, in applying paragraph 134 (d) of IAS 36, to provide comprehensive disclosures on whether and how climate-related matters are factored into the determination of cash flows, of the discount rate used (such as WACC), and of the growth rate or terminal value. Issuers should disclose the key assumptions on which management has based its cash flow projections, including, where applicable, disclosure of how climate-related expenditures necessary to meet the issuer's decarbonisation strategy (including carbon credits) were incorporated and disclosure explaining how climate scenarios were taken into account in cash flows scenarios.

Finally, ESMA expects issuers to provide clear descriptions of the climate-related assumptions made in their sensitivity analysis disclosed. For example, automobile companies should disclose how phasing out of internal combustion engine vehicles in favour of electric vehicles was considered in the input parameters. Where commodities prices are considered key assumptions (such as oil, gas or electricity prices), ESMA expects that issuers provide quantification of these assumptions, including an explanation of how the figures have been derived, any associated judgements and sensitivity analysis. [14]

Provisions, contingent liabilities and contingent assets

ESMA draws issuers' attention to the requirements in IAS 37 *Provisions, Contingent Liabilities and Contingent Assets* as climate commitments such as reductions of carbon emissions may give rise to legal or constructive obligations under paragraph 10 of IAS 37.[15]

Power purchase agreements

ESMA has noted that some issuers have established agreements that define the price for the delivery of green energy in advance of their consumption (e.g., virtual power purchase agreements) to enable them to achieve their objectives of reducing their carbon footprint and/or to hedge against volatile prices. ESMA calls for transparency on the financial impacts and the accounting treatment applied to such agreements, including but not limited to, whether those agreements include clauses that require the issuer to (i) consolidate any entities under IFRS 10 or apply the equity method under IFRS 11 *Joint Arrangements* or (ii) account for the contracts under IFRS 16 *Leases* or IFRS 9 *Financial Instruments.*

[13] Paragraph 36 of IAS 36.

[14] Paragraphs 30 and 134 (d), (e) and (f) of IAS 36 and paragraphs 125-129 of IAS 1 (where there is significant risk of resulting in a material adjustment to the carrying amounts of assets and liabilities).

[15] Please refer to IFRS IC decision on *negative low emissions vehicle credits—IAS 37*, 20 July 2022.

1.2. Priority 2: Direct financial impacts of Russia's invasion of Ukraine

ESMA statement on implications of Russia's invasion on half-yearly financial reports

In May 2022, ESMA published a statement[16] addressing the implications of Russia's invasion of Ukraine on half-yearly financial reports. ESMA considers that most messages included therein[17] are also relevant in the context of annual financial statements. Therefore, when examining the 2022 annual financial reports, enforcers will pay particular attention to these areas when monitoring and assessing the application of the relevant reporting requirements. In addition, ESMA reminds issuers of the following requirements.

Presentation of the impacts of Russia's invasion in the financial statements

ESMA calls for caution regarding any separate presentation of the impacts of Russia's invasion of Ukraine in the profit or loss statement. Due to the pervasiveness of such impacts, a separate presentation may not faithfully represent an issuer's overall financial performance and may be misleading to users' understanding of the financial statements. Consequently, instead of presenting the impacts separately in the profit or loss statement, ESMA urges issuers to disclose, in the notes, qualitative and quantitative information on the significant impacts, the judgements and assumptions applied in the recognition, measurement and presentation of assets, liabilities as well as with regards to profit or loss effects. ESMA underlines that such impacts should be provided in a clear and unbiased way. When including APMs in management reports, ad-hoc disclosures under the Market Abuse Regulation[18] or prospectuses under the Prospectus Regulation,[19] issuers should consider the guidance in Q&A 18 of ESMA Q&As on APMs.[20]

Loss of control, joint control or the ability to exercise significant influence

ESMA notes that assessing whether control, joint control or significant influence has been lost requires a careful consideration of all facts and circumstances and potentially the use of judgement. ESMA calls for heightened attention to clauses included in contracts to dispose of interests in other entities that (i) include call options to buy back shares or deferred payments, or (ii) enable a continuing involvement with the local management and/or with the operation of a business. Issuers should consider carefully, if, in light of the existence of such contracts and clauses, they meet the requirements set out in IFRS 10, IFRS 11 or IAS 28 *Investments in Associates and Joint Ventures* on losing control, joint control or significant influence. ESMA expects that, where such clauses exist, issuers should provide detailed disclosures of the sale agreements (e.g., whether the buyer is local management, the main characteristics of call options, the main features of clauses which may imply the issuer's continuing involvement in the operational or financial activities of the entities sold). ESMA also reminds issuers that options (such as call options to buy back shares) may have to be accounted for at fair value with fair value changes recognised through profit or loss under IFRS 9.

Discontinued operations, non-current assets and disposal groups held for sale

ESMA acknowledges that some issuers have presented exit plans concerning operations located in Russia and Belarus. In this context, ESMA reminds issuers that a discontinued operation is a component of an entity that either has been disposed of, or is classified as held for sale, and either (a) represents a separate major line of business or geographical area of operations, or (b) is part of a single coordinated plan to dispose of a separate major line of business or geographical area of operations. ESMA urges caution regarding the classification of non-current assets held for sale and/or discontinued operations under IFRS 5 *Non-current Assets Held for Sale and Discontinued Operations* and calls for transparency regarding any judgements made on the classification and measurement of assets and liabilities under this

[16] ESMA, Public Statement, *Implications of Russia's invasion of Ukraine on half-yearly financial reports*, 13 May 2022.
[17] Including ESMA recommendations regarding interim management reports.
[18] Regulation (EU) No 596/2014
[19] Regulation (EU) 2017/1129
[20] ESMA, *Questions and answers – ESMA Guidelines on APMs,* 1 April 2022, Question 18 which was developed for Covid impacts should be applied *mutatis mutandis* to the impacts of Russia's invasion of Ukraine.

Standard. Issuers should also ensure consistency between the information included in financial statements and in management reports and/or ad-hoc disclosures.

Impairment of non-financial assets

In addition to the messages included in the ESMA statement on implications of Russia's invasion on half-yearly financial reports, ESMA expects that, as a result of the gas supply restrictions and potential rationing of energy to certain industries in connection with the Ukrainian/Russian conflict, issuers should consider the impact of various energy price-scenarios and potential restrictions in their impairment test sensitivity analysis and disclose the key assumptions made in accordance with paragraph 134 (f) of IAS 36.

1.3. Priority 3: Macroeconomic environment

ESMA observes that the current macroeconomic environment, resulting from a combination of remaining pandemic-related effects, inflation, increase in the interest rates, deterioration of the business climate, geopolitical risks and uncertainties regarding future developments, pose significant challenges to issuers and their operations. ESMA urges issuers to (i) assess and reflect the impacts that the macroeconomic environment and uncertainties[21] will have on their financial statements (for example, on the issuer's ability to continue as a going concern or the impacts of energy costs on their operations) and (ii) provide clear and detailed disclosures to ensure that investors obtain relevant, accurate and timely information.

Impairment of non-financial assets

ESMA expects that the increased interest rates and uncertainty will affect the discount rates used in impairment tests. Amongst other aspects, increases in discount rates which could lead to material decreases in recoverable amounts are indications to consider when assessing whether assets may be impaired.[22]This is even more relevant if the 2021 recoverable amount was particularly sensitive to moderate discount rate increases. In addition, ESMA expects that issuers exposed to high price volatility of commodities (e.g., oil, gas, electricity and certain agricultural products) provide granular disclosures of how the key assumptions used in impairment tests (cash flows projections, terminal value and growth rates) took such volatility and price increases into account, both with regards to the costs of production and the company's ability to pass on higher costs to their customers. Where relevant, issuers should disclose how government measures taken to mitigate the effect of price increases were considered.

In light of the current macroeconomic environment, ESMA expects that issuers (i) ensure that potential indications of impairment are identified and acted upon on a timely basis,[23] (ii) explain the impact of the increasing interest rates on impairment tests (e.g., potential changes in WACC) and (iii) consider adjustments to the range of reasonable possible changes in assumptions in their sensitivity analysis.[24]

Employee benefits

ESMA reminds issuers to ensure that actuarial assumptions used reflect the current economic outlook and are mutually compatible, including estimated future salary increases.[25] ESMA is aware that some post-employment benefit plans are linked to inflation and some issuers may have a past history of increasing benefits to mitigate the effects of inflation, with no indication that this practice will change in the future.[26] Finally, ESMA expects issuers to provide the disclosures required by paragraphs 140-141 (reconciliations), 144 (actuarial assumptions) and 145 (sensitivity analysis) of IAS 19.

[21] Paragraph 125 of IAS 1.
[22] Paragraph 12 (c) of IAS 36.
[23] Paragraph 9 of IAS 36.
[24] Paragraph 134 (d)(i) and (f) of IAS 36.
[25] Paragraphs 75 and 87 (b) of IAS 19.
[26] Paragraph 88 of IAS 19.

Revenue from contracts with customers

ESMA calls for caution in recognising an asset from the costs incurred to fulfil a contract in accordance with paragraph 95 (c) of IFRS 15 in a context of strong inflation, as additional costs due to the rising prices of materials, energy costs, salary increases, for instance, might not be recovered. In addition, issuers, who may not be able to reflect the increase of costs in the sale prices of services and goods, may need (i) to assess whether contracts have become onerous in accordance with IAS 37[27] and (ii) to provide the adequate disclosures in line with paragraphs 84 and 85 of IAS 37.

ESMA also reminds issuers who are able to increase their contracted selling prices about the requirements for: (i) variable consideration through an inflation index under paragraphs 84 to 86 or (ii) changes in the transaction price under paragraphs 87 to 90 of IFRS 15. ESMA expects issuers to provide the disclosures required by paragraph 126 of IFRS 15.

Financial instruments

In the current environment of increasing interest rates and borrowing costs, ESMA highlights the importance of disclosures that enable users of the financial statements to evaluate (changes in) issuers' exposure to interest rate risks, commodity price risks and related liquidity risks in accordance with paragraph 31 of IFRS 7 *Financial Instruments: Disclosures*. Where material, issuers shall provide detailed sensitivity analyses for these types of risks, including a description of the methodologies and assumptions applied and the changes from the previous period.[28]

ESMA notes that the current macroeconomic environment may pose a significant challenge for the ECL models used by financial institutions due to a lack of experience in modelling such circumstances. ESMA therefore highlights the need for providing sufficient transparency on the impact the changing economic environment has on the ECL calculation to enable users of financial statements to understand the effect of credit risk on the amount, timing and uncertainty of future cash flows as required by paragraph 35B of IFRS 7. In addition, ESMA reiterates the message included in its 2021 ECEP on the need for enhanced transparency when material adjustments ('management overlays') are used in the measurement of ECL.

Moreover, ESMA notes that different groups of borrowers may be affected differently by the current macroeconomic developments. Rising energy costs are expected to have sector-specific effects. The ability to pass the inflation on to clients varies across the economic sectors. In addition, different sectors are uniquely exposed to global trade dependencies (customers and suppliers from different regions with their specific risks) as well as risks arising from technological and environmental transformation. In light of this, ESMA calls for enhanced consideration of sector-specific drivers in the banks' ECL measurement and the provision of detailed disclosures on risk concentrations related to specific sectors.[29]

Finally, ESMA notes that reclassifications of financial assets are only permitted when an issuer changes its business model for managing financial assets and are applied prospectively from the reclassification date (paragraphs 4.4.1 and 5.6.1 of IFRS 9). ESMA expects such reclassifications to be very infrequent, even in the current macroeconomic context. The changes must be significant to the issuer's operations and demonstrable to external parties.[30] In the case of a reclassification, issuers shall provide a clear and detailed explanation of the change in business model and other disclosures required by IFRS 7.[31]

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[27] As recently amended to precise how to determine the cost of fulfilling a contract, such amendments being mandatorily applicable for annual reporting periods beginning on or after 1 January 2022.
[28] Paragraph 40 of IFRS 7.
[29] Paragraphs B5.5.1 and B5.5.4 of IFRS 9.
[30] Paragraphs B4.4.1 – B4.4.3 of IFRS 9.
[31] Paragraphs 12B, 12C and 12D of IFRS 7.

SECTION 2: PRIORITIES[32] RELATED TO NON-FINANCIAL STATEMENTS

2.1 Priority 1: Climate-related matters

ESMA observes that legislators, regulators and users of non-financial information currently have a strong focus on climate change. The EU has adopted the European Green Deal to transition to a more sustainable economic and financial system, and in the coming years detailed reporting requirements on climate change will become applicable as part of the European Sustainability Reporting Standards under the upcoming Corporate Sustainability Reporting Directive. For these reasons, in applying the requirements of the Non-Financial Reporting Directive (NFRD), issuers should be mindful that the general expectation from both users and regulators is in the direction of increased transparency on climate-related matters.

Strategy

One particularly important disclosure area related to climate is represented by transition plans which help users understand whether and how an issuer intends to shift its business model, operations and asset base towards a trajectory that is compatible with the latest climate science recommendations. ESMA observes that increased transparency is needed when issuers prepare transition plans, as some issuers tend to present ambitious goals without addressing how these goals were established / under which scenario they are developed and how the issuer concretely intends to reach them. ESMA calls on issuers to provide specific disclosure covering, for example, the reference scenario used, the means the issuer will use to accomplish its transition plan (e.g., changing its supply chains and / or asset base), how many resources it will allocate to this and the challenges it may face in reaching its goals. In this regard, ESMA reminds issuers of the guidance included in the European Commission's *Guidelines on reporting climate-related information*, section 3.1.[33]

In the context of transition plans, ESMA further urges issuers to be cautious as well as specific in their disclosure on carbon neutrality commitments. Therefore, issuers should avoid making boilerplate claims and should instead provide concrete explanations of how they intend to contribute to carbon neutrality. This may notably include the levers for action they will use (reducing their own greenhouse gas (GHG) emissions, increasing carbon sinks, etc.). In this regard, ESMA reminds issuers to clarify which base year they have used for determining their reductions and recommends that issuers make a clear distinction in their disclosure between GHG emission reductions in the value chain and other contributions occurring outside the value chain, such as the use of carbon credits, so that users get a clear understanding of the relative contribution of each in the undertaking's carbon neutrality efforts.

Metrics and targets

Climate-related key performance indicators (KPIs) are an important way for issuers to give users a clear understanding of their past performance and future ambition. A particularly relevant topic is the disclosure issuers provide in relation to their GHG emissions.

In relation to GHG emission reduction targets (forward-looking disclosure), ESMA's review of the implementation of the 2020 ECEP,[34] summarised in its last activity report[35], showed that issuers tend not to include sufficient explanations on the uncertainties that surround their climate-related targets. Targets are a powerful way of showing climate ambition and may give users an overly optimistic impression if they

[32] Member States have transposed Articles 19a and 29a of the Accounting Directive with some differences. As a result, a limited number of enforcers 1) can supervise and enforce non-financial information only if it is set out within the management report or published together with it or 2) only have the power to check the *existence* of the non-financial information as opposed to the *content* or 3) 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.
[33] European Commission, *Guidelines on reporting climate-related information*, 17 June 2019.
[34] ESMA, Public statement – *European common enforcement priorities for 2020 annual financial reports*, 28 October 2020.
[35] ESMA, Report – *2021 Corporate reporting enforcement and regulatory activities*, 30 March 2022.

are communicated without context. ESMA therefore highlights that a true and fair (re)view would require issuers to be balanced in their disclosure of GHG emission reduction targets and to explain how likely it is, in light of science-based evidence, that those targets will be achieved given current and potential future challenges. Where issuers have been unable to make the expected progress towards their targets, they should explain why, as required by Article 19a(1) / 29a(1) of the NFRD.

To achieve a balanced presentation and a fair review, it is important that when issuers address one sustainability matter, they do not omit material information on the other matters referred to in the NFRD. This might be the case, for example, if an issuer would leave out material information on expected negative impacts on other sustainability matters arising from the measures they have taken, or plan to take, to reduce their GHG emissions. ESMA therefore invites issuers to disclose material conflicts among different environmental objectives to the extent this is necessary to enable a proper understanding of the impact of its activity, as required by Article 19a(1) /29a(1) of the NFRD.

In relation to metrics for actual emissions (backward-looking disclosure), ESMA reminds issuers that Article 19a(1)(e) / 29a(1)(e) of the NFRD requires transparency on the metrics used. ESMA considers that material information on metrics includes the methodological principles, including assumptions, and reporting boundaries underpinning those metrics. This is especially relevant for Scope 3 GHG emissions, since the way an undertaking defines the boundaries of its Scope 3 emissions can significantly impact the total volume of emissions. Additionally, data on Scope 3 emissions may be connected with more uncertainty as it relates to activities in an undertaking's value chain. Therefore, ESMA urges issuers to provide clear disclosure on their Scope 3 emissions. Notably, issuers should clearly explain the boundaries they use, provide justifications if certain Scope 3 elements are excluded from the calculation and mention any uncertainties connected to their data. ESMA reminds issuers that the European Commission's *Guidelines on reporting climate-related information* contain helpful guidance on this matter in section 3.5. Furthermore, if issuers have material Scope 3 emissions but do not provide disclosure on them, ESMA would expect that they explain why.

ESMA observes that some issuers may conclude that Russia's invasion of Ukraine will impact their ability to meet their pre-defined targets, in particular in relation to GHG emissions and transition plans (due to issues such as disruptions in the supply of natural gas and consequent shift to other, more emission-intense, energy sources). Issuers should be clear about whether their transition plans have been affected and, when they have, they should provide the reasons they were unable to meet their targets and pursue their transition plans in 2022, in accordance with Article 19a(1) / 29a(1) of the NFRD.

Material impacts, risks and opportunities and connectivity with financial reporting

ESMA observes that the double materiality perspective is a key pillar of the NFRD. In this context, ESMA invites issuers to keep enhancing their descriptions of how they have identified the material impacts, risks and opportunities connected with climate change for their undertaking. Issuers are reminded that the European Commission's *Guidelines on reporting climate-related information* provide relevant guidance in this regard (sections 2.2 and 2.3).

Lastly, as highlighted in the introduction to this Public Statement, ESMA observes that users continue to require a strong link between issuers' non-financial information and financial reporting.

2.2 Priority 2: Disclosures relating to Article 8 of the Taxonomy Regulation

Non-financial undertakings: reporting on alignment with climate change objectives in 2023

ESMA observes that 2023 is an important year for the reporting under Article 8 of the Taxonomy Regulation (TR), as financial year 2022 is the first time non-financial undertakings are required to disclose not only the taxonomy eligibility, but also the taxonomy alignment, of their economic activities vis-à-vis the climate change mitigation and climate change adaptation objectives, including the disclosures foreseen in the complementary climate delegated act (Delegated Regulation (EU) 2022/1214).[36] In this context, ESMA reminds issuers that it is mandatory to use the templates in Annex II of the Article 8 Disclosure Delegated Act.[37] ESMA further underlines that when the same activity substantially contributes to multiple environmental objectives, no more than 100% of the total turnover, CapEx and OpEx related to that activity can be allocated for the purpose of the taxonomy analysis. Furthermore, the aggregation of eligible and non-eligible activities should always amount to 100% of the issuer's activities. ESMA also highlights that the disclosure required by the Article 8 Disclosure Delegated Act is not subject to the materiality assessment and should always be provided (except where the materiality exemption relating to OpEx for non-financial undertakings applies, cf. Article 8 Disclosure Delegated Act, Annex I, Section 1.1.3.2 which requires specific disclosures in these cases).

In addition to the quantitative information which is to be provided in the templates, ESMA highlights the importance of the accompanying contextual information. One area in which ESMA calls on issuers to provide robust disclosure is the description of the nature of their economic activities, whether they are taxonomy eligible and aligned and how compliance with the alignment criteria has been assessed (Article 8 Disclosure Delegated Act, Annex I, Section 1.2.2.1). So far, some issuers have tended to provide very generic disclosure in relation to whether their economic activities are taxonomy eligible (limited to "our activities X, Y and Z are [/ are not] eligible").

ESMA observes that users need more information to understand issuers' assessment, regardless of the outcome of the assessment. This includes information on the assumptions issuers have made on the alignment criteria, including the principles on 'do no significant harm' and minimum social safeguards, notably in relation to assets and activities outside of the EU. Such enhanced transparency is important in relation to the assessment of eligibility and will be especially important in relation to the assessment of alignment. Furthermore, ESMA reminds issuers of the importance of ensuring strong transparency on the methodological choices they have made when preparing their disclosure. This transparency should cover information on specific areas of judgement and the methodological principles issuers have followed (e.g., how they have ensured that they avoid double counting).

ESMA additionally notes that Sections 1.2.1 and 1.2.3 of Annex I to the Article 8 Disclosure Delegated Act require issuers to be transparent in case there are large variations in the eligibility rate of their economic activities compared to the eligibility rate they disclosed in 2022. Reasons for such variations may for example be that the issuer commenced a new eligible activity or that it has fine-tuned its methodology for assessing eligibility. Equally, it is helpful for users to receive explanations for large differences between the eligibility rate and the alignment rate of an issuer's economic activities. ESMA notes that such large differences will most likely arise because of the stricter conditions associated with alignment compared to eligibility.

Lastly, ESMA invites issuers to make sure there is consistency between the disclosure they provide in relation to Article 8 and disclosure elsewhere in the non-financial reporting (e.g., consistency with the issuer's strategy and policies related to climate change).

ESMA reminds issuers that a number of resources are available to support them as they prepare their Article 8 reporting. Firstly, the European Commission has issued two documents with guidance on frequently asked questions.[38] Secondly, ESMA has issued two Q&As relating to ESG financial measures.[39]

[36] ESMA notes that according to Article 27(2)(b) of the TR, starting from 1 January 2023, the reporting under Article 8 shall address all six environmental objectives listed in Article 9 of the TR. According to Article 3(d) of the TR, an economic activity shall qualify as environmentally sustainable where, amongst other conditions, it complies with technical screening criteria established by the European Commission. ESMA observes that, at present, the technical screening criteria for the remaining four environmental objectives (i.e., points (c), (d), (e) and (f) of Article 9 of the TR) are not established in EU law.

[37] Commission Delegated Regulation (EU) 2021/2178.

[38] European Commission, *FAQ 1*, December 2021; European Commission *FAQ 2*, February 2022.

[39] ESMA, *Questions and answers – ESMA Guidelines on APMs*, 1 April 2022 (Questions 19 and 20).

Financial undertakings: preparedness for taxonomy alignment reporting in 2024

ESMA reminds financial undertakings of their upcoming obligation to disclose not only the taxonomy eligibility, but also the taxonomy alignment, of their economic activities in 2024. To ensure preparedness, ESMA urges these issuers to finalise the necessary steps to enable their systems to support this increased reporting requirement.

2.3 Priority 3: Reporting scope and data quality

Scope of the issuer's non-financial reporting (value chains)

ESMA observes that, to provide a comprehensive picture of the non-financial matters listed in Article 19a(1) / 29a(1) of the NFRD, an undertaking would have to report on at least the same scope as that used for its financial reporting. ESMA further notes that Article 19a(1)(d) and 29a(1)(d) of the NFRD require undertakings / groups to disclose information on risks linked to their own operations, including, where relevant and proportionate, those of their business relationships, products or services that are likely to cause adverse impacts – an approach that will be further reinforced in the future European Sustainability Reporting Standards.

With this in mind, ESMA invites issuers to consider reporting on a larger perimeter than that used for its financial reporting when this would be necessary to provide material information on non-financial matters. To this end, ESMA recommends that issuers describe their supply and sales chains (suppliers, subcontractors, distributors, franchisees and other relevant third parties in the value chain) and clarify the extent to which they have covered these entities in their non-financial reporting. Issuers who have not previously covered the value chain in their non-financial reporting could consider identifying KPIs of particular significance for them and expanding their reporting perimeter to cover (parts of) the value chain on those KPIs. For example, as noted in Section 2, *Priority 1: Climate-related matters* of this Public Statement, Russia's invasion of Ukraine may cause disruptions in some issuers' value chains. This may have an impact on the climate-related matters of those issuers, but possibly also on other sustainability areas and, therefore, constitute material information that should be disclosed.

Regardless of whether the issuer decides to expand its scope, ESMA recommends that issuers explicitly state whether the reporting scope corresponds to that used in the issuer's financial reporting.

Apart from expanding the scope, issuers may also sometimes make exclusions to their non-financial reporting scope compared to financial reporting. When this is the case, issuers should specify the type of exclusion (subsidiary, geographic area, segment, etc.), its scale (does it affect one or several KPIs, one or more policies, etc.) and the reasons for the exclusion (immateriality, lack of access to the necessary data beyond reasonable efforts, etc.).

Robustness of the data used for the non-financial reporting

ESMA observes that the value of an issuer's non-financial reporting can only be as good as the quality of the underlying data. To provide users with transparency on data quality, issuers can consider reporting on their data collection processes and the due diligence performed by their board or other relevant internal decision-making bodies in relation to the data. In this regard, ESMA highlights the important role which robust information systems play for data collection and management.

SECTION 3: OTHER CONSIDERATIONS

Alternative Performance Measures (APMs)

ESMA reminds issuers that some subtotals included within the primary financial statements or in the notes (such as Operating Results, EBIT, EBITDA or financial ratios) are within the scope of the Guidelines if those are included simultaneously also outside the financial statements. Therefore, ESMA expects issuers to comply with the Guidelines if they decide to include such subtotals in their management report, ad-hoc disclosures and/or prospectuses. ESMA highlights that ESMA Q&A no. 2[40] provides further information on this matter.

Without prejudice of the above and where applicable, ESMA reminds issuers, amongst other requirements, to provide reconciliations of the APM to the most directly reconcilable line item, subtotal or total presented in the financial statements of the corresponding period, separately identifying and explaining the material reconciling items.[41] In addition, definitions should describe all components of a specific APM. In this respect, definitions whereby issuers only refer to non-recurring or special items without separately identifying what these items refer to are not compliant with the Guidelines and should not be used.[42]

ESMA reminds issuers that, according to paragraph 41 of the APM Guidelines, the definition and calculation of an APM should be consistent over time. Therefore, ESMA recommends that issuers use caution when making adjustments to APMs used and/or when including new APMs.

European Single Electronic Format (ESEF)

ESMA reminds issuers that, starting from financial year 2022, disclosures included in IFRS consolidated financial statements shall be marked up, as a minimum, with the elements contained in Annex II of the RTS on ESEF.[43] Annex II of the RTS on ESEF includes a number of elements defined with the “textBlockItemType” i.e., block tags for larger pieces of information which are of different granularity. Therefore, issuers should consider the accounting meaning of a taxonomy element when selecting the appropriate block tag for marking up such disclosure. This is particularly important when there are multiple block tags of different granularity (with narrower and wider elements) that can match a given disclosure. In such cases, issuers should use each of the tags and multi tag the information to the extent that it corresponds with the underlying accounting meaning of the information.

Finally, issuers are encouraged to consult the update to the ESEF Reporting Manual[44] where notably a new section 1.9 “Block tagging” provides further guidance on ESMA’s expectations on how to perform block tagging, for example, multi tagging of information, the granularity expected when block tagging tables or how to block tag information contained in different sections of the notes.

[40] ESMA, *Questions and answers – ESMA Guidelines on APMs,* 1 April 2022.
[41] ESMA, Guidelines, *ESMA Guidelines on APMs*, 5 October 2015 (please refer to paragraph 26 of the APM Guidelines).
[42] ESMA, Report, *On the use of APMs and on the compliance with ESMA’s APM Guidelines*, 20 December 2019.
[43] Commission Delegated Regulation (EU) 2019/815.
[44] ESMA, *ESEF Reporting Manual*, 5 August 2022.