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PUBLIC STATEMENT

European common enforcement priorities for 2023 annual financial reports

INTRODUCTION

The European Securities and Markets Authority (ESMA) issues its annual Public Statement setting out the European common enforcement priorities (ECEP) for the 2023 annual financial reports[1] of issuers admitted to trading on European Economic Area (EEA) regulated markets.

ESMA, together with national enforcers in the EEA (enforcers), will pay particular attention to these areas when examining the application of the relevant reporting requirements. In addition, enforcers will continue to focus on other entity-specific issues. 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, 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 in relation to Alternative Performance Measures (APMs) and European Single Electronic Format (ESEF):

	Priorities related to IFRS financial statements	**Priorities related to non-financial statements**	**Other considerations on APMs and ESEF**
Jump to…	*Section 1*	*Section 2*	*Section 3*
Climate and other environmental matters			
• *Impact on the financial statements*	✓		
• *Article 8 of the Taxonomy Regulation*		✓	
• *Targets, actions and progress*		✓	
• *Scope 3 emissions*		✓	
Macroeconomic environment	✓		
Identification and consistency of APMs			✓
ESEF block tagging			✓

ESMA urges issuers, supervisory bodies and auditors to consider the topics and detailed recommendations included in this Public Statement when preparing, supervising and auditing the 2023 annual financial reports. These recommendations should be taken into account by issuers in light of their materiality and relevance for the issuer's operations and annual financial report.

[1] As defined by Article 4 of Directive 2004/109/EC (Transparency Directive or TD).

General considerations and reminders

Insurance Contracts

In the first year of application of the new requirements pursuant to IFRS 17 *Insurance Contracts*, ESMA reiterates the call for transparency in the implementation of this standard. Disclosures are required on significant judgements, estimates and accounting policies with a particular focus on the transition impacts[2]. The disclosures should also include information about the interactions between the implementation of IFRS17 and IFRS 9 *Financial Instruments*. ESMA refers to its statements published in 2022 (on IFRS 17)[3] and in 2016 (on IFRS 9)[4] and also to the APMs subsection of this statement.

Amendments to IAS 12: International Tax Reform Pillar Two Model Rules[5]

Issuers shall consider the application of the mandatory temporary exception from the recognition and disclosure of deferred taxes arising from implementation of the OECD's Pillar Two Model Rules. For periods in which Pillar Two legislation is (substantively) enacted but not yet effective, issuers should disclose information known or reasonably estimable (qualitative and quantitative information) to help users of financial statements to understand the issuer's exposure to Pillar Two income taxes at the end of the reporting period.

Considerations on sustainability reporting

Preparations in view of the entry into application of the Corporate Sustainability Reporting Directive

As of first January 2024, the reporting requirements set out in the Corporate Sustainability Reporting Directive (CSRD) will become applicable for the annual financial reports published in 2025. While the related European Sustainability Reporting Standards (ESRS), are still undergoing the legislative process after their adoption by the European Commission on 31 July 2023[6], it can generally be expected that the issuers impacted by the new requirements will likely face a significant learning curve when implementing the new requirements.

Issuers are therefore expected to start as soon as possible *ad-hoc* transition projects to implement the new requirements. To support the implementation of the ESRS, EFRAG, the body providing technical advice to the European Commission on the draft ESRS, has indicated that it will host an online portal for technical questions. Issuers are also encouraged to consider liaising with their enforcers on any application questions. ESMA and enforcers are ready to contribute to implementation support with the objective of promoting consistent application of the ESRS.

ESMA highlights that the larger scope of application envisaged by the CSRD compared to the Non-Financial Reporting Directive (NFRD) will result in an extension to a wider group of issuers of the reporting requirements pursuant to the Taxonomy Regulation. ESMA therefore stresses the importance for issuers that are new to these requirements to put in place adequate planning and resources to ensure that they are able to undergo this *dual transition* towards both ESRS and compliance with the Taxonomy Regulation.

ESMA notes that amongst the first issuers that will apply the new CSRD requirements from the financial year 2024 most issuers will already have experience with the preparation of non-financial statements. While these issuers will generally be able to leverage on the existing reporting to prepare their future sustainability information under the CSRD, the time and effort needed for an effective and timely transition to the new requirements is still expected to be substantive. Key organisational decisions in terms of data collection and

[2] ESMA notes that for some issuers, 2023 is also the first year of implementation of IFRS 9.
[3] ESMA, Public Statement, *Transparency on implementation of IFRS 17 Insurance Contracts*, 13 May 2022
[4] ESMA, Public Statement, *Issues for consideration in implementing IFRS 9: Financial Instruments*, 10 November 2016.
[5] Subject to endorsement.
[6] The final European Commission delegated regulation was adopted on 31 July 2023 by the European Commission, the relevant documents are available here. Alongside the final delegated act, the Commission has also published a Q&A document which can be found here. In terms of next steps, the ESRS delegated act will be formally transmitted to the European Parliament and to the Council for scrutiny. The scrutiny period runs for two months, extendable by a further two months. The European Parliament or the Council may reject the delegated act, but they may not amend it.

elaboration flows, internal controls, procedures supporting the mandatory assurance requirement will therefore need to be carefully considered. These decisions should also take into account the need to establish closer connectivity with the financial statements, of which the new sustainability reporting should effectively constitute a separate, but closely connected counterparty.

ESMA stresses that all issuers preparing consolidated sustainability reporting will need to ensure that an effective, consistent and sound process for the production, collection and consolidation of sustainability-related data exists across the group's entities, including for what concerns the reporting from relevant actors of the respective value chains. ESMA also highlights the importance of conducting adequate education initiatives and onboarding of the group entities, including for their administrative, management and supervisory bodies. ESMA also recommends that issuers build and, where necessary, acquire as soon as possible the necessary resources and competences to effectively apply the new requirements.

The above considerations also apply to the remaining issuers which will gradually apply the CSRD requirements, starting from 1st January 2025 and from 1st January 2026 for listed small and medium sized entities. ESMA therefore highlights the importance also for issuers with less experience in the application of non-financial reporting requirements to set up the necessary implementation projects to adopt these new requirements on a timely basis.

European Commission's recommendation on Transition finance

On 27 June 2023, the European Commission published a Recommendation[7] aimed at providing guidance as well as practical examples for companies and the financial sector on the use of various tools of the EU sustainable finance framework on a voluntary basis to channel the investments into the transition and manage their risks stemming from climate change and environmental degradation. Amongst other aspects, this recommendation highlights, in particular: the application of a double materiality analysis to define entity-specific transition pathways, the use of the EU Taxonomy as a transition tool beyond a reporting tool and the relevance that credible transition plans and the related metrics and targets have for investors that are willing to fund the transition efforts of the concerned issuers. ESMA strongly encourages issuers to carefully consider this Recommendation whose relevant contents will further be referred to in Section 2.

SECTION 1: PRIORITIES RELATED TO IFRS FINANCIAL STATEMENTS

1.1 Priority 1: Climate-related matters

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]. Considering the continuing rising prevalence and relevance of climate-related matters to investors, this Public Statement reinforces and builds on IFRS requirements as highlighted by the IASB in its educational material[9] and included in the 2021 and 2022 ECEP[10]:

2021 ECEP	2022 ECEP
• *Significant judgements and estimation uncertainty* • *Useful lives of assets* • *Expected credit losses (ECL)* • *Carbon and greenhouse gas (GHG) emission trading schemes*	• *Consistency between IFRS financial statements and non-financial information* • *Impairment of non-financial assets* • *Provisions, contingent liabilities and contingent assets* • *Power purchase agreements (PPAs)*

[7] *Commission Recommendation (EU)2023/1425 of on facilitating finance for the transition to a sustainable economy*, 27June 2023.
[8] IASB, *IFRS Practice Statement 2: Making Materiality Judgements*,14 September 2017.
[9] IASB, *Effects of climate-related matters on financial statements*, republished in July 2023.
[10] ESMA, Public Statement, *2021 European Common Enforcement Priorities*, 29 October 2021.
ESMA, Public Statement, *2022 European Common Enforcement Priorities*, 28 October 2022.

Enforcers will continue to monitor issuers' adherence to these requirements and recommendations with respect to the 2023 annual financial statements. Furthermore, issuers are also encouraged to consider ESMA's report *Disclosures of Climate-Related Matters in the Financial Statements*,[11] which provides practical examples on how issuers may improve their disclosures on climate-related matters in IFRS financial statements.

Consistency between IFRS financial statements and non-financial information

Consistent treatment of climate-related matters across the annual financial report is a key element in mitigating the risk of greenwashing[12]. ESMA continues to call for consistency between the assumptions used in estimations and measurements related to climate matters and the information provided across the different sections of the annual financial report, with a focus on climate-related commitments and targets, such as the reduction of greenhouse gas (GHG) emissions and decarbonisation plans[13]. In this respect, ESMA expects that issuers assess and, where relevant, disclose in the financial statements the timing and the financial impacts of planned investments and transition plans (e.g. costs or investments incurred or to be incurred to reach such objectives).

Furthermore, where applicable, issuers should explain any deviations between the assumptions used in impairment tests (including sensitivity analysis)[14] or provisions recognised (or not) and their climate-related commitments, plans and/or strategy.

Accounting for emission trading schemes and renewable energy certificates

ESMA reiterates that issuers should provide information on the accounting policies used for the recognition, measurement and presentation of emission trading schemes and renewable energy certificates (including information on the main terms and nature of such schemes)[15]. Disclosures should explain how these schemes impact their financial performance and financial position, indicating which line items in the financial statements are affected and, where applicable, any differences and impacts across different jurisdictions. For example, issuers should provide quantitative disclosures on the amount of GHG credits or renewable energy certificates owned and/or owed, consumed or sold.

Moreover, ESMA highlights that, where applicable, issuers may need to recognise provisions (and provide disclosures) when local legal arrangements on GHG emissions give rise to obligations to purchase GHG emission rights exceeding any rights that the issuer currently holds[16].

Impairment of non-financial assets

Issuers should consider risks arising from climate-related matters (either physical or transition risks) when assessing if indications exist that non-financial assets may be impaired. ESMA notes that cash flow projections in value in use measurements should be based on reasonable and supportable assumptions representing management's best estimate of the range of economic conditions (related to climate matters) that will exist over the remaining useful life of the asset[17].

When a parameter linked to climate-related matters is identified as a key assumption, ESMA expects issuers to disclose, unless impracticable, (i) the quantified assumptions used (e.g. the current and forecasted prices used - e.g. CO_2 prices, timing and amounts of replacement of certain assets) and (ii) the basis of such quantifications, (i.e. internal or external estimates – noting that a greater weight should be given to external evidence).

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[11] ESMA, Report, *The heat is on: Disclosures of Climate-Related Matters in the Financial Statements*, 25 October 2023.
[12] Please refer to the common understanding and definition of greenwashing in the financial sector. ESMA, Report, *Progress Report on Greenwashing*, 31 May 2023.
[13] ESMA, Report, *27th Extract from the EECS's Database of Enforcement*, 29 March 2023. EECS/0123-07 and EECS/0123-08.
[14] Paragraph 31 and 122-123 of IAS 1 *Presentation of Financial Statements*. For example, investments considered in the decarbonisation plans but not in impairment tests, acquisition of emission certificates not yet recognised in financial statements.
[15] Paragraph 112 of IAS 1 and Paragraph 10 of IAS 8 Accounting Policies, Changes in Accounting Estimates and Errors.
[16] Paragraphs 14, 84-92 of IAS 37 Provisions, Contingent Liabilities and Contingent Assets.
[17] Paragraph 33 of IAS 36 *Impairment of assets*.

Finally, where applicable, ESMA expects issuers to provide information when climate-related matters impact: (i) the business plan assumptions used when estimating the recoverable amount of assets, (ii) the period considered beyond the business plan and if and how cash flows are impacted in this context, and/or (iii) the financial assumptions used, such as the discount rate and the growth rate.

Power Purchase Agreements (PPAs)

In light of the increasing use of PPAs, ESMA expects issuers to provide details on the characteristics of the PPAs used (e.g. price terms, volume of energy contracted, objectives and duration) as well as the accounting treatment followed (e.g. if they apply the 'own use' exemption in paragraph 2.4 of IFRS 9)[18].

Specific considerations for financial institutions

ESMA expects financial institutions to disclose information on their engagement in green financing (e.g. ESG-indexed loans and other investments linked to ESG criteria), such that users can understand the impacts and assess the nature and extent of the specific risks associated with these financial instruments (e.g. the key characteristics of the financial instruments, carrying amounts, maturities, environmental criteria, the impact and sensitivity on cash flows, the specific risks associated with those instruments and how they are measured and managed)[19]. Moreover, issuers should disclose the significant accounting judgements used when accounting for such instruments. This may include, but is not limited to, assessing whether contractual cash flows of financial assets with characteristics associated with ESG are payments of principal and/or interest on the principal amount outstanding[20].

In addition, ESMA notes that climate risk is becoming a significant factor affecting banks' expected credit losses (ECL) which should be adequately incorporated into banks' provisioning framework. ESMA strongly encourages banks to strengthen their efforts to capture the impact of climate risk on loan loss provisions and to ensure sufficient transparency in their financial statements in this regard.

1.2 Priority 2: Macroeconomic environment

1.2.1 Refinancing and other financial risks

Increase in interest rates and impact on (re)financing

The impact of recent increases in interest rates on the financial statements may be pronounced for issuers that are highly dependent on financial debt. ESMA reminds issuers that interest rate risk arises not only on interest-bearing financial instruments recognised in the statement of financial position, but also for some financial instruments not recognised on the balance sheet (e.g. certain loan commitments). Consequently, issuers should explain how changes in the macroeconomic environment affect their risk exposures (distinguishing between floating rate and fixed rate financial instruments) and how they manage these risks.

Furthermore, as in the previous year, ESMA reminds issuers exposed to interest rate risk to provide a sensitivity analysis, showing how profit or loss and equity would have been affected by reasonably possible changes in interest rates[21]. In this regard, ESMA notes that the reasonably possible changes in interest rates may need to reflect their recent volatility. ESMA also notes that issuers may provide different types of sensitivity analyses for different classes of financial instruments[22].

Moreover, where the macroeconomic environment requires changes in the methods and assumptions used in the preparation of the sensitivity analyses, these should be disclosed together with the reasons for such changes[23].

[18] See IFRS - IFRIC Update June 2023.
[19] Paragraph 31, 33 and 34 of IFRS 7 *Financial Instruments: Disclosures.*
[20] Paragraphs 4.1.2(b) and B4.1.1–B4.1.26 of IFRS 9.
[21] Paragraphs 40–42 and B17 – B21 of IFRS 7.
[22] Paragraph B21 of IFRS 7.
[23] Paragraph 40(c) of IFRS 7.

Finally, ESMA notes that the effects of high inflation and volatile interest rates may impact an issuer's ability to meet the covenant requirements included in long-term loan arrangements. For example, higher interest rates may lead to decreases of fair value of investment properties (see below), the decrease of issuers' equity, thus affecting compliance with the covenants. Therefore, issuers should consider providing disclosures about covenants and the impact of potential breaches.

Liquidity risk

Paragraph 39 of IFRS 7 *Financial Instruments: Disclosures* requires an entity to provide (i) a maturity analysis for both its non-derivative and its derivative liabilities and (ii) describe how it manages the liquidity risk inherent in these liabilities. In doing so, issuers should disclose quantitative data on liquidity risk exposures accompanied by explanations on how such data is determined[24]. ESMA reminds issuers that contractual amounts disclosed in the maturity analysis are the contractual undiscounted cash flows and thus, this amount will differ from the amount included in the statement of financial position[25]. Issuers should note that in the case of interest-bearing liabilities, not only the principal but also the interest payments should be included in this amount.

ESMA notes that, in volatile markets, liquidity risk may be increased by the posting of additional collateral due to margin calls on derivatives. In such cases, issuers must provide qualitative and quantitative disclosures of their collateral arrangements to explain how the liquidity risk is managed. As required by paragraph 14 of IFRS 7, the carrying amount of financial assets pledged as collateral for liabilities or contingent liabilities should be disclosed together with the terms and conditions relating to its pledge.

ESMA reminds issuers of the IFRS 7 disclosure requirements on risk concentration. In particular, in the current context, financial institutions should assess and disclose their exposure to risk concentration both on the assets (e.g. credit risk) and liabilities side (e.g. customer deposits) and how they manage such risks[26]. Moreover, financial institutions whose borrowers are exposed to refinancing risk (especially in sectors such as commercial real estate) should carefully assess and disclose the effect of this risk on their ECL. Furthermore, in the context of liquidity risk, issuers should disclose information on the use of factoring contracts and supplier finance (reverse factoring) arrangements. The disclosure should include the main terms and conditions and impacts on the issuer's financial statements (e.g. management's judgements exercised regarding presentation of liabilities and/or cash flows, or whether receivables covered by factoring contracts are still recognised on the issuer's statement of financial position)[27].

Cash flow decreases due to inflation and interest rates may prompt issuers to seek additional financing or to amend the terms of existing debt. Issuers (borrowers and lenders) should provide transparency on financing renegotiated during the year, notably by disclosing the main changes in the terms of debt agreements and their financial impacts. Substantial modification of financial liabilities result in their derecognition followed by recognition of a new financial instrument[28]. As no explicit guidance for financial assets is provided in IFRS 9, issuers should disclose the accounting policy applied to determine when a modification of a financial asset results in its derecognition[29].

Hedge accounting requirements

The current economic environment may also affect issuers' ability to apply hedge accounting. Issuers should assess whether (i) the occurrence of hedged forecasted transactions is still highly probable, as this may be relevant for instance when using interest rate swaps to hedge future debt issuances, (ii) an increased risk of counterparty default should lead to a discontinuation of hedge accounting and (iii) unanticipated withdrawals of deposits by bank customers have a significant impact on macro hedging

[24] Paragraph B10A of IFRS 7.
[25] Paragraph B11D of IFRS 7.
[26] Paragraphs 34(c), 35B(c) and 39(c) of IFRS 7.
[27] ESMA notes that the amendment to IAS 7 and IFRS 7 requires detailed disclosures on these arrangements, issuers are encouraged to provide such disclosures in their 2023 annual financial statements (i.e. in advance of its effective date).
[28] Paragraph B3.3.6 of IFRS 9.
[29] Paragraph 117 of IAS 1.

relationships applying the bottom layer approach. In such cases, ESMA urges issuers to provide (i) detailed disclosures on the effectiveness of hedging relationships during and at the end of the reporting period and (ii) information on discontinued hedging relationships[30].

1.2.2 Fair-value measurement and disclosures

In the current macroeconomic situation, an increased level of uncertainty may exist with respect to the determination of fair values. Changes in the fair value may have a material impact on an issuer's financial position and performance, especially when issuers apply the fair value model to measure their investment properties[31] or to estimate the recoverable amount of assets for impairment testing in accordance with IAS 36. ESMA expects that the current macroeconomic conditions (e.g. high interest rates, yields and vacancy expectations) are reflected in issuers' fair value measurement (in particular, on Level 3 inputs) and in the disclosures provided.

Fair values of investment properties

IAS 40 encourages the practice of independent valuers determining the fair value of investment property[32]. However, the use of external experts does not alleviate issuers' responsibility of ensuring that the applied fair value measurements comply with the requirements of IFRS 13 *Fair Value Measurement*. In this context, ESMA expects that issuers retain detailed information about the valuation – the inputs, the processes and the outcomes – as this is also crucial to adequately fulfil the disclosure requirements set out in IFRS 13 (in particular paragraph 93). Specifically, ESMA expects issuers to explain how they determined all key inputs, such as the capitalisation rate and/or the rate of return[33].

ESMA notes that the fair value measurement of investment property is sometimes based on prices used in comparable transactions (market approach)[34]. With a decline in the activity in real estate markets, there may be limited information on comparable transactions in recent periods. Furthermore, prices observed in the past may not reflect the macroeconomic conditions at the end of the reporting period. Therefore, issuers may need to apply additional valuation methods to ascertain that the price estimated using the comparable transactions approach is within a reasonable range of values[35].

IFRS 13 requires a narrative description of the sensitivity of the fair value measurement to changes in unobservable inputs if a change in those inputs might result in significant changes in the fair value measurement[36]. Although IFRS 13 does not specifically require disclosure of sensitivity analysis for observable inputs, issuers are encouraged to provide such analysis for key inputs.

Finally, when providing disclosures on the valuation techniques and inputs used, issuers should describe any significant changes (including transfers between levels)[37] from the previous reporting period and the reasons for those changes. Where applicable, ESMA expects issuers to explain how climate matters have been considered in the measurement of investment properties (e.g. transition and physical risks)[38].

Fair values of financial instruments measured at amortised cost

Paragraph 25 of IFRS 7 requires the disclosure of the fair value for each class of financial assets and financial liabilities, including those that are measured at amortised cost. ESMA urges issuers to pay particular attention to these disclosures in light of the current macroeconomic conditions as issuers, especially those experiencing difficulty in meeting their financial obligations, may need to sell financial assets to generate additional liquidity.

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[30] Paragraph 22A and 24C of IFRS 7.
[31] Paragraphs 33–55 of IAS 40 *Investment Property*.
[32] Paragraph 32 of IAS 40.
[33] Paragraph 92(d) of the IFRS 13.
[34] Paragraph B5 of IFRS 13.
[35] Paragraph 63 of IFRS 13.
[36] Paragraph 93(h)(i) of IFRS 13.
[37] Paragraphs 93(c) and 93(e)(iv) of IFRS 13.
[38] Paragraphs 91(a) and 93(d) of IFRS 13.

IFRS 13 requires disclosures for each class of assets and liabilities that are not measured at fair value in the statement of financial position but for which the fair value is disclosed[39]. These include (i) the level of the fair value hierarchy and (ii) a description of the valuation techniques and the inputs used in the fair value measurement of Level 2 and Level 3 financial instruments including any changes from the previous reporting period and reasons for those changes.

SECTION 2: PRIORITIES[40] RELATED TO NON-FINANCIAL STATEMENTS

2.1 Priority 1: Disclosures relating to Article 8 of the Taxonomy Regulation

As already set out in the 2022 Public Statement on the ECEPs, the financial year 2022 was the first time that non-financial undertakings were required to report not only the taxonomy eligibility, but also the taxonomy alignment, of their economic activities vis-à-vis the climate change mitigation and adaptation objectives. ESMA has conducted, together with enforcers, a limited-scope fact-finding exercise to take stock on the evidence from this first reporting season under the complete set of requirements. The fact-finding exercise is available here.

In this context, firstly ESMA reminds issuers that, independently of the level of eligibility and alignment of the respective economic activities, it is mandatory to use the latest reporting templates set out in the Article 8 Delegated Act[41]. These templates shall be used in the form provided for in the Delegated Act without any adaptation or amendments[42].

ESMA further underlines that, when an economic activity substantially contributes to multiple environmental objectives, *double-counting* shall be avoided when calculating the Key Performance Indicators (KPIs) required by the Taxonomy Regulation. In these cases, the accompanying narrative disclosure should provide transparency on: (i) how an issuer assessed the compliance with the technical screening criteria with respect to multiple environmental objectives; (ii) the turnover, CapEx and OpEx that arise from the activities that contribute to multiple environmental objectives; and (iii) explain how an issuer has addressed the occurrence of *double counting*, including the rationale for selecting one specific objective over the multiple available objectives.

In this respect, ESMA reminds issuers that, to be able to properly fulfil the applicable disclosure requirements under the Taxonomy Regulation, they are expected to scan the economic activities they undertake in light of the criteria set out in the relevant European Commission's delegated acts addressing the respective environmental objectives. Consequently, issuers are expected to test their economic activities for which relevant screening criteria exist. When screening criteria exist for the same economic activity under multiple objectives, issuers are expected to test that activity under all the relevant objectives. ESMA emphasises that these practices support the compliance with the applicable disclosure requirements and ensure the completeness of the taxonomy assessment which is instrumental to enable financial market participants to develop financial products with genuine sustainability features.

In addition, as highlighted in ESMA's fact-finding exercise, explanations accompanying the taxonomy reporting should be further improved. Such improvements are particularly necessary with regards to how an issuer has assessed compliance with the substantial contribution criteria, as well as the 'do-no-

[39] Paragraph 97 of IFRS 13.

[40] 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.

[41] Commission Delegated Regulation (EU) 2021/2178, as amended by the delegated acts adopted by the European Commission in June 2023 and subject to the finalisation of scrutiny by the Parliament and the Council.

[42] For example, adaptations or amendments should not take place even in the event of non-eligibility or if an issuer applies the materiality exemption relating to the OpEx KPI.

significant-harm' and the minimum safeguards[43] requirements. These accompanying disclosures – that are not necessarily limited only to qualitative information – should also address the key assumptions made in the preparation of the taxonomy information, including areas where they have exercised significant judgement. These disclosures should also provide the key elements of change compared to the previously reported figures and the related explanations. ESMA therefore recommends that issuers carefully prepare their accompanying disclosures to provide clear, complete and entity-specific (non-boilerplate) explanations about their taxonomy assessments.

ESMA notes that while several issuers currently indicate in their Taxonomy reporting that they are seeking to expand their taxonomy-aligned activities, still too few issuers prepare and disclose their CapEx plans. In this respect, in line with the European Commission's Recommendation on transition finance[44], ESMA encourages issuers to carefully consider the development of CapEx plans with clear indication of the transition investments needed. These plans would increase the transparency towards investors and other providers of capital with regards to an issuer's willingness and ability to put in place measures to implement concrete and credible transition actions.

ESMA also highlights that, whenever issuers develop CapEx plans that comply with the requirements of the Taxonomy Regulation, they are required to include the related capital expenditures[45] in the numerator of the CapEx KPI and to disclose these plans accompanied by the relevant contextual information.

Finally, ESMA notes that, except for OpEx in specific and duly justified cases of non-materiality, the Taxonomy Regulation currently does not foresee the possibility of omitting information about any of the other KPIs.

New EU Taxonomy criteria and related disclosures

ESMA emphasises that on 27 June the European Commission adopted final delegated acts supporting the Taxonomy Regulation which are currently undergoing the final steps of the legislative process and, subject to their finalisation, the related reporting obligations will apply to Taxonomy-related disclosures published from 1st January 2024 (for annual reporting periods occurring in 2023).

These delegated acts include updates to the mandatory reporting templates, set out technical screening criteria for additional activities for the first two environmental objectives[46], and introduce the technical screening criteria and related reporting obligations for activities pursuing the remaining four environmental objectives[47].

In the first year of reporting in relation to the newly established criteria for the remaining environmental objectives as well as for the newly introduced activities in relation to climate change mitigation and

[43] Article 18 of the Taxonomy Regulation requires that undertakings implement procedures to ensure the alignment with the OECD Guidelines for Multinational Enterprises and the UN Guiding Principles on Business and Human Rights, including the principles and rights set out in the eight fundamental conventions identified in the Declaration of the International Labour Organisation on Fundamental Principles and Rights at Work and the International Bill of Human Rights. On 27 June 2023, the Commission issued a notice on the interpretation and implementation of legal provisions of the EU Taxonomy Regulation relating to minimum safeguards and links to the Sustainable Finance Disclosure Regulation which is available here.

[44] Commission Recommendation (EU) 2023/1425 of 27 June 2023 on facilitating finance for the transition to a sustainable economy, p. 23.

[45] ESMA highlights that these capital expenditures are eligible for inclusion in the CapEX KPI when they are part of a five-year (exceptionally ten-year) plan to expand Taxonomy-aligned economic activities or to allow Taxonomy-eligible economic activities to become Taxonomy-aligned.

[46] According to the final delegated act of 27 June 2023 amending Delegated Regulation (EU) 2021/2139 establishing additional technical screening criteria for climate change mitigation or climate change adaptation: "The additional economic activities that contribute substantially to climate change mitigation cover largely the transport sector and its value chain. The additional economic activities that contribute substantially to climate change adaptation cover largely activities enabling adaptation to the unavoidable effects of climate change, including desalination and services for preventing and responding to climate-related disasters and emergencies". (Recital 3).

[47] Sustainable use and protection of water and marine resources, transition to a circular economy, pollution prevention and control and protection and restoration of biodiversity and ecosystems.

adaptation[48], non-financial undertakings will only be required to disclose the proportion of Taxonomy-eligible and Taxonomy non-eligible economic activities vis-à-vis these objectives. ESMA reminds issuers to closely monitor the finalisation of the legislative process in this area and to carefully take into account the reporting implications of these new provisions for the non-financial statements published in 2024.

Educational and support materials for the application relating to the EU Taxonomy reporting regime

ESMA reminds issuers that a number of free resources are available to support them as they prepare their Article 8 Taxonomy reporting. Firstly, the European Commission has issued several frequently asked questions which ESMA strongly encourages issuers to consider when preparing their disclosures as they provide guidance which supports the consistent application of the Taxonomy requirements[49]. ESMA also highlights the availability of an EU Taxonomy Compass[50] that can support issuers in navigating through the different technical criteria underpinning the eligibility and alignment assessments. Lastly, ESMA also reminds issuers that in 2022 it issued two Q&As relating to ESG financial measures which remain still relevant[51].

2.2 Priority 2: Disclosures of climate-related targets, actions and progress

General aspects

As in past Public Statements on the ECEPs, ESMA continues to stress the relevance of increased transparency in reporting on climate-related matters, which gains further relevance in light of the forthcoming application of the enhanced disclosure regime set out in the CSRD. In this context, ESMA notes that issuers should pay particular attention when providing disclosures about their climate-related targets.

Targets are most useful when they are measurable, time-bound and clarify: (i) the expected outcomes in terms of mitigation of, or adaptation to, climate-related risks, (ii) any benefits arising from climate-related opportunities, or (iii) any impacts on people or the environment.

ESMA stresses the importance of clarifying how the climate-related targets are linked and instrumental to meeting any pre-set entity-specific or public policy objectives and whether they are science-based[52]. For example, issuers may use climate scenario analysis to identify their preferred future and set their strategic ambitions accordingly. When this is the case, climate-related targets should be set and reported on in a way that enables users of non-financial statements to assess their consistency with the strategic ambition[53]. ESMA also emphasises that, in order to assess the reliability of an issuer's climate commitments, it is necessary that entities provide clear disclosure of the progress made in meeting all targets compared to pre-set target levels set out in a specific base-year.

ESMA reminds issuers to provide information about the methodologies and assumptions underlying those targets and the scope of activities and the entities that they cover, including whether they address own operations of the issuer, its value chain or both.

It is also important to highlight that, to be credible and effective, targets are expected to be set out as part of a broader strategy and the related more specific policies and implementation actions. Such

[48] The amendments proposed by the European Commission on 27 June introduced the following activities: Sections 3.18 to 3.21, Sections 6.18 to 6.20 of Annex I to Delegated Regulation (EU) 2021/2139 and Sections 5.13, 7.8, 8.4, 9.3, 14.1 and 14.2 of Annex II to Delegated Regulation (EU) 2021/2139.

[49] European Commission FAQ 1, December 2021; European Commission FAQ 2, February 2022 (published in the OJ in October 2022); European Commission FAQ 3, December 2022 (focusing on the Climate delegated act); and European Commission FAQ 4, December 2022 (focusing on the Disclosure delegated act); and European Commission notice 27 June 2023 (focusing on minimum safeguards and links with the Sustainable Finance Disclosure Regulation – SFDR). All Commission's FAQs are also accessible at: https://ec.europa.eu/sustainable-finance-taxonomy/faq.

[50] Available at: https://ec.europa.eu/sustainable-finance-taxonomy/taxonomy-compass/the-compass.

[51] ESMA32-51-370 Questions and answers – *ESMA Guidelines on Alternative Performance Measures (APMs)*, 1 April 2022 (Questions 19 and 20).

[52] For example, reference material could be found in the Science-Based Targets Initiative at https://sciencebasedtargets.org/.

[53] See for example, the 2021 TCFD guidance on Metrics, Targets and Transition Plans, available here.

actions should then help assess the effectiveness and orientate any possible revisions of those targets. ESMA therefore reminds issuers to provide disclosures about the rationale for selecting the specific climate-related targets and their relationship with any pre-defined strategic objective by disclosing, in particular, how the actions and milestones put in place to meet those targets are instrumental in achieving the pre-defined strategic objectives.

Furthermore, ESMA highlights the importance of providing disclosure on how the climate-related targets are monitored and reviewed, including reporting on a regular basis on the progress made and periodically assessing their consistency with a pre-set strategy and policies. One effective way of linking strategy, policies, actions and targets and to show progress in meeting them is to set out climate transition plans. ESMA's 2022 ECEP Statement[54] included recommendations in relation to transition plans which it encourages issuers to consider.

GHG emission reduction targets

One particularly important disclosure area related to climate for the purpose of climate change mitigation is the disclosure of GHG reduction targets and the actions taken to meeting them. While all the considerations in the previous paragraph also apply to this type of targets, the following specific aspects are worth highlighting.

Firstly, to assess the credibility of these targets it is important to provide an explanation of how the undertaking's targets and its underlying assumptions are compatible with commonly understood European and international objectives, most notably those of limiting global warming to 1.5°C compared to pre-industrial levels. It is also important to clarify which emissions scopes and categories are captured by the target and, in particular, whether Scope 3 emissions are also taken into account (see Priority no. 3 in Section 2.3 of this Public Statement).

Issuers should also provide an explanation of the decarbonisation levers identified accompanied by: (i) a quantitative indication of their contribution to the target; and (ii) an explanation of whether these are internal (e.g. the application of cleaner technologies for reducing emissions) or external (e.g. collaborative actions with key actors in the value chain) levers. ESMA also recommends that in providing these explanations issuers should enable users of the reporting to understand the business implications linked to the decarbonisation levers identified including, for example, potential changes in the product and / or service portfolio of the issuer and any expected changes in technology.

If GHG emission reduction targets are presented in the context of broader climate neutrality claims, issuers are expected to explain the role of gross emission reductions in fulfilling those claims compared to other measures, such as use of carbon credits, GHG removals or storage[55].

It is also essential that issuers provide information on the financial resources and investments that are necessary to meet these targets (e.g. CapEx required to implement the related actions). These amounts should, where relevant, be reconciled with the appropriate amounts already accounted for within the financial statements or presented within Taxonomy disclosures. In that regard, the European Commission's Guidelines on climate-related reporting[56] invites entities to describe the impact of climate-related risks and opportunities on the company's financial planning, as well as how the climate-related risks and impacts and the way the issuer manages them influences its financial performance, where possible with reference to financial KPIs.

[54] ESMA32-63-1320 - Public Statement – European common enforcement priorities for 2022 annual financial reports.
[55] While acknowledging that the credibility of climate neutrality claims broadly relies on the largely predominant if not exclusive role of emission reductions in achieving those targets, should other measures be used transparency about such measures would be necessary to support investors' and other users' decision-making.
[56] Communication from the Commission (2019/C 209/01), Guidelines on non-financial reporting: Supplement on reporting climate-related information.

Lastly, ESMA reminds issuers to also disclose potential transition risks and any locked-in GHG emissions from the issuer's key assets and products.

Targets supporting transition trajectories

ESMA particularly highlights the role that the use of targets plays in explaining an issuer's trajectory towards more sustainable business models. In this respect, ESMA emphasises that the recent European Commission Recommendation on transition finance suggests that the EU Taxonomy can also constitute a valid tool to set targets to specify the timeframes over which an issuer aims to meet the technical screening criteria under one or more environmental objectives and the necessary investments to meet these targets.

When issuers set entity-level targets that reference or are based on Taxonomy criteria the related disclosures should clarify that such targets are separate from the mandatory Taxonomy disclosures pursuant to Article 8 of the Taxonomy Regulation.

ESMA also notes that the European Commission's recommendation on transition finance[57] recalls that under specific conditions set out in Article 6 of the Regulation addressing EU Climate Transition Benchmarks and EU Paris-aligned Benchmarks[58], issuers setting and publishing GHG emission reduction targets and properly disclosing their GHG emissions can benefit from an increased weight in the EU climate benchmarks.

2.3 Priority 3: Scope 3 emissions

In March 2023, ESMA's 2022 report on the Corporate Reporting Enforcement and Regulatory activities[59] highlighted that significant improvements could be made in a number of areas of non-financial disclosures, including on Scope 3 greenhouse gas (GHG) emissions.

More detailed requirements in relation to the disclosure of GHG emissions will become effective with the first application of the CSRD. However, ESMA notes that, in accordance with the NFRD, it is mandatory to disclose information to the extent necessary for an understanding of the undertaking's development, performance, position and impact of its activity, relating to several sustainability matters, including environmental matters. In this respect, ESMA is aware that disclosures on Scope 3 GHG emissions are part of the information that investors would consider as necessary input to sustainable investment decisions. ESMA therefore reiterates some important aspects in relation to these disclosures which were already partly highlighted in its 2022 ECEP statement.

Firstly, issuers should assess whether the reporting on GHG emissions can be considered complete in all material respects in the absence of disclosures on Scope 3 emissions. Particularly, for financial institutions, the assessment on the completeness of the emissions disclosures should include their financed emissions. When disclosures of Scope 3 emissions are considered not to be material, ESMA encourages issuers to state that fact and to provide adequate explanations as to the most significant judgements leading to this conclusion.

When Scope 3 emissions are material, ESMA recommends that issuers provide full transparency about the boundaries of the Scope 3 emissions calculation, including on the reasons for excluding certain categories from the calculation, and the quantitative impact thereof. When Scope 3 emissions are only partially reported, ESMA recommends that issuers provide clarity through appropriate labelling of the emissions metrics disclosed to clearly signal the partial nature of the Scope 3 calculation.

[57] Commission Recommendation (EU) 2023/1425 of 27 June 2023 on facilitating finance for the transition to a sustainable economy, p. 20.
[58] Commission Delegated Regulation (EU) 2020/1818 of 17 July 2020 supplementing Regulation (EU) 2016/1011 of the European Parliament and of the Council as regards minimum standards for EU Climate Transition Benchmarks and EU Paris-aligned Benchmarks.
[59] ESMA32-63-1385 – Report - 2022 Corporate reporting enforcement and regulatory activities.

ESMA stresses the need for transparency on the categories of Scope 3 emissions that are reported in accordance with the reporting methodology[60] that issuers declare to follow. In such cases, issuers are expected to provide information: (i) whether Scope 3 emissions were determined based on estimates; (ii) the relative amounts of emissions covered by these estimates; and (iii) the related methodology and most significant inputs and assumptions.

ESMA recommends that gross amounts of Scope 3 GHG emissions are disclosed separately from the effect related to the possible use of carbon credits and other measures such as removals and storage, in accordance with the reporting methodology[61]. ESMA also emphasises the importance of providing comparative information accompanied by explanations of the drivers of the evolution compared to previous years.

Lastly, ESMA recommends that issuers consider providing further details on additional breakdowns of scope 3 emissions, by categories, main lines of business, or geographical area.

SECTION 3: OTHER CONSIDERATIONS

3.1 Alternative Performance Measures (APMs)[62]

ESMA reminds issuers that the APM Guidelines apply to measures disclosed outside financial statements (e.g. the management report, ad-hoc disclosures and/or prospectuses) unless they are defined or specified in the applicable financial reporting framework. Q&A n.2 and Q&A n.14 of ESMA's Q&As on APMs should assist issuers to identify which measures fall within the scope of the Guidelines.

ESMA highlights that, under paragraph 41 of the APM Guidelines, the definition and calculation of an APM should be consistent over time. Issuers should use caution, in particular in the context of APMs linked to insurance contracts, when making adjustments to APMs used and/or when disclosing new APMs. Issuers should consider the guidance in Q&A n.18 *mutatis mutandis* in the context of APMs linked to these contracts[63]. ESMA urges issuers to provide consistent APMs across all documents used (including those outside the scope of the Guidelines) in their communications with investors.

Furthermore, ESMA notes that, amongst other requirements, issuers should 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. Definitions should describe all components of a specific APM: i.e. 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[64].

Finally, ESMA also highlights that APMs presented by issuers should be neutral. In this respect, ESMA recalls that Q&A n.17 notes that presenting biased APMs which are adjusted to exclude only one-off losses (e.g. impairment losses) but include one-off gains of the same nature (e.g. reversal of impairments or grants) may violate the principles set out in articles 4 and 5 of the Transparency Directive relating to fair review of the development and performance of the business and the position of the issuer.

[60] GHG Protocol or any other admitted methodology.
[61] The GHG reporting frameworks prohibit any emissions "netting". This means that avoided, sequestered, stored or "offset" emissions cannot be used to reduce the company's GHG emissions figures. These actions must be the subject of a separate presentation.
[62] ESMA, Guidelines, *ESMA Guidelines on APMs*, 5 October 2015.
[63] ESMA, Questions and answers – ESMA Guidelines on APMs, 1 April 2022.
[64] ESMA, Guidelines, *ESMA Guidelines on APMs*, 5 October 2015 (please refer to paragraph 25 of the APM Guidelines).

3.2 European Single Electronic Format (ESEF)

ESMA reminds issuers that all numerical datapoints in the primary consolidated financial statements shall be marked up using the core taxonomy element with the closest accounting meaning to the disclosure being marked up. When no appropriate element is available, the issuer must create an extension element. ESMA encourages issuers to carefully read and assess the element labels, the documentation labels and the references to the relevant IFRS Accounting Standards of the different taxonomy elements contained in the core taxonomy in Annex VI of the ESEF Regulatory Technical Standards (ESEF RTS)[65] to determine whether the accounting meaning of a taxonomy element corresponds to the closest accounting meaning of the specific disclosure. ESMA also stresses that issuers should not create an extension taxonomy element when a suitable taxonomy element already exists in the core taxonomy (Annex IV of the ESEF RTS).

ESMA reminds issuers that the goal of marking up (block tagging) the notes is for users to be able to navigate through the notes to the consolidated financial statements and to easily extract the relevant information. To fulfil this purpose, ESMA highlights that the extracted information from a block tag should be legible and clear even if the style is not necessarily maintained. Similarly, information that is contained in tables in the human readable report should be meaningfully transcribed in the extracted tagged information.

In addition to using the mandatory elements in Annex II of the ESEF RTS, issuers can complement the mark up of the notes by using the taxonomy elements contained in Annex VI of the ESEF RTS. Nevertheless, ESMA reminds issuers that the use of these elements from Annex VI of the ESEF RTS, even when they have the closest accounting meaning, does not prevail over the use of the mandatory elements contained in Annex II of the ESEF RTS. Furthermore, in the rare circumstance where there is no appropriate element available in Annex II or Annex VI, issuers may, on a voluntary basis, mark up the notes by creating an extension taxonomy element and anchoring this extension.

Finally, issuers are encouraged to consult the update to the ESEF Reporting Manual[66] which provides further guidance on ESMA's expectations on the above and additional topics.

[65] *ESEF RTS*, Consolidated text 19 January 2023.
[66] *ESEF Reporting Manual*, Update August 2023.