

# ESMA enforcement priorities for 2019



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**“Transparent, entity-specific disclosures continue to be the theme for 2019 financial statements as well as the application of the new standards. Companies need to step up their efforts to improve the quality of financial information to meet users’ needs.”**

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## European regulator highlights priorities for 2019 financial statements prepared under IFRS® Standards

### Highlights

- New standards remain topical
- Income tax emerges as a new priority
- IBOR reform may have significant impact
- Other key areas of focus – including non-financial information and APMs

The European regulator, ESMA<sup>1</sup>, has issued a **statement** highlighting the common areas that European national securities regulators will be focusing on when reviewing listed companies’ 2019 annual reports. The aim is to promote the consistent application of IFRS Standards and other EU-specific reporting requirements.

Although the topics included in the statement are those deemed to be most relevant at a European level, regulatory bodies outside Europe are also likely to pay particular attention to many of the same priorities. The list is not exhaustive, however, and national regulators may have additional areas of focus.

### Areas of focus for financial statements under IFRS Standards

#### Specific issues on applying the new standards

ESMA is calling for improvements in how the new standards – IFRS 9 *Financial Instruments* and IFRS 15 *Revenue from Contracts with Customers* – are being applied and continues to stress the need for transparent and relevant disclosures that enhance the users’ understanding of the preparer’s financial performance, financial position and cash flows. ESMA expects to see:

- entity-specific accounting policies;
- significant judgements and estimates disclosures; and
- granular and disaggregated information.

In this first year of applying the new leases standard, IFRS 16, ESMA highlights key areas that require judgement and significant assumptions, and expects quality disclosures. Preparers are also expected to provide information on the transition method adopted, including any practical expedient(s) applied.

1. European Securities and Markets Authority.

ESMA also strongly recommends that preparers of financial statements consider tentative and final decisions made by [the IFRS Interpretations Committee](#) on implementation and application issues related to the new standards.

Topics	Specific issues preparers need to consider
<b>Applying IFRS 9 – Credit institutions</b>	<ul style="list-style-type: none"> <li>– Using reasonable and supportable forward-looking information when determining expected credit losses (ECL).</li> <li>– Assessing at the reporting date whether credit risk has increased significantly.</li> <li>– Presenting reversals of impairment losses in the statement of profit or loss in the impairment line, not as interest income.</li> <li>– Enhancing disclosures about ECL, both quantitative and qualitative, including:               <ul style="list-style-type: none"> <li>- assumptions and judgements used to determine the ECL recorded, as well as any changes from the prior period;</li> <li>- disaggregation of disclosures on credit risk exposures and ECL by stage and by class of instruments;</li> <li>- application of the significant increase in credit risk criteria, disaggregated by class, and explanations of how forward-looking information is incorporated in determining ECL; and</li> <li>- sensitivity analyses of staging and calculation of ECL that reflect the credit risk profile of financial instruments.</li> </ul> </li> </ul>
<b>Applying IFRS 15 – Corporates</b>	<ul style="list-style-type: none"> <li>– Providing entity-specific accounting policies consistent with information provided in other parts of the annual financial report.</li> <li>– Disclosing significant judgements and estimates – e.g.:               <ul style="list-style-type: none"> <li>- identifying performance obligations and timing of completion;</li> <li>- assessing principal vs agent;</li> <li>- determining the transaction price (including variable consideration); and</li> <li>- allocating the transaction price to performance obligations.</li> </ul> </li> <li>– Disaggregating revenue into categories, considering information disclosed outside the financial statements, and reconciling with segment disclosures.</li> <li>– Providing qualitative and quantitative explanations of significant changes in contract balances.</li> </ul>
<b>Applying IFRS 16 – Lessees</b>	<ul style="list-style-type: none"> <li>– Making significant judgements and estimates used in applying the standard (and disclosing these), in particular in determining:               <ul style="list-style-type: none"> <li>- whether a contract meets the definition of a lease;</li> <li>- the lease term; and</li> <li>- the discount rate applied.</li> </ul> </li> </ul>

Topics	Specific issues preparers need to consider
<b>Applying IFRS 16 – Lessees (continued)</b>	<ul style="list-style-type: none"> <li>– Providing information on:               <ul style="list-style-type: none"> <li>- how the methodologies, inputs and assumptions used for impairment tests have changed – e.g. in determining the carrying amount and the recoverable amount of the cash-generating unit that includes the right-of-use asset, as well as treatment of lease liabilities in the impairment test; and</li> <li>- the effect that leases have on financial performance, financial position and cash flows.</li> </ul> </li> <li>– Presenting appropriately lease-related items in the statement of financial position and statement of cash flows.</li> <li>– Providing transition-related disclosures, including:               <ul style="list-style-type: none"> <li>- transition method and use of practical expedients; and</li> <li>- the lessee’s weighted-average incremental borrowing rate under the modified retrospective method, and any significant variances from the operating lease commitments disclosed under the previous leases standard.</li> </ul> </li> </ul>

For information and resources on the new standards, visit our [revenue, financial instruments](#) and [leases](#) topic pages.

### Specific issues related to the application of IAS® 12 Income Taxes

Income taxes feature regularly on ESMA’s agenda. In July 2019, ESMA issued a [public statement](#) on recognition of deferred tax assets arising from unused tax losses. This matter and the application of newly effective requirements will draw specific attention from regulators when they review 2019 financial statements.

Topics	Specific issues preparers need to consider
<b>Deferred tax assets related to unused tax losses</b>	<ul style="list-style-type: none"> <li>– Recoverability assessment of deferred tax assets, including providing sufficient evidence to support the conclusion that future taxable profits will be available.</li> <li>– Providing meaningful disclosures.</li> </ul>
<b>Tax consequences of dividends</b>	<ul style="list-style-type: none"> <li>– Newly effective requirements on the recognition of tax consequences of dividends.</li> <li>– Clear disclosures about income tax consequences of payments on instruments classified as equity, if they are material.</li> </ul>
<b>Uncertain tax treatments</b>	<ul style="list-style-type: none"> <li>– Newly effective requirements on uncertain tax treatments.</li> <li>– Transparent disclosures about:               <ul style="list-style-type: none"> <li>- judgements made;</li> <li>- accounting policies used for recognition and measurement; and</li> <li>- the impacted carrying amount if the uncertain tax treatment is a major source of estimation uncertainty.</li> </ul> </li> </ul>

See our [web article](#) for more information on IFRIC® 23 *Uncertainty over Income Tax Treatments*.

## IBOR reform and its impact

ESMA draws attention to the recent amendments to IFRS 9 relating to reform of interbank offered rates (IBOR), and encourages preparers to get ready to implement these once they are endorsed. It also highlights potentially significant implications of transition to alternative nearly risk-free rates.

See our [web article](#) for more information on IBOR reform.

## Other key areas of focus on information presented outside financial statements

### Non-financial information

ESMA reminds preparers about the EU requirements and guidance on reporting non-financial information, which may be included either in the management report or in the separate non-financial statement. It reiterates some general principles to promote improvements in the quality of reporting of non-financial information with the aim of providing a comprehensive, fair and balanced understanding of the preparer's development, performance and position and the impact of its activity on non-financial matters.

ESMA also recommends that preparers consider entity-specific and relevant key performance indicators (KPIs), environmental and climate change-related matters and its supply chains when preparing their non-financial information.

### Alternative performance measures (APMs)

The statement includes a reminder of the requirements in [ESMA's Guidelines on Alternative Performance Measures](#), which are aimed at promoting the usefulness and transparency of APMs. These provide a particular focus on the explanation of relevance/reliability of APMs presented and the principle of consistency. Preparers need to explain any changes in APMs and restate any comparatives, including changes that relate to the implementation of IFRS 16. For more information, see our article [Communicating effectively through non-GAAP information](#).

### Other relevant issues

ESMA also highlights the following areas:

- **Brexit** – companies are expected to monitor Brexit negotiations and disclose the company's exposure to Brexit risk and its impact. Visit KPMG's [Brexit homepage](#) to find out more about the impacts on your business; and
- European single electronic format – listed companies need to prepare for timely compliance with the new requirements, which are effective from 1 January 2020.

### Further information

In addition to the guidance referred to above, also available are the 2019 editions of our [guides to annual financial statements](#), which include [Illustrative disclosures](#) and a companion [Disclosure checklist](#). With [Insights into IFRS](#) and our [web tool](#) on newly effective standards, these form part of your reporting toolkit for the year end.

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