



COMMITTEE OF EUROPEAN SECURITIES REGULATORS

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Date: 23 September 2010  
Ref.: CESR/10-917

**Activity Report  
On IFRS enforcement  
2009**



## EXECUTIVE SUMMARY

This Report provides an overview of the monitoring and enforcement of IFRS in Europe in the year to 31 December 2009. The report is based on the activities of the European Enforcement Co-ordination Sessions (“EECS”) under the auspices of the Corporate Reporting Standing Committee of the Committee of European Securities Regulators (CESR). The main objective of EECS is to co-ordinate the enforcement activities of member states in order to foster and maintain investor confidence.

CESR is pleased to report a number of improvements in the enforcement structures and processes in a number of jurisdictions in Europe in 2009, as described in section 1 of the Report. Developments in this area have also contributed to increased consistency amongst member states.

The deterioration of the global capital markets in 2009 created significant challenges for the preparers of financial information and regulators increased their enforcement activities in response to the heightened risk and concerns of the investment community. This is reflected in the number of decisions and emerging issues analysed by EECS in the year under review, which corresponded to 170 out of around 900 actions taken around Europe. Issues discussed arose from the full range of International Financial Reporting Standards (“IFRS”). Some areas, however, attracted more interest than others – either because of their heightened significance when reporting during an economic crisis or because they represent the most challenging requirements to apply when accounting for complex transactions and arrangements. These issues included, for example, various aspects of financial instrument reporting; impairment of non-financial assets and business combinations, as detailed in section 2.

In order to contribute to the quality of future financial reporting under IFRS on a global basis, CESR continued its dialogue with the SEC and other third country enforcers of financial information. It is very pleased to have arranged an inaugural seminar of global IFRS enforcers allowing European enforcers greater opportunity to share experiences with fellow regulators outside the EEA. A further seminar is planned for 2011.

CESR will continue to communicate with the market on matters relating to the future development of European enforcement activity.



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## INTRODUCTION

### *Objective and scope of the report*

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The aim of this report is to provide a review of the activities of accounting enforcers within the European Economic Area ("European enforcers"), in the year ended 31 December 2009.

The report is intended to be of interest to all market participants, including European issuers, investors on European markets, auditors, other regulators and the general public.

This report aims to:

- provide an overview of enforcement activities in EEA and the coordination of enforcement through EECS
- present the outcome and some tentative conclusions relating to the enforcement of IFRS
- provide a summary of EECS engagement with third country accounting enforcers.

The report draws on EECS activities during the year 2009 and additional information provided by European enforcers relating to:

- Ex-ante activities incurred as part of the preparation of the annual review process
- Findings in respect of reviews conducted in 2009
- Actions taken to improve the quality of future financial reporting
- Decisions and emerging issues discussed during EECS meetings in the year
- Details of reports published by national enforcers on their enforcement activities
- The range of actions available to them

This document also reports on the programme of co-operation between CESR-Fin and the US SEC in the enforcement area. The content of this section is largely derived from the outcome of meetings held between CESR members and the US SEC, reports by members about progress made in signing individual protocols of cooperation with the US SEC and the extent to which these protocols have facilitated co-operation between regulatory authorities.



## 1. DESCRIPTION OF ENFORCEMENT IN EUROPE

This section provides a description of the main features of the European enforcement system, the coordination of which at European level is ensured by EECS. Enforcement activity refers to the monitoring of compliance of financial information with the applicable reporting framework and the taking of appropriate measures in respect of infringements discovered in the course of compliance reviews.

### *1.1. CESR's European enforcers' coordination sessions (EECS)*

#### *Objectives*

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EECS is a forum organised by CESR in which CESR members and other European enforcers who are not members of CESR exchange views and discuss experiences relating to the enforcement of financial reporting standards. EECS currently has 35 members from 29 countries

EECS aims to promote a high level of consistency amongst enforcers in the decisions they take in respect of their reviews of financial statements. Consistency is achieved through analysis and discussion of decisions taken, or to be taken, by European enforcers relating to the application of IFRS. Through EECS, European enforcers are also able to share and compare their practical experiences on the enforcement of the IFRS financial information provided by companies who have or who are in the process of having securities admitted to trading on a regulated market in Europe.

The framework of enforcement activity was established by CESR through the issuance of two principles based standards: Standard No. 1 – Enforcement of standards on financial information in Europe (ref. CESR/03-073<sup>1</sup>) and Standard No. 2 – Co-ordination of enforcement activities (ref. CESR/03-317c<sup>2</sup>), accompanied by Guidance for implementation of co-ordination of enforcement of financial information (ref. CESR/04-257b<sup>3</sup>), see also section 1.3.

EECS also aims to contribute to the harmonization of the application of IFRS in Europe by identifying areas which are not covered by financial reporting standards or which may be open to widely diverging interpretations for referral to the IASB or IFRS Interpretation Committee (hereafter “IFRS IC” or formerly named IFRIC), as appropriate.

#### *Enforcer decisions and emerging issues discussed during EECS meetings*

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To facilitate the sharing of enforcement decisions and experiences, CESR Standard No 2 provides for the establishment of an internal database to which EECS members are obliged to submit decisions they have taken as part of their national enforcement process according to established submission criteria. The criteria are set out in full in the “Guidance for implementation of co-ordination of enforcement of financial information” and include material misstatement, general interest, complexity of facts and circumstances and potential to conflict with other decisions taken by EECS members.

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<sup>1</sup> CESR 03-073 <http://www.cesr.eu/index.php?docid=192>

<sup>2</sup> CESR 03-317c <http://www.cesr.eu/index.php?docid=2046>

<sup>3</sup> CESR 04-257b <http://www.cesr.eu/index.php?docid=2557>



EECS met 8 times during 2009, with a significant part of the meetings being dedicated to the discussion of decisions submitted by members. As of 31 December 2009, around 300 decisions had been entered onto the EECS database, of which around 140 were analysed in meetings held during the year.

The agenda for EECS meetings also provides for discussion of emerging issues where enforcers can summarise the facts and circumstances relating to cases they are currently considering and where they look for guidance and assistance from other enforcers in advance of deciding on the case in hand. Other enforcers may have dealt with similar issues or may be able to offer advice about how to approach an issue or to help expand the basis on which the decision might be concluded. These discussions enable enforcers to better analyse, explain and refine their rationale for making their decisions on the basis of what they may learn from other enforcers. Where emerging issues are urgent, perhaps because of the issuer's reporting timetable, EECS members may also discuss matters on a bi-lateral basis between meetings.

The EECS database contains around 110 emerging issues, of which 27 were submitted and discussed in 2009.

### *Publications*

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In line with CESR Standard No 2, CESR regularly publishes enforcement decisions to contribute to the promotion of market confidence and convergence of the application of IFRS. As of 31 December 2009, a total of 88 decisions had been published, spread across 7 packages, 3 of which, containing 32 decisions, were published during 2009 (Ref CESR 09-252<sup>4</sup>, 09-720<sup>5</sup> and 09-1134<sup>6</sup>). CESR plans to publish packages on a regular basis. A further 13 decisions were published in an 8th package on 13 July 2010 which brings the total number of cases up to 101.

If particular issues arise during the year, the EECS may undertake specific targeted reviews. In 2009, due to its particularly high importance in a period of financial crisis, and at CESR-Fin's request, EECS members performed a review exercise of IFRS 7 and related disclosures. In October 2009, CESR published a statement, "Application of Disclosure requirements related to financial instruments in the 2008 Financial Statements" (ref. CESR/09-821<sup>7</sup>). The study was conducted with the specific purpose of emphasising the importance of clear and comprehensive disclosures in respect of financial instruments and to assess the adequacy of the disclosures made in this area. The study, which involved the review of the 2008 accounts of 96 economically significant financial institutions selected across European member states, also took the opportunity of considering the degree to which issuers had provided additional disclosures which were not mandatory at that time but which had been recommended by other regulatory authorities as enhancing the quality of reporting in this area.

A follow-up statement will be published in the second half of 2010 in order to assess the extent of any improvement in the quality of reporting of financial instruments in an area which remains of significance to European investors.

### *Meetings with IFRS IC*

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In 2009, EECS organised 2 meetings with IFRS IC representatives in order to discuss complex issues identified by EECS members either for which there is no specific IFRS guidance or where widely diverging interpretations exist. 14 issues were addressed in these meetings and included:

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<sup>4</sup> CESR 09-252 <http://www.cesr.eu/index.php?docid=5647>

<sup>5</sup> CESR 09-720 <http://www.cesr.eu/index.php?docid=5936>

<sup>6</sup> CESR 09-1134 <http://www.cesr.eu/index.php?docid=6341>

<sup>7</sup> CESR 09-821 <http://www.cesr.eu/index.php?docid=6156>



aspects of reclassification of financial instruments as part of the IAS 39 amendment, impairment testing of goodwill and assets or cash-generating units and their interaction with reporting of operating segments, accounting for changes in investment holdings from joint venture to full control status and the challenges posed where control is acquired through a series of linked transactions. The meetings also gave EECS members the opportunity to provide IFRS IC with feedback on how standards are being applied in practice and to indicate where there might be a degree of uncertainty as to how they are interpreted.

### *Other matters*

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In addition to discussing decisions and emerging issues, EECS provides members with the opportunity to discuss other matters relevant to their enforcement activity and to develop a better understanding of processes and procedures within enforcement authorities across Europe through reviews or working groups.

In 2009, supporting the continuous development of optional tools available to European enforcers, a working group updated and improved the internal IFRS checklist to assist enforcers with their review process.

Additionally, a group was set up to investigate the range of actions available to European enforcers and to identify the circumstances in which these had been used since the establishment of EECS in 2005 based on decisions submitted to the database.

EECS also provides members with the means of sharing their national publications with fellow enforcers –, e.g. enforcers' Activity Reports and other announcements to national markets on issues relating to the monitoring of IFRS. These papers are often tabled for presentation during EECS meetings.



## ***1.2. General information about European enforcers***

The harmonisation of enforcement in Europe is needed in order to contribute to the creation of an efficient single capital market in Europe within the context of evolving EU legislation.

In accordance with article 24.1 of the Transparency Directive, the Competent Authority for enforcement of financial information is designated in each member state within the European Economic Area. Other bodies are allowed to carry out enforcement either in their own right or on behalf of the competent administrative authorities, providing that these bodies are supervised by, and responsible to, the relevant competent administrative authority. The Competent Authority is generally the CESR member. In 6 member states (Denmark, Ireland, Germany, Iceland, Sweden and UK) accounting enforcement is carried out in cooperation with other authorities or bodies designated under local legislation and in some cases by delegated authority.

Irrespective of the different structures adopted by national enforcers which can lead to different processes and scopes of activity, they all serve a single and common objective – to promote market confidence and protect investors by contributing to the transparency of financial information relevant to the investors' decision making process. The key focus of their work is the application of IFRS in financial statements.

An independent assessment of the enforcement activity in Europe is regularly performed by the CESR Review Panel Committee who opines on the extent to which national enforcers comply with CESR Standards no. 1 and no. 2. The last assessment was published in 2009 and related to enforcement activity in the year ended 31 December 2008 (ref. CESR/09-188<sup>8</sup>). Since that date, a number of enforcers have reported improvements to their systems that increase the level of compliance with the Standards.

While the scope of enforcement under the Transparency Directive covers all reporting frameworks that might be applicable to listed issuers, including national GAAPs when applied to non-consolidated financial statements or third countries' accounting standards for non-European issuers, this report focuses only on enforcement activities related to IFRS financial statements, and takes no account of any other monitoring activity.

## ***1.3. Enforcement in Europe***

CESR Standard No. 1 refers to a range of corrective and other actions that may be taken by enforcers in respect of infringements of relevant reporting requirements in annual or interim financial reports.

Enforcers also seek, more generally, to improve the quality of future financial reporting in Europe. In order to achieve that, many enforcers engage in ex-ante activities designed to provide helpful guidance to issuers in advance of their preparation of their financial information.

### ***Ex-ante activities***

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Ex-ante activities may include the following:

- *Issuance of alerts indicating the main areas of examination for the forthcoming financial year:* many European enforcers announce their main areas of focus ahead of the next

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<sup>8</sup> CESR/09-188 <http://www.cesr.eu/index.php?docid=5786>





reporting period before issuers commence the preparation of their accounts. In 2009, a number of enforcers had a focus on the following: financial instruments, impairment of assets, presentation of financial statements, operating segments.

- *Pre-clearance*: in some jurisdictions, issuers may approach their enforcer for formal notification in advance of their accounts preparation whether their proposed accounting treatment for a specific transaction or reporting area is in accordance with the relevant reporting framework. Pre-clearance takes different forms in different countries but may include a comprehensive written description of the specific facts and circumstances underlying the issue; a detailed analysis of the options available with respect to the accounting treatment and a rationale supporting the issuer's proposal. The benefit of pre-clearance is that it can help to ensure that non-compliant information is avoided in the preparation of the IFRS financial statements.
- *Informing a small sample of issuers whose accounts have been chosen for partial review of that fact in advance of publication of their accounts.*
- *Open seminars with issuers and auditors in advance of the interim or year-end financial reporting.*

### *Review of financial statements*

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A review of a set of financial statements refers to the process of analysing financial information for compliance with the requirements of the relevant reporting framework. Such a review may cover a company's full set of financial statements ("full review") or only certain areas ("partial review").

The selection of issuers whose accounts are subject to a full review is based on CESR Standard No.1 and its application guidance which advocates a risk-based approach combined with random selection or rotation. This approach depends on both the probability of a material misstatement in the financial statements and the potential impact of such a misstatement on market confidence and investor protection.

The partial review, by definition, does not involve the enforcer analysing all areas of the financial statements for compliance with the reporting requirements. Partial reviews might be prompted by a number of considerations including known areas of non-compliance by issuers in previous years, first time application of mandatory standards or areas of particular focus given the economic climate or trading conditions.

Where potential infringements of the reporting framework are identified on review, they are brought to the attention of the issuer. Following exchanges of correspondence and/or meetings with the issuer in which the enforcer may ask for additional information or explanation and, possibly, discussion at EECS, the enforcer makes a decision whether or not the treatment adopted by the issuer complies with the relevant reporting framework. After taking into account the materiality of the issue, materiality being consistently defined for both reporting and enforcement purposes, if the enforcer concludes that the treatment is not acceptable, the case may result in one or more of the following enforcement actions:

If the infringement is considered material:

- *Issuance of new financial statements accompanied by a new audit opinion (where applicable)*: this action entails the withdrawal of the original accounts and issuance of revised financial statements which may be subject to a new audit opinion.



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- *Public corrective note or other type of communication to public:* this may mean a press release either by the issuer or the enforcer informing the market of the error and the effect of the corrective action in advance of the issuance of the next annual or interim financial statements
  - *Correction in the next financial statements:* the issuer adopts an acceptable treatment in the next accounts and corrects the prior year by restating the comparative amounts through applying IAS 8 or otherwise includes additional disclosures not requiring the restatement of comparatives.

If the infringement is found not to be material:

- Notification of the issuer of the infringement but normally no information is published to the market.

## **2. ANALYSIS OF FINDINGS IN RESPECT OF THE APPLICATION OF IFRS**

This section highlights the main findings derived from enforcement activities in 2009 and the areas where issuers were most often challenged by European enforcers.

### ***2.1. Main results of the review process in 2009***

European enforcers performed full review of around 1200 companies' accounts (annual and interim), covering in the region of some 18% of listed entities in Europe. The coverage from one country to another varies because of the very different number of issuers across jurisdictions, the diversity in size and their risk profile.

Some 900 accounts were subject to partial review, representing a coverage of 15% of the population of listed entities. The main themes selected by European enforcers were: impairment of assets, financial instruments disclosure, operating segments, going concern, current/non-current classification of liabilities.

In terms of enforcement actions taken by the enforcers as a result of their reviews, the statistics indicates around 900 actions, split as follows:

- 19 actions required issuance of revised financial statements
- Around 160 cases required public corrective notes or other public announcement
- Around 560 actions required corrections in future financial statements
- 170 other actions, such as a notice to the issuer, but without requiring any corrective action or public announcement.

### ***2. 2. Overall assessment of the quality of IFRS reporting in Europe***

Since the first application of IFRS in Europe in 2005, preparers of financial information have developed significant experience in IFRS accounting which is reflected in the quality of their financial reporting which, generally, EECS members have found to have improved. Nevertheless, based on the number of actions taken during the year 2009, the members consider also that there is still room for improvement in the financial reporting of the issuers.

2009 saw an unprecedented deterioration of the global capital markets which posed significant challenges to listed companies preparing financial statements. Lack of available credit in many areas coupled with a downturn in demand tested many of the assumptions on which accounts were produced. IFRS continued to develop at a fast pace, particularly in relation to financial instruments where, in the context of the banking crisis, there was continued focus.

Given the difficult economic conditions, enforcers drew attention to the heightened importance of quality disclosures relating to the risks and uncertainties that issuers faced. It was important for users to be able to understand the main judgements made by management in the application of their accounting policies and other areas of reporting which require an approach commonly referred to as 'through the eyes of management'.

Specific areas of judgement which enforcers raised concerns about with issuers included the fair value of financial instruments, the estimations supporting the reporting of deferred taxes and aspects of revenue recognition and assumptions used in impairment testing of issuer's assets.

EECS members found that financial reports varied considerably in the extent to which issuers disclosed clearly, consistently and sufficiently comprehensively, the main judgements made in the



preparation of financial statements. Even where such disclosure is not required by a more specific standard, IAS 1 includes a general overarching requirement to provide the judgements management has made in the process of applying the company's accounting policies and that have the most significant effect on the amounts recognised in the financial statements.

For many companies, the tightening of the credit markets also influenced the nature and extent of major sources of estimation uncertainty that resulted in a significant risk material adjustment being required to the carrying amounts of assets and liabilities within the following financial year. Disclosures supporting this requirement were varied but in many cases did not reach the expected level of transparency.

European enforcers often had cause to complain about boiler-plate disclosure and explanations that did not focus sufficiently on the company's specific facts and circumstances and which could have applied to any company reporting on that area – examples of such areas are goodwill allocation to cash generating units; factors affecting the identification of goodwill and summaries of accounting policies that merely repeat the wording of the standard without explaining how the policy is applied in practice.

### ***2. 3. Recurring issues identified by EECS members***

The examples presented under this section reflect those areas that featured more commonly in decisions brought to EECS for discussion and where there was seen to be value in sharing experiences and regulatory responses. In some cases, this was due to there being a range of accounting treatments which might be acceptable. Discussion at EECS was intended to increase the consistent application of the standards subject to the specific facts and circumstances pertaining to the decisions under discussion. The following paragraphs reflect those areas which featured more frequently in approaches to companies and where relatively more infringements were detected requiring corrective action.

The following examples are not intended to represent all types of issues discussed at EECS nor even all areas where application of IFRS had been challenged by national enforcers; they are merely illustrative of some of the more frequent questions raised.

#### ***Financial Instruments***

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Within the international framework, financial instruments are dealt with in IAS 32, IAS 39 and IFRS 7. Throughout the financial crisis, this area of reporting became one to which enforcers and others paid particular attention given its potential impact on financial reporting generally and the accounts of financial institutions in particular. The importance was reflected in the increased number of enforcement decisions taken in respect of this area, many of which were discussed at EECS in order to find a common ground for assessing the acceptability of the accounting solutions chosen.

**Impairment of financial assets available for sale:** The impairment of equity instruments classified as assets available for sale is to be measured against the notion of a “significant or prolonged decline in fair value below cost”. There were many discussions within EECS regarding the application of paragraph 61 of IAS 39. The lack of guidance in the standard on the meaning of “*significant or prolonged*” created divergent practices across Europe. The matter was referred to IFRS IC who decided not to take the matter onto their agenda. However, while not judging it necessary to develop an interpretation, IFRS IC did highlight a number of practices which were not consistent with IAS 39, and which preparers of financial statements should take account of. The IFRS IC also noted that determining what constitutes a significant or prolonged decline is a matter of fact which requires judgement and that an entity should disclose in the notes to the



accounts those judgements upon which its assumption of objective evidence is based. These deliberations heightened the significance of management judgement in this area.

**Impairment calculation for portfolios of assets:** In a number of cases, enforcers found that methods used by companies to estimate impairment losses on groups of financial assets did not take into account important factors as required by the standard (e.g. the time effect on future cash flows, or the use of the best estimate of expected cash flows at the time of valuation).

**Assessment of active/ non-active markets and the impact on fair value measurement and disclosure:** A particular difficulty encountered by some issuers was the determination of fair value in the case of inactive markets and the level of disclosures required in such circumstances. European enforcers identified cases where issuers had used valuation techniques for fair value measurement even in situations where, viewed objectively, an active market could be shown to have existed, and requested issuers to correct their financial statements. In other cases the disclosures proved insufficient to give the user an appropriate understanding of the method used or the factors which indicated that an active market had not existed.

**Determination of fair value:** Preparers can use a range of methods and techniques when determining the fair value of financial instruments. Detailed disclosures are required in order to help users understand both the methods adopted and the underlying rationale so that they can assess their appropriateness and make valid comparisons with other issuers. Where a valuation technique is used, the assumptions applied must also be disclosed. European enforcers found that, in general, the level and clarity of the information provided to support both these aspects of valuations could have been improved.

**Sensitivity analysis:** IFRS 7 specifically requires issuers to disclose sensitivity analyses. The requirement is further supported by IAS 1 which requires the disclosure of assumptions where a reasonably possible change would have a significant effect on the amounts recognised in the financial statements. This was an area in which European enforcers found issuers' disclosures could have been improved.

### *Impairment of non-financial assets*

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Against a background of economic downturn, impairment testing remained of high importance as conditions generally meant that many preparers would be faced with impaired assets. Several enforcers in Europe therefore undertook targeted reviews of impairment reporting both to assess its adequacy and to stimulate improvement in the type of supporting information provided in financial reports. Impairment of non-financial assets is dealt within IAS 36.

**Valuation issues:** A deterioration in economic conditions generally since 2007 affected the assumptions made in calculating fair value and value in use, resulting in many companies having to recognise impairment charges as a result. Enforcers paid particular attention to the parameters used for the determination of value in use: for example, the calculation of the discount rate, of the long term growth rate used as the basis for determining future cash-flows and comparison with the prior period's assumptions. The review of the calculation of the discount rate used in the determination of cash flow values indicated a variety of practices around the related components of the discount rate, such as risk premium and cost of equity. Regarding the estimated cash-flows, enforcers challenged whether the cash-flow projections used by the issuers in impairment testing were based on reasonable and supportable assumptions. Particular attention was paid by some enforcers to the assumptions applied by market participants and their coherence with specific market indicators as published by analysts. Enforcement actions resulted in a number of corrective notes or other information being published to the market.



**Identification of cash-generating units and goodwill allocation:** Regarding the accounting policies applied in respect of impairment, it was found that despite a continuous improvement since the adoption of IFRS, there are still issuers who present boiler-plate policy descriptions by taking text from the standard, instead of giving specific information relating to how they identify cash-generating units and subsequently allocate goodwill. This area of reporting requires determination of factors such as how management monitors the company's operations and makes decisions on whether to hold or dispose of the company's assets and operations and what is the lowest level within the entity at which the goodwill is monitored for internal management purposes. Impairment testing of goodwill will be performed at that level and the determination of the testing level may affect the outcome of impairment testing.

**Sensitivity analysis:** As part of their ex-ante activities, many enforcers stressed that one of the critical disclosures for the year-end reporting cycle would be sensitivity analysis, which indicates the effect of reasonably possible changes to key assumptions on the carrying amount of assets, including goodwill. Enforcers urged companies to consider carefully whether they should extend their disclosures to include, for example, expected profit margins and other highly sensitive assumptions that can have a significant impact on future cash flows. Where a reasonably possible change in a key assumption would result either in an impairment charge or in the headroom being reduced to nil or close to nil, then additional disclosures about those sensitivities should be provided including quantification of the headroom in the current year impairment calculation, quantification of the key assumptions made, and determination of by how much the key assumptions would need to change for the remaining headroom to be removed. Where a reasonably possible change in a key assumption would result in the headroom being significantly reduced but where a reasonable amount of headroom remained, additional disclosures about sensitivities might be helpfully provided by issuers.

### *Operating segments*

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IFRS 8 - "Operating segments" (applicable for periods beginning on or after 1 January 2009) was first required to be applied to 2009 interim reports, although some issuers had early adopted the standard. Several enforcers drew the markets' attention to the new standard in advance of the 2009 year end and considered whether it should be the subject of a focussed study.

**Identification of operating segments:** Under the new standard, the reporting of segment information is based on the data used by those who review the performance of operating segments and allocate resources to them, even if this information is not prepared on an IFRS basis. The underlying approach was expected by some commentators to lead to an increase in the number of operating segments reported but, in some cases, a decline in the number of segments was reported, due in part to the interpretation of the aggregation criteria for aggregating segments for reporting purposes. The bases on which the chief operating decision makers and operating segments are identified often required enforcers to work closely with issuers in order to better understand their business model and operations in order to prove the reasonableness of management's assessment.

**Impact on impairment test:** The identification of operating segments based on IFRS 8 raised a specific point with regard to the impairment tests conducted in previous periods. The retrospective application of IFRS 8 requires these to be conducted on the basis of the operating segments identified under IFRS 8, with potential changes in goodwill allocation and the effect of impairment charges to be recognised in retained earnings for prior periods or as a current period event. This issue was subsequently addressed to IFRS IC, but not yet taken onto their agenda as IFRS IC considered it was not possible to provide guidance on a timely basis (last information provided in the IFRIC Update March 2010).

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## *Business combinations*

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The economic crisis has had a significant negative impact on the number of acquisitions undertaken across Europe in 2009. Nevertheless, due to the materiality of business combinations to individual issuers and the often complex issues to which they can give rise, enforcers continued to have a focus on the application of IFRS 3. The publication and endorsement of the revised IFRS 3, particularly the possibility of early application prompted enforcers to keep practices in this area under review. More issues are expected to be identified as part of the review process once the standard is mandatory.

**Business combination in the case of a transaction between entities under common control.** This subject featured in many EECS decisions as it is one that is scoped out of IFRS 3. As the revised standard does not bring any additional clarity as to how such combinations should be accounted for, in terms of the often complex structure of deals involving transactions between entities under common control, enforcers continued to discuss the accounting treatments that are acceptable under IFRS, taking into account the relevant requirements of IAS 8 “Accounting policies, changes in accounting estimates and errors”.

**Definition of a business combination:** The distinction between the acquisition of a business and the acquisition of assets and liabilities can be a difficult matter to assess, particularly in certain industries; for example, the real estate sector. Enforcers identified a number of cases where the combination of the structure of the transaction and the specificities of the industry had to be considered carefully in order to understand the nature of the transaction. In such cases, preparers needed to be particularly well prepared and be able to support their treatment with a robust rationale.

**Identification of the acquirer/ reverse acquisition:** Complex structured transactions may lead to a situation where the legal acquirer of a business is different from the acquirer for accounting purposes. In a number of cases considered during the year, enforcers challenged issuers on the comprehensiveness of the factors they had considered when identifying the acquirer under IFRS 3 and, in several cases, the issuer had to change their accounting treatment. Supporting disclosure of the accounting treatment adopted for such transactions was considered insufficient in a number of cases.

**Identification of intangible assets as part of the purchase price allocation:** Enforcers identified a number of issuers who did not appear to appropriately recognise identifiable and measurable intangible assets separately from goodwill in accordance with IAS 38. Enforcers also found that some issuers had recognised “negative goodwill” in situations where such recognition was not justified.

**Insufficient information on factors affecting the recognition of goodwill:** IFRS 3 requires disclosure of the factors contributing to goodwill for all material transactions. Such information should be specific to each transaction and should allow a clear understanding of the nature and financial effect of business combinations and of why a premium was paid on acquisition. Nevertheless, where disclosure was provided, some issuers had a tendency to disclose a boiler-plate explanation in the note on goodwill recognition rather than refer to the specific reasons why the transaction had given rise to goodwill.

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## *Presentation of Financial Statements*

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The presentation of financial statements is governed by IAS 1 for full financial statements and IAS 34 in the case of interim reporting. IAS 7 prescribes the rules for the preparation and presentation of the cash flow statement/statement of cash flows. The most common issues on which enforcers reported non-compliance relating to presentation issues were as follows:

**Long term/ short term classification:** The financial crisis has created conditions which render the breach or potential breach of covenants more likely, which in turn gives rise to an increase in the number of long term loans becoming redeemable immediately. IAS 1 requires a liability to be classified as current if a provision of a long-term arrangement is breached on or before the end of the reporting period even if the lender, after the balance sheet date, agrees not to demand payment. Enforcers found that some issuers did not comply with this requirement and required them to reclassify.

**Disclosure of judgements and estimates:** IAS 1 provides an overarching requirement for management to disclose their judgements underlying the application of their accounting policies and major sources of estimation uncertainty. As noted above, the financial crisis increased the focus on the judgments and estimates made by management in an unstable economic environment with users seeking to understand the extent to which the accounts had been affected. Issuers often did not provide sufficient relevant disclosure here. Where enforcers accepted treatments adopted by preparers when there was a choice of accounting treatments, enforcers often required preparers to document their rationale better for their chosen approach.

**Use of alternative performance indicators:** IAS 1 provides that additional line items, headings and subtotals should be presented on the face of the income statement when such presentation is relevant to an understanding of the entity's performance. In some cases enforcers found that issuers unnecessarily adopted additional line items and headings, the use of which impaired the comparability of common operating items.

**Cash and cash equivalents:** Under IAS 7, items to be classified as cash equivalents are short-term, highly liquid investments that are readily convertible to known amounts of cash and which are subject to an insignificant risk of changes in value. A number of issuers' classification of cash equivalents failed to satisfy all of these criteria –notably, the requirement to be highly liquid.

**Selected explanatory notes:** Interim reports prepared in accordance with IAS 34 include presentation of selected explanatory notes relating to events and transactions that are significant to an understanding of the changes in the financial position and performance of the entity since the last annual report. Enforcers found that some issuers omitted to present an appropriate level of information to satisfy this requirement.





### **3. CESR'S CO-OPERATION WITH THIRD COUNTRY AUTHORITIES**

#### ***3.1 Co-operation with the US SEC***

In 2006, CESR and US SEC signed a work plan with the aim of promoting high quality and consistent application of reporting standards and avoiding conflicting regulatory decisions on the application of both IFRS and US GAAP. In order to fulfil the objectives of the work plan, the two parties met twice in 2009 to discuss areas of common interest or concern. As part of the CESR-Fin delegation, the Chair of EECS participated in both meetings with the US SEC.

##### ***Enforcement issues***

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In a year marked by the global financial crisis, it was noted that the attention of enforcers was particularly oriented to issues related to the impairment of financial and non-financial assets. The timing of the recognition of impairment charges was also discussed which had led to a general lack of comparability across industries. Other subjects discussed related to the reporting of operating segments and revenue recognition issues.

##### ***Accounting issues - convergence***

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A key issue discussed was the development of the new international standard on financial instruments, IFRS 9, as the focal point of the IASB-FASB convergence project for the subsequent period. The main features of the new standard were discussed together with different possible ways to measure financial instruments at cost or fair value.

##### ***Exchange of information***

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At the end of 2009, 8 European countries had signed individual protocols with the SEC relating to the exchange of confidential information relating to dual listed issuers. The SEC has indicated that it would continue to remain in contact with other European enforcers on a case by case basis.

#### ***3.2 Co-operation with other authorities***

CESR organised a first seminar on enforcement of IFRS on 3 and 4 December 2009 in Paris. The seminar was attended by 69 participants representing enforcers from 33 countries. Enforcers and representatives of the International Accounting Standards Board (IASB), other European fora and auditors met to discuss the enforcement of IFRS around the world. Participants included staff from all of the IFRS enforcers of the European Economic Area (EEA) and representatives of eleven enforcers from other countries: Brazil, China, Egypt, India, Israel, Japan, Mexico, South Africa, Switzerland, Turkey and the USA.



## APPENDIX 1 – List of EECs members

Member State	CESR Member./ Competent Authority	
Austria	Financial Market Authority	FMA
Belgium	Banking, Finance and Insurance Commission	CBFA
Bulgaria	Financial Supervision Commission	FSC
Cyprus	Cyprus Securities and Exchanges Commission	CySEC
Czech Republic	Czech National Bank	CNB
Denmark	Danish Financial Services Authority Danish Securities Council Danish Commerce and Companies Agency	Finanstilsynet DSC DCCA
Estonia	Estonian Financial Supervision Authority	EFSA
Finland	Finish Financial Supervisory Authority	FIN-FSA
France	Financial Markets Authority	AMF
Germany	German Federal Financial Supervisory Authority Financial Reporting Enforcement Panel	BaFin FREP
Greece	Capital Market Commission	HCMC
Hungary	Hungarian Financial Supervisory Authority	HFSA
Ireland	Irish Financial Services Regulatory Authority Irish Auditing and Accounting Supervisory Authority	IFSRA IAASA
Iceland	Financial Supervisory Authority	FME
Italy	Companies and Securities National Commission	Consob
Latvia	Financial and Capital Markets Commission	FCMC
Lithuania	Lithuanian Securities Commission	LSC
Luxembourg	Financial Markets Supervisory Commission	CSSF
Malta	Malta Financial Services Authority	MFSA
Netherlands	Financial Market Authority	AFM
Norway	Norway Financial Supervisory Authority	NFSA
Poland	Polish Financial Supervision Authority	PFSA
Portugal	Securities National Commission Bank of Portugal Insurance Portugal Institute	CMVM BP ISP
Romania	Romanian National Securities Commission	CNVMR
Slovakia	National Bank of Slovakia	NBS
Slovenia	Securities Market Agency	SMA
Spain	Securities National Commission	CNMV
Sweden	Swedish Financial Supervisory Authority The Nordic Growth Market Nasdaq OMX Stockholm	Finansinspektionen NGM AB Nasdaq OMX
United Kingdom	Financial Services Authority Financial Reporting Review Panel	FSA FRRP