



Observations on Selected Financial Reporting Issues

Years ending on or after 31 December 2015

(October 2015)



MISSION STATEMENT

Our mission is to promote high quality financial reporting and effective regulation of accountants and auditors through the delivery of independent and effective supervision which protects the public interest

IAASA publications referred to in this *Observations* document are available on IAASA's website at www.iaasa.ie/publications

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1 INTRODUCTION

1.1 Financial reporting review remit of IAASA

IAASA is the accounting enforcer in Ireland tasked with the examination and enforcement of certain listed entities' periodic financial reporting ('issuers'). As such IAASA examines the annual and half-yearly financial reports of certain equity, debt and closed ended fund issuers with securities admitted to trading on a regulated market within the European Union ('EU') for compliance with the relevant reporting framework. The relevant reporting framework for the purposes of this document is confined to those issuers preparing their financial statements under International Financial Reporting Standards ('IFRS') and financial reporting standards issued by the Financial Reporting Council in the UK ('Irish/UK GAAP'). Therefore, although IAASA's review activity may extend to periodic financial reports prepared under other financial reporting standard frameworks (e.g. US GAAP), the observations offered in this document are limited to the requirements as they apply to IFRS and Irish GAAP issuers.

The matters raised in this document derive from a combination of:

- a) financial reporting matters identified during IAASA's examinations and surveys undertaken in 2015;
- b) matters identified in the course of IAASA's work, but not raised with specific issuers;
- c) IAASA's expectations of issuers regarding the upcoming financial reporting season; and
- d) financial reporting matters discussed at the European Securities and Markets Authority ('ESMA') sponsored European Enforcer Co-ordination Sessions ('EECS') meetings at which meetings IAASA is an active participant.

1.2 Purpose of this *Observations* document

The purpose of this document is to assist issuers' management and those charged with issuers' governance in the preparation of high quality financial reports by offering observations on selected financial reporting issues to coincide with the preparation of issuers' 2015 financial statements. It is also intended that some of the matters set out in this document will be the focus of IAASA's attention when examining issuers' financial reports in 2016.

The audience for this document is principally intended to be those involved in the preparation, approval and/or review of issuers' financial reports. This includes issuers' management, Audit Committees and Boards, providers of audit and other assurance services, legal advisors, listing agents and, where applicable, fund administrators and/or other relevant service providers. The document may also help the primary users of financial statements to understand the significant judgements made by issuers' directors in preparing financial statements and to highlight those matters on which they may wish to focus when reviewing those financial statements. Item 2.5 below regarding the use of alternative performance measures may be of particular interest to media commentators as those measures, as opposed to the amounts measured in accordance with the accounting Standards, tend to be reported by journalists when analysing the financial reports of issuers. In that context, IAASA encourages the widest possible transmission of this document.

1.3 Publication of IAASA's financial reporting enforcement findings

Issuers are reminded of the new publication powers of IAASA following the amendment on 9 February 2015 to the Transparency (Directive 2004/109/EC) Regulations 2007 by the Minister for Jobs Enterprise and Innovation. The amended Regulations allow for greater transparency by IAASA in reporting its financial reporting enforcement activities. Further details on how IAASA intend to implement the amended Regulations can be found in IAASA's [Policy Paper on Publication of Financial Reporting Enforcement Activities](#).

1.4 Continued applicability of matters raised in previous years' *Observations* documents

This is the 8th *Observations* document for year end financial reporting published by IAASA and some of the matters raised in previous years' *Observations* documents have continued applicability in the upcoming financial reporting season. This document should be read in conjunction with those earlier years' documents which are available on the IAASA website¹. For ease of reference, the topics addressed in those earlier years' documents are summarised in Appendix I to this document.

1.5 Financial reporting environment

1.5.1 Changing economic climate

All the indicators are that the domestic economy is in recovery mode and that the challenges faced by many entities from the financial crisis are abating.

'The Irish economy is expected to grow by 5.6% in 2015 and 4.0% in 2016, significantly higher than the forecasts [previously] published'

DKM Economic Consultants, *Economy Watch*, issue 16, 9 October 2015²

'The economy is powering ahead. At 5.2%, Irish GDP was the fastest growing in the OECD in 2014. This year we expect growth of around 5% again – which would likely see Ireland remain the fastest growing economy in the OECD two years running!'

Angel Gurría, Secretary-General, OECD, Dublin, 15 September 2015³

'Following GDP growth of 4.8 per cent last year, the strong recovery of the Irish economy has continued in the first half of 2015. While the initial strengthening of activity in 2014 was driven by net export growth, the recovery over the past year has become more balanced, with domestic drivers increasingly playing a more prominent role'

Central Bank of Ireland Quarterly Bulletin Q3 2015, 29 July 2015⁴

'Most recent economic data confirm that the Irish economy is likely to register significant growth in 2015'

ESRI Quarterly Economic Commentary – Summer 2015, 10 June 2015⁵

This is also borne out by many of the half-yearly financial reporting results published this year together with very positive outlook statements. Further evidence of a recovery is the level of merger and acquisition activity reported and/or planned.

1.5.2 Financial reporting in a recovery

The *Observations* documents in previous years reflected the then economic climate and focused on such matters as risk and uncertainty in the recognition, measurement and classification of revenues, expenses, assets and liabilities in financial statements in the context of what could be best described as accounting for a downturn. This focus has now shifted and many of the items highlighted in this *Observations* document reflect matters pertaining to financial reporting in a recovery.

¹ Available at <http://www.iaasa.ie/Publications/FRSU>

² Source: http://dkm.ie/en/news/dkm_publishes_economy_watch_issue_16

³ Source: <http://www.oecd.org/ireland/launch-of-2015-economic-survey-of-ireland.htm>

⁴ Source: <http://www.centralbank.ie/publications/Documents/Quarterly%20Bulletin%20No.%203%202015.pdf>

⁵ Source: http://www.esri.ie/UserFiles/publications/QEC2015SUM_ES.pdf

Notwithstanding the above, IAASA is mindful of the fact that the past performance and future prospects of Irish issuers is varied and our enforcement activities continue to reflect this.

1.5.3 New financial reporting requirements

A number of new financial reporting standards were introduced in recent years that have had a significant impact on issuers' financial statements including, the 'consolidation suite of IFRSs' (IFRS 10, IFRS 11 and IFRS 12), fair values (IFRS 13) and amendments to existing Standards. New Standards issued but not yet effective such as IFRS 9 *Financial Instruments* and IFRS 15 *Revenue from Contracts with Customers* will have a significant impact for some issuers and they are strongly advised to assess their impact as soon as possible given that these may entail major internal systems changes in some instances.

At a national level, a number of issuers (mainly closed ended fund and debt issuers) will be preparing their first annual reports under new Irish/UK GAAP Standards in 2016 (FRS 100, FRS 101, FRS 102). This represents possibly the most significant change in the accounting reporting regime in Ireland for many years.

The Companies Act 2014 came into force on 1 June 2015 and is the most significant change to domestic company legislation in a number of decades.

1.5.4 Accounting enforcement in a European context

At a European level, IAASA continues to align its enforcement policies and methodologies with best practice in Europe. ESMA is accelerating the level of co-ordination amongst national accounting enforcers and sets annual Europe-wide common enforcement topics to be examined at national level. ESMA will undertake a review of its Guidelines to assess the extent of compliance by national accounting enforcers. Therefore, issuers can expect IAASA enforcement activity to reflect both national enforcement priorities and European common enforcement priorities. A practical consequence of this is that issuers may be questioned on their financial reporting treatments in relation to items that are ESMA areas of focus, rather than necessarily being a question of any non-compliance with the Standards from an IAASA perspective.

2 OBSERVATIONS ON SELECTED FINANCIAL REPORTING ISSUES

2.1 Business combinations and fair value accounting

As stated in section 1 above, part of the evidence of the economic recovery is the level of acquisition and merger activity reported by issuers or planned in the near future. IFRS 3 *Business Combinations* is the financial reporting standard applicable when an acquirer obtains control of a business as a result of an acquisition. Such business combinations are accounted for using the acquisition method under which assets acquired and liabilities assumed are generally measured at their fair values at the acquisition date. Any goodwill arising is recognised as an asset and is tested for impairment on an annual basis.

2.1.1 Survey of business acquisition activity

IAASA undertook a desk top survey of the 2013 and 2014 annual financial reports of 27 Irish equity issuers to assess the quantum of business acquisition activity and found that:

- a) fourteen equity issuers had acquisition activity during the year (2013: nine);
- b) the total consideration paid equity issuers for acquisitions amounted to €1.8bn (2013: €1.4bn);
- c) following the acquisitions, equity issuers recognised goodwill of €897m (2013: €558m) equating to 49.5% (2013: 39.7%) of the total consideration paid;
- d) €14bn (2013: €12.7bn) of cumulative goodwill was recognised on equity issuers' balance sheets which equates to 59% (2013: 57%) of total equity; and
- e) cumulative goodwill on equity issuers' balance sheets equated to 38% (2013: 37%) of total non-current assets.

Given the large percentage of equity issuers' assets which is made up of goodwill and intangible assets acquired, IAASA has examined and will continue to examine the accounting for same. As the scale of business combinations increases, it is expected that IAASA will examine in more detail, issuers' recognition (or non-recognition) and measurement of intangible assets and, as a consequence, the amount of goodwill and intangibles recognised in financial statements.

Message for Directors and Audit Committees

Directors and Audit Committees should closely examine the basis upon which identifiable intangible assets acquired in a business acquisition are recognised and measured.

2.1.2 Determining the fair value of intangible assets

Paragraph 27 and Appendix B3 of IFRS 13 *Fair Value Measurements* prescribe the fair value measurement of non-financial assets and the application of the valuation premise for such non-financial assets.

Paragraph 10 of IFRS 3 states that, as of the acquisition date, the acquirer shall recognise separately from goodwill the identifiable assets acquired, the liabilities assumed and any non-controlling interest in the acquiree. Paragraph 18 of IFRS 3 states that the acquirer shall measure the identifiable assets acquired and the liabilities assumed at their acquisition date fair values.

In particular, IAASA has examined issuers' recognition (and, in some instances, non-recognition) of the following intangible assets in business combinations:

- a) customer relationships;
- b) brands;
- c) workforce;

- d) technology;
- e) non-compete agreements;
- f) re-acquired rights; and
- g) other potential intangible assets.

IAASA examined the key assumptions used by the issuer in determining the fair value of intangible assets acquired including:

- a) the fair value valuation methodology, e.g. multi-period earnings, discounted cash flow, lost profits method;
- b) the remaining useful lives of each class of intangible asset;
- c) the discount rate applied to future cash flows;
- d) estimated EBIT margin;
- e) functional obsolescence rate;
- f) long-term growth rate of each asset; and
- g) other data provided by external experts and relied upon by the directors.

Issuers' judgements related to the fair value measurement of financial and non-financial assets, including intangible assets, under IFRS 13 will remain an area of focus for IAASA.

Message for Directors and Audit Committees

Directors and Audit Committees should carefully consider the key judgements applied in the recognition and measurement of the fair value of intangible assets together with the disclosures related to same.

2.2 Value-in-use ('VIU') calculations of Cash Generating Unit(s) ('CGUs') – IAS 36 Impairment of Assets

IAASA's messages on the recognition, measurement and disclosure of the VIU calculation of CGUs contained in IAASA's 2013 and 2014 *Observations* documents continue to be of relevance to issuers in preparing future financial statements.

The following points should be seen as additional to these outlined in previous documents.

2.2.1 Discount rate

Paragraphs 55 to 57 of IAS 36 refer to the use of an asset specific discount rate. Paragraph A18 of IAS 36 requires that discount rates be adjusted to:

- a) reflect the way that the market would assess the specific risks associated with the asset's estimated cash flows; and
- b) exclude risks that are not relevant to the assets estimated cash flows or for which the estimated cash flows have been adjusted.

In addition, the disclosures required by paragraph 134(d)(v) of IAS 36 are required for each CGU rather than at an aggregated level so that important differences in assumptions by CGU are not obscured. A discount rate based on the weighted average cost of capital ('WACC') without adjustment to reflect the way that the market would assess the specific risks associated with the asset's/CGU's

estimated cash flows does not comply in full with IAS 36. Paragraph A19 of IAS 36 states that the discount rate is independent of the entity's capital structure.

In a number of IAASA examinations it was noted that the pre-tax discount rate used in the VIU calculations remained unchanged for a number of years despite apparent significant changes in the issuer's performance and financial position over that time. In some instances the discount rate was unchanged for a period in excess of 5 years. IAASA detected a number of issuers who failed to disclose a discount rate for each CGU.

During its financial statement examinations IAASA has queried issuers as to the basis for:

- a) using an unchanged WACC over a number of years;
- b) the equity risk premium component of the WACC;
- c) small-sized entity premium component of the WACC;
- d) the selection of entities used as comparators when quantifying a target industry debt/equity ratio for use in the WACC; and
- e) failure to disclose the discount rate used for each CGU that has significant amounts of goodwill or intangible assets.

As a result of these IAASA examinations a number of issuers have provided undertakings in respect of future financial reports.

Message for Directors and Audit Committees

The WACC is a starting point for a CGU specific discount rate for impairment purposes. Directors and Audit Committees should ensure they carefully review the assumptions underpinning the discount rate used for each CGU (or group of units) to ensure it reflects the specific risks associated with the estimated cash flows of the CGU(s).

2.2.2 Limited or no headroom – additional VIU disclosures

In accordance with paragraph 134(f) of IAS 36 an entity shall disclose the following information for each CGU (or group of units) if a reasonably possible change in a key assumption would cause the unit's (or group of units) carrying amount to exceed its recoverable amount:

- a) the amount by which the unit's (group of units) recoverable amount exceeds its carrying amount;
- b) the value assigned to the key assumption; and
- c) the amount by which the value assigned to the key assumption must change, after incorporating any consequential effects of that change on the other variables used to measure recoverable amount, in order for the unit's (group of units) recoverable amount to be equal to its carrying amount.

Issuers should consider the impact of reasonably possible changes after incorporating any consequential effects on other variables. Limited or no headroom is likely to mean that CGUs are highly sensitive to any variation in the key assumptions resulting in further impairment.

IAASA will examine the reasonableness of issuers' key impairment assumptions in this regard. IAASA has sought the following information from issuers where the headroom was limited:

- a) a working copy of the spreadsheet setting out the detailed workings of the recoverable amount calculations of CGUs;
- b) extracts from external industry data that was relied upon to support the discount rates used; and

- c) details of the long term growth rate used by each of the peer entities that was relied upon to support the entity's long term growth rate.

Issuers are reminded that the aforementioned additional disclosures are required where the headroom for a CGU (or group of units) is low or nil e.g. where the CGU has been recently materially impaired.

In order to avoid boilerplate disclosures in this area issuers are reminded that the additional disclosures are not required where the changes to key assumption(s) required to wipe out the entire headroom are not reasonably possible.

Message for Directors and Audit Committees

Directors and Audit Committees should carefully consider the value in use methodologies applied and the nature of disclosures provided in annual financial statements. Particular care should be given in instances where there is no or limited headroom and/or where a reasonably possible change in a key assumption(s) would cause the carrying amount to exceed its recoverable amount.

2.3 The Consolidation Suite of Standards

For most Irish issuers under IAASA's financial statement examination remit, their 2014 annual financial statements were the first in which IFRS 10 *Consolidated Financial Statements*, IFRS 11 *Joint Arrangements* and IFRS 12 *Disclosure of Interests in Other Entities* were applied. While it is too early to draw definitive conclusions on the quality of issuers' application of the Consolidation Suite of Standards, IAASA has conducted a preliminary desktop based survey of a small sample of issuers to establish the level of compliance with those Standards. Some issuers applied all three Standards and for other issuers only two of the three Standards were applicable.

Some of the results of this preliminary desktop based survey of IFRS 10 to IFRS 12 were as follows:

- a) 80% of the selected issuers reported the initial application of IFRS 10 had not resulted in a change in their assessment of control. One issuer consolidated an SPE that was previously unconsolidated;
- b) 40% of the issuers reported that they consolidated entities in which they held 50% or less of the voting rights;
- c) some of the issuers which consolidated entities in which they held 50 % or less of voting rights seem to have provided boilerplate disclosures in connection with paragraphs 5 to 7 of IFRS 10 and paragraphs 7 and 9 of IFRS 12;
- d) some issuers did not disclose the significant judgements and assumptions used to justify why they did not consolidate an entity (or group of entities) although they held more than 50% of the voting rights (paragraphs 7 and 9 of IFRS 12 refers); and
- e) a high proportion of issuers sampled, did not disclose restrictions on the access or use of assets/settlement of liabilities (paragraphs 13(a) and 13(b) of IFRS 12 refers) or any protective rights of non-controlling interests;

It should be noted that this was a preliminary desktop based survey of issuers' financial statements and the selected issuers were not requested to explain the disclosures or apparent absence of some disclosures. IAASA will be engaging with some issuers based on the results of this survey.

Message for Directors and Audit Committees

The Consolidation Suite of Standards (IFRS 10, 11 and 12) require a number of key subjective assumptions to be applied by issuers in determining whether an entity is controlled, or jointly controlled and properly disclosed. Directors and Audit Committees should ensure they carefully evaluate the accounting applied for these transactions, disclose the key judgements made and

provide the new disclosure requirements introduced by IFRS 10, 11 and 12 in a meaningful way and tailored to the issue.

2.4 Deferred tax assets ('DTAs')

IAASA's messages with regard to the accounting for DTAs contained in our [2014 Observations document](#) continue to be of relevance to issuers in preparing future financial statements (item 2.2 of the 2014 Observations document refers).

Notwithstanding the recovery evident in many issuers' reports, it is still relevant to draw attention to the onus on entities (by paragraph 56 of IAS 12 *Income Taxes*) to reduce the carrying amount of a deferred tax asset to the extent that it is no longer probable that there will be sufficient taxable profits to allow all or part of that deferred tax asset to be utilised.

During 2015 IAASA continued to monitor the recognition and measurement of deferred tax assets by issuers where these amounts are material to the financial position and/or financial performance.

In particular IAASA has examined the recognition of material amounts of DTAs arising from the re-organisation of some entities and have queried the basis for the amount and rationale for material amounts of DTA recognised during a period. Some issuers (mainly financial institutions) have relied on forecasts of taxable profits over a prolonged period of time to support the recognition of material amounts of deferred tax assets. IAASA have examined the long term DTA forecasts of some issuers in more detail. The longer the forecast period necessary to recover DTA results in an increase in the uncertainty of those forecasts. Thus those long term forecasts are less likely to be in the category of '*convincing other evidence*' as required by paragraph 35 of IAS 12. As well as continuing to engage with issuers, IAASA has met the IASB and ESMA to discuss the matter and such engagement is continuing.

Message for Directors and Audit Committees

Directors and Audit Committees are reminded to apply a robust reassessment of forecasts of taxable profits that extend over a prolonged period to ensure it remains convincing in nature and consequently complies with IFRS.

2.5 Alternative Performance Measures ('APMs')

The 2014 *Observations* document re-iterated IAASA's recommendations⁶ with regard to the disclosure by issuers of APMs. APMs in this context are best described as financial measures of financial performance, financial position, or cash flows, other than a financial measure defined or specified in accounting Standards; common APMs presented by Irish equity issuers include operating profit, underlying earnings, adjusted earnings per share, free cash flow and constant currency performance measures. IAASA continued to engage with issuers during 2015 on their use of APMs and have obtained various undertakings for improvements in future financial reports.

The European Securities and Markets Authority ('ESMA') published its [Guidelines on Alternative Performance Measures](#) ('ESMA APM Guidelines') on 30 June 2015.

The ESMA APM Guidelines apply to issuers with securities admitted to trading on regulated markets, and persons responsible for drawing up a prospectus. They will be supervised by competent

⁶ Recommendations:

- a) explain the reason for the use of each APM;
- b) clearly define each APM;
- c) explain the calculation of each APM;
- d) reconcile each APM to the relevant IFRS-based measure;
- e) include comparative amounts for each APM;
- f) disclose all APMs in a single location in the annual report;
- g) avoid presenting APMs that detract from or conflict with IFRS-based financial statement measures; and
- h) avoid giving undue prominence to non-IFRS-based APMs

authorities and other bodies in the EU with responsibilities under the Transparency Directive, Prospectus Directive or Market Abuse Regulation. In the context of the separate responsibilities of IAASA and the Central Bank under the Transparency Directive, IAASA is engaging with the Central Bank in order to decide who will be responsible for enforcing the different aspects covered by the Guidelines.

The ESMA APM Guidelines are consistent with the findings and recommendations from IAASA's surveys on the use of APMs by Irish equity issuers, the results of which have been published in two papers, namely:

- a) *Alternative Performance Measures – A Survey of their Use together with Key Recommendations (November 2012)*; and
- b) *Alternative Performance Measures – A Survey of their Use together with Key Recommendations: An Update (January 2015)*.

The ESMA APM Guidelines are effective for all documents issued on or after the effective date of 3 July 2016.

The coming into force of the ESMA APM Guidelines will give added impetus to IAASA's activity in this area.

Message for Directors and Audit Committees

While some issuers adhere to a high standard in reporting their APMs, it is unacceptable that others flatter their results by excluding certain items from performance measures. Directors and Audit Committees should endeavour to comply with IAASA recommendations and the ESMA APM Guidelines to the fullest extent possible in advance of the latter becoming mandatory in 2016.

2.6 Fair Value measurement and disclosure

2.6.1 Valuation techniques – significant unobservable inputs

IFRS 13 *Fair Value Measurement* requires a number of disclosures in relation to the valuation techniques and inputs used in fair value measurement, including:

- a) a description of the valuation technique and the inputs used in the fair value measurement [IFRS13.93(d)];
- b) quantitative information about the significant unobservable inputs used in the fair value measurement [IFRS13.93(d)]; and
- c) a narrative description of the sensitivity of the fair value measurement to changes in unobservable inputs if a change in those inputs to a different amount might result in a significantly higher or lower fair value measurement [IFRS 13.93(h)(i)]

IAASA had findings where the above information for all of the significant unobservable inputs identified in the annual financial statements was not disclosed.

Message for Directors and Audit Committees

Directors and Audit Committees should ensure that the mandated disclosures in relation to the valuation techniques and inputs used in fair value measurement are provided in the annual financial statements.

2.6.2 Average forced sale value – orderly transactions

Paragraph 9 of IFRS 13 defines ‘fair value’ as:

*‘the price that would be received to sell an asset or paid to transfer a liability **in an orderly transaction** between market participants at the measurement date ...’*

Appendix A of IFRS 13 states that an ‘orderly transaction’ is:

‘A transaction that ... is not a forced transaction (e.g. a forced liquidation or distress sale)’.

It is IAASA’s view that the carrying value of a financial instrument derived from the average forced sale value is not compliant with IFRS 13 and we have enforced in this regard.

Message for Directors and Audit Committees

Directors and Audit Committees should ensure that the fair value methodology applied complies in full with IFRS 13 *Fair Value Measurements*.

Issuers are reminded that, where they have relied on fair values provided by external party/pricing specialists, it remains the Directors’ responsibility to ensure that the methodology complies in full with IFRS 13.

2.7 Judgments, assumptions, and auditors’ risks of material misstatements

IAS 1 requires an entity to disclose the judgments, apart from those involving estimations, that management has made in the process of applying the entity’s accounting policies and that have the most significant effect on the amounts recognised in the financial statements.

During the year, IAASA undertook a desk top survey of twenty equity issuers’ disclosures of assumptions and judgements together with a survey of the risks of material misstatement identified by equity issuers’ auditors. The list of issuers selected for this survey, together with the principal findings are presented in Appendix III.

Directors’ critical accounting judgment disclosures should be provided in such a manner as to help users of the financial statements to understand the judgments, assumptions and estimations that the directors have made about the future. The nature and extent of the disclosures provided will vary according to the circumstances.

IAASA notes with interest that a number of topics identified by the directors as critical accounting judgments, together with the assessed risks of material misstatements identified by the independent auditors had already been identified by IAASA in its annual *Observations* documents from 2008 to 2014. Such topics will have been raised with individual issuers though IAASA’s enforcement activity and will include in some instances undertakings which had been obtained.

Message for Directors and Audit Committees

Given the significance of such disclosures (by their very nature) to users of the financial statements, Directors and Audit Committees should give very careful consideration to the quality and extent of the disclosures.

2.8 Avoiding the use of boilerplate and excessive disclosures in financial reports

Section 10 of the 2013 *Observations* document summarises IAASA’s previous messages to issuers on the topic of the need to avoid boilerplate disclosures in issuers’ financial reports. It is extremely important that issuers carefully evaluate the presentation and disclosure of items in periodic financial reports that will provide users of those statements with **relevant** information. The inclusion of too much information may obscure significant matters and may not contribute to users’ understanding of the financial reports.

Where financial statements contain boilerplate disclosures it often results in:

- a) insufficient information necessary for an understanding of the financial position, financial performance and cash flows of the entity being provided to users of those statements; and / or
- b) the more important features of the entity's financial position, financial performance and cash flows of the entity being obscured from users.

While there are various initiatives by standard setters and fellow accounting enforcers ongoing in this regard, it is IAASA's view that the current accounting standards are, in many instances, robust enough to deal with this issue. IAASA has in the past enforced in this regard where it felt that the disclosures were too boilerplate, not issuer specific and provided limited, if any, decision useful information to users. In this regard the following extracts from IFRS have been used by IAASA:

a) *IAS 1 Presentation of Financial Statements*

Paragraph 17(b) of IAS 1 requires an entity to present information, including accounting policies, in a manner that provides **relevant**, reliable, comparable and understandable information.

Paragraph 17(c) of IAS 1 states that a fair presentation requires an entity to provide additional disclosures when compliance with the specific IFRS is insufficient to enable users to understand the impacts of particular transactions, events or conditions on the entity's financial position and financial performance.

The IASB's *Disclosure Initiative (Amendments to IAS 1)*, issued on 18 December 2014 and, subject to EU endorsement which is expected in Q4 2015, effective for annual periods beginning on or after 1 January 2016, inserts a new paragraph 30A to IAS 1 which states that:

'When applying this and other IFRSs an entity shall decide, taking into consideration all relevant facts and circumstances, how it aggregates information in the financial statements, which include the notes. An entity shall not reduce the understandability of its financial statements by obscuring material information with immaterial information or by aggregating material items that have different natures or functions.'

b) *IAS 34 Interim Financial Reporting*

Paragraph 15 of IAS 34 specifically states that it is not necessary for the notes to an interim financial report to provide relatively insignificant updates to the information that was reported in the most recent annual financial report. This is a very explicit reference to provide only relevant information that updates the most recent annual financial report.

c) *IFRS 7 Financial Instruments: Disclosures*

Paragraph B3 of IFRS 7 refers to striking a balance between overburdening financial statements with excessive detail and not obscuring important information as a result of too much aggregation.

Paragraph 35 of IFRS 7 states that where quantitative data is unrepresentative of the risk exposure then an entity shall provide further information that is representative. This can be used to ensure disclosures are representative, issuer specific and not boilerplate.

d) *Forthcoming IASB publication on materiality*

An entity should only disclose information that is material and, thus, how the concept of materiality is applied will determine the level of disclosures provided. The IASB will shortly issue a Practice Statement on Materiality for comment the purpose of which is assist management in applying the concept of materiality to financial statements. As chair of the previous ESMA working group on materiality, the Head of Financial Reporting Supervision has had input into the drafting of the IASB's forthcoming publication. Issuers are encouraged to read and be guided by the IASB Practice Statement when it is issued.

Message for Directors and Audit Committees

Directors and Audit Committees should pay particular attention to the presentation and disclosure in periodic financial reports to ensure that all relevant information is provided to users. The financial

reports should avoid the use of boiler plate disclosures and Directors and Audit Committees should assess that value added of each disclosure in their financial reports to ensure compliance with IFRS.

2.9 Cash flow statements

Information about the cash flows of an entity is useful in providing users of financial statements with a basis to assess the:

- a) ability of the entity to generate cash and cash equivalents; and
- b) cash flow needs of the entity.

The economic decisions that are taken by users require an evaluation of the ability of an entity to generate cash and cash equivalents and the timing and certainty of their generation.

The objective of this Standard is to require the provision of information about the historical changes in cash and cash equivalents of an entity by means of a statement of cash flows which classifies cash flows during the period from operating, investing and financing activities.⁷

In October 2014, IAASA published the findings from its thematic examination of how selected Irish equity issuers prepare cash flow statements under IAS 7 *Statement of Cash Flows*⁸. That thematic examination concluded that while the level of compliance with the presentational requirements of IAS 7 by the equity issuers selected was satisfactory there are a number of areas where the presentation of cash flows does not result in information that is readily comparable between equity issuers.

For example, the selected issuers application of IAS 7 differed in the following respects:

- a) their approach to the presentation of operating cash flows on the face of the cash flow statement or in the related notes;
- b) their classification of interest paid as a cash outflow from operating activities or as a cash outflow from financing activities;
- c) the level of disaggregation regarding the components of certain financing activities on the face of the cash flow statement; and
- d) whether or not an accounting policy for cash and cash equivalents was disclosed.

Our findings show a lack of consistency in the application of IAS 7; however, this does not necessarily mean that issuers did not comply with the Standard.

In the course of its financial statement examinations in 2015, IAASA has continued to challenge issuers, and, in particular, fund and debt issuers, as to the presentation of items in the cash flow statement.

Given that the statement of cash flows is one of the four primary financial statements that entities are required to produce, this is an area that will continue to be an area of focus in the forthcoming reporting season. It is also expected that this will be a topic that will be included in the ESMA common enforcement priorities and so we will also be co-operating with our European colleagues in this regard.

Message for Directors and Audit Committees

Directors and Audit Committees should scrutinise the cash flow statement to ensure full compliance with the objective and requirements of IAS 7 *Cash Flow Statements*.

⁷ IAS 7 'Objective'

⁸ *Review of the application of IAS 7 Statement of Cash Flows by selected Irish equity issuers* (October 2014) available at http://www.iaasa.ie/getmedia/657706ea-cb26-47d7-ba7a-5dbd96936a3d/IAS7_2014.pdf?ext=.pdf

2.10 Matters of particular relevance to financial institutions

2.10.1 Movements in loan impairment provision rates

The 2014 financial statements of Financial Institutions saw significant reversals of impairment provisions which were examined by IAASA. According to the Financial Institutions these arose primarily due to large increase in loan restructurings, recovering house prices, falling arrears levels and improved economic data. IAASA have noted that, at a sub class of loan level, impairment charges in some loan segments have increased.

The latter impairment charges were described as being attributed to the ECB Asset Quality Review ('AQR') and changes to the Central Bank's Impairment Guidelines.

Disaggregated loan impairments will continue to be monitored by IAASA in 2016.

Message for Directors and Audit Committees

Directors and Audit Committees should ensure that significant changes in cumulative impairment provisions at a sub class of loan level and impairment charges/reversals are directionally consistent with observable data. In addition, Directors should ensure that any changes in key impairment assumptions during the period or sensitivities to changes in these assumptions that are reasonably possible are fully disclosed in the financial statements and transparent to users.

2.10.2 Other matters raised with financial institutions

Other matters raised with financial institutions during 2015 included:

- a) gross movements in the banks impairment provisions before offsetting new impairments with reversals;
- b) forborne loan disclosures;
- c) disclosure of the sensitivities of key impairment assumptions for the non mortgage loan book;
- d) revised definition of non performing loans;
- e) basis of consolidation of SPVs;
- f) Sale of non-core assets;
- g) APMs;
- h) retirement benefit obligation- movement and risks;
- i) accounting for the results of the ECB Comprehensive Assessment and AQR results; and
- j) evidence to support the recognition and revision of deferred tax assets.

Message for Directors and Audit Committees

IAASA will continue to examine the financial statements of financial institution for a range of matters including, but not limited to, impairment provisioning.

2.10.3 Subgroup of EECS on Accounting of Financial Institutions

At a European level, IAASA has a representative on the dedicated subgroup of EECS (*Accounting of Financial Institutions*) which is discussing the accounting issues related to accounting by financial institutions. This includes implementation of IFRS 9 and the application by banks of the new impairment model. A range of other matters are under consideration including the follow up to the ECB AQR, funding value adjustments in the calculation of the fair value of financial instruments, deferred tax assets, reporting of contributions arising from the Bank Recovery and Resolution Directive, accounting for deposit guarantee schemes and banks' exposure to country risk.

Message for Directors and Audit Committees

Directors and Audit Committees are reminded that examinations of the financial statements of Irish financial institutions are increasingly reflecting European mandated accounting topics. The trend is for further coordination of enforcement activities of the IFRS-based financial statements of European banks.

2.10.4 Disclosing the impact of IFRS 9 *Financial Instruments*

Financial institutions are reminded that given the significance of IFRS 9 and the impact of a move to an expected loss model, paragraph 30 of IAS 8 *Accounting Policies, Changes in Accounting Estimates and Errors* is of particular relevance for other IFRSs issued but not yet effective (see Section 2.11).

It is IAASA's expectation that financial institutions will provide the directors' key judgements it has made in applying IFRS 9 together with estimates of the possible impact the application of the new Standard will have on the entity's financial statements in the period of initial application as soon the information is available. It is IAASA view that a boilerplate statement such as the bank is assessing the impact of adopting IFRS 9 will not be sufficient in their next annual financial statements. Issuers are encouraged to be as transparent as possible with their disclosures of known or reasonably estimable information.

Message for Directors and Audit Committees

Directors and Audit Committees should disclose the directors' key judgements and estimates that the impact of IFRS 9 *Financial Instruments* will have on the financial institutions' financial statements in the period of initial application as soon the information is available.

2.10.5 Deposit guarantee schemes

Directive 94/19/EC on deposit guarantee schemes was amended by Directive 2014/49/EU and requires Member States to ensure that one or more deposit guarantee schemes are introduced. These can have the character of ex-ante or ex-post schemes.

In addition, the Bank Recovery and Resolution Directive ('BRRD') has been implemented into Irish law by the European Union (Bank Recovery and Resolution) Regulations 2015. The BRRD allows up to 30% of the available financial resources for ex-ante contributions to be contributed in the form of Irrevocable Payment Contributions rather than in cash.

IAASA is working with its European counterparts to ensure consistent application and enforcement in this area, and in particular to achieve consistent accounting treatment regarding:

- a) accounting for ex-ante non-refundable cash contributions to deposit guarantee schemes; and
- b) accounting for irrevocable payment commitments.

Message for Directors and Audit Committees

Directors and Audit Committees should ensure the accounting for deposit guarantee schemes complies in full with IFRS and takes account of any Guidance which is expected to be issued by ESMA.

2.11 IFRSs issued but not yet effective: IFRS 9 *Financial Instruments* and IFRS 15 *Revenue from Contracts with Customers*

IFRS 9 was issued by the IASB on 24 July 2014 as a replacement of IAS 39 *Financial Instruments: Recognition and Measurement*. IFRS 9 includes requirements for recognition and measurement, impairment, de-recognition and general hedge accounting. IFRS 9 is mandatorily effective for periods beginning on or after 1 January 2018 with early adoption permitted (subject to EU endorsement).

IFRS 15, issued by the IASB on 28 May 2014, specifies how an entity recognises revenue and requires entities to provide users of financial statements with more disclosures. The Standard provides a single, principles based five-step model to be applied to all contracts with customers. Subject to EU endorsement, IFRS 15 applies to annual reporting periods beginning on or after 1 January 2018.

Significant judgements are likely to include, but are not limited to, the following:

- a) the timing of satisfaction of the performance obligation; and
- b) determining the transaction price and the amounts allocated to performance obligations.

Paragraph 30 of IAS 8 requires an entity, when it has not adopted a new IFRS that has been issued but is not yet effective, to disclose both that fact and known or reasonably estimable information relevant to assessing the possible impact that initial application of the new IFRS will have on its financial statements. This disclosure applies irrespective of whether that IFRS has or has not been endorsed by the EU.

Paragraph 31 of IAS 8 elaborates on this disclosure requirement and, in particular, requires disclosure of either a discussion of the impact that initial application of the IFRS is expected to have on the entity's financial statements or, if that impact is not known or reasonably estimable, a statement to that effect.

Message for Directors and Audit Committees

In evaluating the impact of IFRS 15, Directors and Audit Committees should ensure that regard is had to the specific terms of contracts with customers in measuring revenue.

In providing the disclosures required by paragraphs 30 and 31 of IAS 8 *Accounting Policies, Changes in Accounting Estimates and Errors* when the issuer has not applied a new IFRS that has been issued but is not yet effective, careful consideration should be given to ensuring the disclosures provide information that, to the fullest extent possible, is useful to users of the financial statements.

GLOSSARY OF TERMS

AQR	Asset Quality Review
APM(s)	Alternative Performance Measure(s)
BRRD	Bank Recovery and Resolution Directive
CGU(s)	Cash Generating Unit(s)
DTA(s)	Deferred tax asset(s)
EBA	European Banking Authority
ECB	European Central Bank
EECS	European Enforcement Coordination Sessions
ESMA	European Securities and Markets Authority
EU	European Union
FRS	Financial Reporting Standard
GAAP	Generally Accepted Accounting Principles
IAASA	Irish Auditing & Accounting Supervisory Authority
IAS	International Accounting Standard
IASB	International Accounting Standards Board
IFRS	International Financial Reporting Standard
Issuer	An entity coming within IAASA's financial statement examination remit under the Regulations
Regulations, the	Transparency (Directive 2004/109/EC) Regulations 2007 (S.I. No. 277 of 2007) (as amended by the Transparency (Directive 2004/109/EC) (Amendment) Regulations 2010 (S.I. No. 102 of 2010), the Transparency (Directive 2004/109/EC) (Amendment) Regulations 2012 (S.I. No. 238 of 2012), the Transparency (Directive 2004/109/EC) (Amendment) (No. 2) Regulations 2012 (S.I. No. 316 of 2012) and the Transparency (Directive 2004/109/EC) (Amendment) Regulations 2015 (S.I. No. 44 of 2015)
SPE	Special purpose entity
UTP(s)	Uncertain tax position(s)
VIU	Value-in-use
WACC	Weighted average cost of capital

APPENDIX I – MATTERS RAISED IN EARLIER YEARS’ OBSERVATIONS DOCUMENTS

This is the 8th *Observations* document published by IAASA. Readers may find it helpful to read this document in conjunction with those earlier years’ documents which are available on the IAASA website – refer to Appendix II for links to each of those earlier years’ *Observations* documents. For ease of reference, the topics addressed in those earlier years’ documents are set out below:

	2014	2013	2012	2011	2010	2009	2008
Risks and uncertainties and risk disclosures			√	√	√	√	√
New and amended accounting pronouncements		√	√	√	√	√	√
Provisions		√	√	√	√		
Impairments	√	√	√		√		√
- impairment of goodwill						√	
Alternative performance measures		√	√			√	√
Assessing control under IFRS 10	√						
Recognition and measurement of deferred tax assets – entities with a history of recent losses -		√					
Presentation of the Income Statement		√					
Forbearance: disclosure	√	√					
Quality of fair value and risk disclosures by debt issuers/special purpose vehicles		√					
ECB / EBA Comprehensive Assessment and Asset Quality Review (‘AQR’) – impact on financial institutions	√						
General disclosures in financial statements		√					
Employee benefits			√				√
- amendments to employee benefit plans				√			
- discount rates		√	√		√		
Related party disclosures						√	√
- Disclosure of Key Management Personnel (‘KMP’) compensation		√			√		
Financial instruments					√	√	√
Cash flow statements			√				
Off balance sheet items: qualitative disclosures			√				
Significant judgements			√				
Financial reporting pronouncements not yet effective			√				
Exceptional items and non-recurring items			√	√			
Restatement and reclassification of amounts			√		√		
Materiality				√		√	
Interim reporting				√	√		
Bank covenants					√	√	
Hedging						√	√
Operating profit						√	√
Recoverable amount of assets / Cash Generating Units (‘CGUs’)				√			
- value-in-use (‘VIU’) calculations	√						
- disclosure of recoverable amount of CGUs containing goodwill or intangible assets with indefinite useful lives	√						
Tax risks and uncertainties				√			
- measurement of uncertain tax positions (‘UTPs’)	√						

	2014	2013	2012	2011	2010	2009	2008
- disclosure of accounting policy	√						
Sovereign debt				√			
Financial reporting considerations relevant to the making of distributions				√			
Presentational errors				√			
Revision to IAS 1 <i>Presentation of Financial Statements</i>					√		
Operating segments					√		
Accounting for Government grants and Government assistance						√	
Management reports						√	
Additional disclosures						√	
Reliance on ' <i>industry practice</i> '						√	
Judgements							√
Deferred tax assets							√
- recognition and measurement	√						
- disclosure	√						
Business combinations							√
Earnings per share							√
Prior period errors							√

APPENDIX II – IAASA’S FINANCIAL REPORTING RELATED PUBLICATIONS

Readers may find it helpful to refer to other IAASA financial reporting related publications, available on the IAASA website, including:

Category	Document
Observations documents	Observations on selected financial reporting issues issuers' financial years ending on or after 31 December 2014
	Observations on selected financial reporting issues issuers' financial years ending on or after 31 December 2013
	Observations on selected financial reporting issues issuers' financial years ending on or after 31 December 2012
	Observations on selected financial reporting issues issuers' financial years ending on or after 31 December, 2011
	Observations on selected financial reporting issues – issuers' financial years ending on or after 31 December, 2010
	Observations on materiality in financial reporting
	Observations on selected financial reporting issues – issuers' financial years ending on or after 31 December, 2009
	Observations on year end financial reporting issues for issuers admitted to trading on a regulated market and whose Home Member State is Ireland
Surveys and commentaries	Alternative Performance Measures – A Survey of their Use together with Key Recommendations: An Update
	Review of the application of IAS 7 <i>Statement of Cash Flows</i> by selected Irish equity issuers
	Commentary on the application of certain aspects of IAS 1 <i>Presentation of Financial Statements</i> by selected Irish equity issuers
	Review of the application of accounting standard requirements in respect of the disclosure of key management personnel compensation by Irish equity issuers
	Alternative Performance Measures – A survey of their use together with key recommendations
	Review of the quality of selected debt and fund issuers' fair value and risk disclosures
	Commentary on half-yearly financial reports prepared since the coming into effect of the Transparency (Directive 2004/109/EC) Regulations, 2007
Policy Paper	Policy Paper on Publication of IAASA's Financial Reporting Enforcement Findings
Guides	Guide to the financial reporting requirements of the EU Transparency Directive
Information Notes	Financial reporting considerations relevant to the disclosure requirements of the European Communities (Takeover Bids (Directive 2004/25/EC)) Regulations 2006

Category	Document
	Information Note: Financial reporting considerations relevant to the making of distributions
Annual Reports	2014 Annual Report 2013 Annual Report 2012 Annual Report 2011 Annual Report 2010 Annual Report 2009 Annual Report 2008 Annual Report 2007 Annual Report 2006 Annual Report

APPENDIX III – FINDINGS FROM THE DIRECTORS’ CRITICAL ACCOUNTING JUDGMENTS SURVEY AND FINDINGS FROM THE AUDITORS’ RISK OF MATERIAL MISSTATEMENT SURVEY

Directors’ critical accounting judgment survey

Context

Paragraph 122 of IAS 1 *Presentation of Financial Statements* requires an entity to disclose the judgements, apart from those involving estimations, that management has made in the process of applying the entity's accounting policies and that have the most significant effect on the amounts recognised in the financial statements. Paragraphs 123 and 124 of IAS 1 elaborate on this requirement.

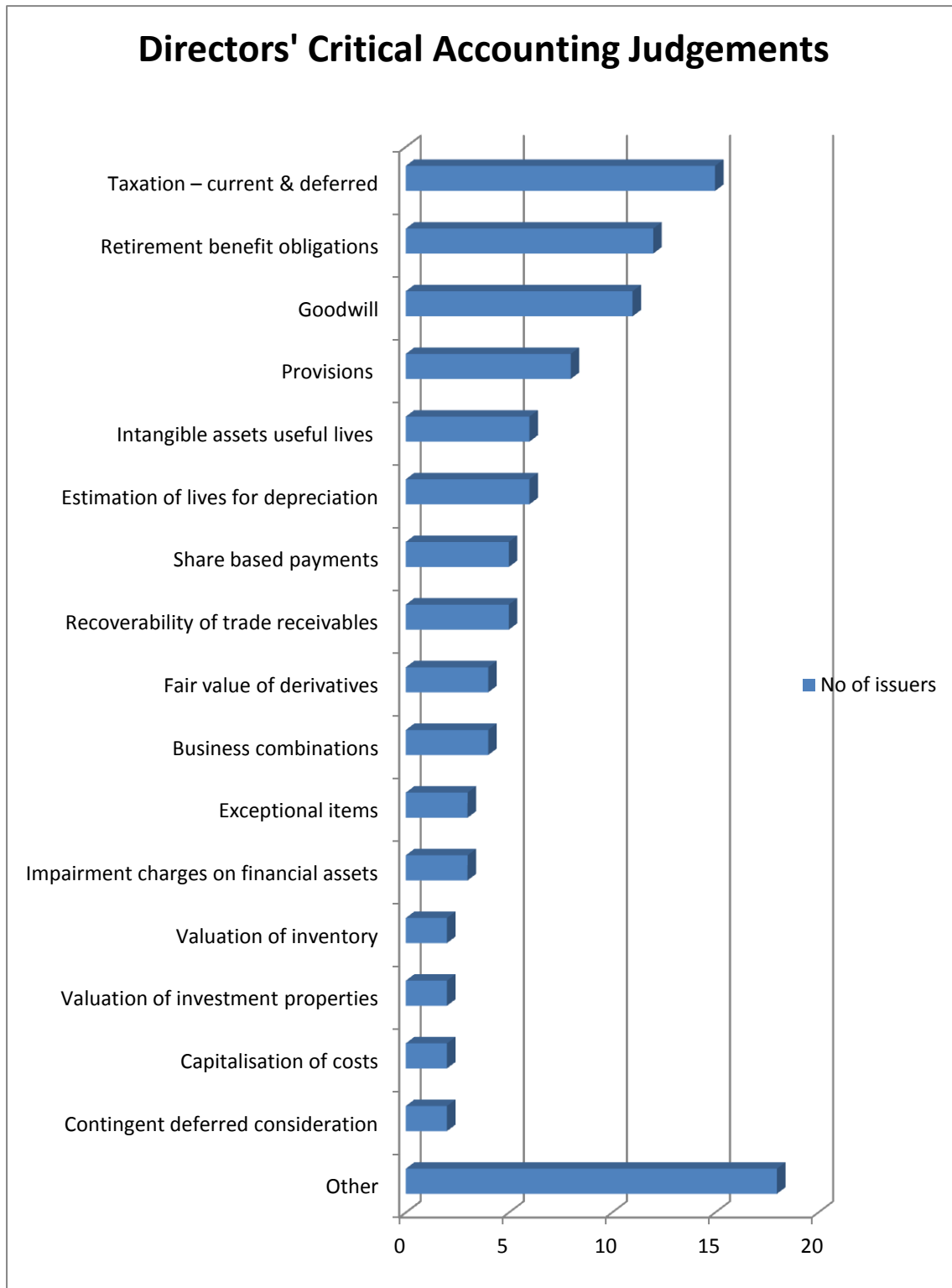
Paragraph 125 of IAS 1 requires an entity to disclose information about the assumptions it makes about the future, and other major sources of estimation uncertainty at the end of the reporting period, that have a significant risk of resulting in a material adjustment to the carrying amounts of assets and liabilities within the next financial year. Paragraphs 126 to 133 of IAS 1 elaborate on this requirement.

Findings

The principal findings from the desktop survey are set out in Table 1 below:

Table 1 - Findings from the directors’ critical accounting judgments survey	
The more common critical accounting judgments identified by the directors of equity issuers	<ul style="list-style-type: none"> • Taxation – identified in 75% of the selected financial statements • Retirement benefit obligations – identified in 60% of the selected financial statements • Goodwill impairment – identified in 55% of the selected financial statements • Provisions – identified in 40% of the selected financial statements
A total of 108 critical accounting judgments were identified by equity issuers directors’	
The number of critical accounting judgments disclosed and reported by directors ranged from three in one instance to ten in another instance	
Twelve issuers disclosed the critical accounting judgments as a separate note, while five issuers included the critical accounting judgments within the accounting policies note. Three issuers outlined the critical accounting judgments in the relevant note to the financial statements	

Figure 1 below illustrates the more common critical accounting judgments identified by equity issuers' directors:



Auditors' risk of material misstatement survey

Context

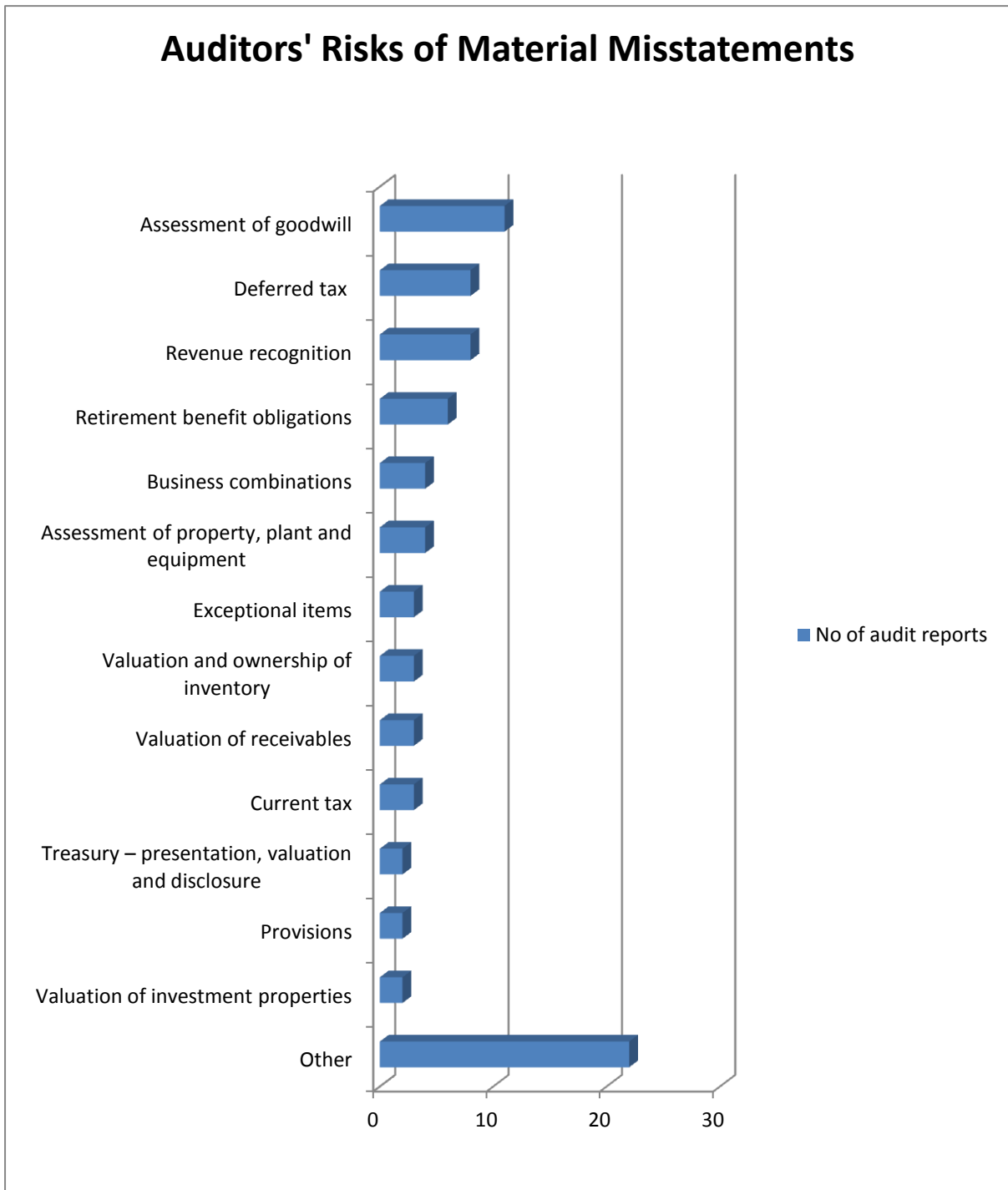
Paragraph 19A of ISA (UK and Ireland) 700 *The Independent Auditors' Report on Financial Statements* requires auditors in their independent audit reports to provide a description of those assessed risks of material misstatement that were identified by the auditor and which had the greatest effect on the overall audit strategy, the allocation of resources in the audit and directing the efforts of the engagement team.

Findings

The principal findings from the desktop survey are set out Table 2 below:

Table 2 – Findings from the auditors' risk of material misstatement survey	
The more common risks of material misstatement identified by the equity issuers' auditors	<ul style="list-style-type: none">• Assessment of goodwill – identified in 55% of the audit reports reviewed• Deferred tax - identified in 40% audit reports reviewed• Revenue recognition – identified in 40% audit reports reviewed• Retirement benefit obligations – identified in 30% of the audit reports reviewed
A total of 81 assessed risks of material misstatement were identified by equity issuers auditors	
The number of assessed risks of material misstatements identified and reported by the auditors ranged from two in one instance to six in another instance	

Figure 2 below illustrates the more common risks of material misstatements identified by the auditors of equity issuers:



Issuers included in the directors' critical accounts judgments survey and auditors' risks of material misstatement surveys

The equity issuers falling under IAASA's financial reporting examination remit which were selected for inclusion in the directors' judgments and assumptions and auditors' risks of material misstatement survey are listed below.

No.	Issuer	Reporting date	Auditor
1	Aer Lingus Group plc	31 December 2014	PricewaterhouseCoopers
2	Bank of Ireland	31 December 2014	PricewaterhouseCoopers
3	C&C Group plc	28 February 2015	KPMG
4	CRH plc	31 December 2014	EY
5	Datalex plc	31 December 2014	PricewaterhouseCoopers
6	DCC plc	31 March 2015	PricewaterhouseCoopers
7	Dragon Oil plc	31 December 2014	EY
8	FBD Holdings plc	31 December 2014	Deloitte
9	Glanbia plc	03 January 2015	PricewaterhouseCoopers
10	Grafton Group plc	31 December 2014	KPMG
11	Greencore Group plc	26 September 2014	KPMG
12	IFG Group plc	31 December 2014	PricewaterhouseCoopers
13	Independent News and Media plc	31 December 2014	KPMG
14	Irish Residential Properties REIT plc	31 December 2014	PricewaterhouseCoopers
15	Kerry Group plc	31 December 2014	Deloitte
16	Kingspan Group plc	31 December 2014	KPMG
17	Paddy Power plc	31 December 2014	KPMG
18	Ryanair Holdings PLC	31 March 2015	KPMG
19	Smurfit Kappa Group plc	31 December 2014	PricewaterhouseCoopers
20	UDG Healthcare plc	30 September 2014	KPMG