Irish Auditing & Accounting Supervisory Authority

OBSERVATIONS ON SELECTED FINANCIAL REPORTING ISSUES

YEARS ENDING ON OR AFTER 31 DECEMBER 2016

OCTOBER 2016

MISSION

To contribute to Ireland having a strong regulatory environment in which to do business by supervising and promoting high quality financial reporting, auditing and effective regulation of the accounting profession in the public interest

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

DISCLAIMER

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1 INTRODUCTION

1.1 Financial reporting review remit of IAASA

IAASA, the accounting enforcer in Ireland, is 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. Luxembourg GAAP and 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 during 2016;

(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 governance in the preparation of high quality financial reports, by offering observations on selected financial reporting topics to coincide with the preparation of issuers' 2016 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 during 2017.

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. In that context, IAASA encourages the widest possible transmission of this document.

1.3 Continued applicability of matters raised in previous years

This is the 9th *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 website[1].

[1] Available at http://www.iaasa.ie/Publications/FRSU

1.4 Financial reporting environment

1.4.1 The Economic backdrop

While at a macro-economic level, the performance of the Irish economy is reporting some favourable trends including a 4.6% increase in GDP to June 2016, a rise in numbers employed by 2.9% over the past 12 months and increasing retail sales volumes, up 6.3% in the year to end July 2016 there are a number of uncertainties facing the economy including Brexit.

> ***'The Irish economy is projected to continue its robust expansion in 2016 and 2017. Both exports and business investment, which surged due to temporary impetus by multinational enterprises, will moderate but remain solid. Activity in the domestic sector will remain firm and employment will grow steadily. Wage growth will be strong as the labour market tightens. Household consumption will be solid, supported by labour earnings growth and tax cuts.'***
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> OECD (2016), "Ireland", in *OCED Economic Outlook, Volume 2016, Issue 1*, OCED Publishing, Paris[2]

> ***'The UK decision to leave the European Union (Brexit) will have a negative impact on Irish GDP, employment and incomes. The key channels through which Brexit impacts the Irish economy include trade, foreign direct investment and the labour market. Under the most adverse scenario, where increased tariff and non-tariff barriers significantly reduce trade flows between Ireland and the UK, the level of Irish GDP could be over 3 percent below a no-Brexit baseline after ten years. A significant short-term impact is also likely. Adverse exchange rate movements together with a negative shock to foreign demand will reduce Irish export growth. Heightened uncertainty and financial market volatility in advance of formal UK exit negotiations could weaken investor and consumer confidence. These effects could then spill over into the labour market with negative consequences for employment and wages.'***
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> Central Bank of Ireland Quarterly Bulletin Q3 2016, 27 July 2016[3]

1.4.2 Financial reporting in uncertain times

Where entities are trading in international markets there are many factors that make it difficult for Boards and directors to make financial reporting judgements about the medium term and longer term assumptions about their business. These factors include volatility in commodity prices (e.g. oil, gas, copper, and iron ore), significant exchange rate fluctuations, country risk (e.g. Russia and Venezuela) low economic growth in many economies, low and negative interest rate environments and, more recently, uncertainty arising from the UK decision to leave the EU. This uncertain economic backdrop poses challenges for issuers in making assumptions and exercising judgements when preparing their 2016 financial reports. The economic environment may impact issuers to a different extent depending on issuers' geographic areas of operation and their risk exposure profile.

Mindful of the uncertainty in global markets, IAASA encourages issuers to give further consideration to a number of topics including, but not limited to, the following:

(a) fair value measurement of assets (and sensitivities therein);

(b) forecasting future cash flows for IAS 36 purposes;

(c) measurement of the amount and timing of provisions (IAS 37 refers);

(d) estimating defined benefit pension obligations (both asset values and discount rates) (IAS 19 refers);

(e) the use of foreign exchange rates, discount rates and long term market growth rates as model inputs;

(f) estimating uncertain tax positions (IAS 12 refers); and

[2] Source: http://www.keepeek.com/Digital-Asset-Management/oecd/economics/oecd-economic-outlook-volume-2016-issue-1/ireland_eco_outlook-v2016-1-25-en#page1
[3] Source: http://www.centralbank.ie/publications/Documents/Quarterly%20Bulletin%20No.%203%202016.pdf

(g) reporting the components of financial performance to the markets (IAS 1).

1.4.3 Accounting enforcement at EU level

IAASA's enforcement policies and methodologies are aligned with the enforcement priorities set at ESMA level. ESMA is accelerating the level of co-ordination amongst national accounting enforcers; it has issued Guidelines to be followed by national enforcers in their undertaking financial statement examinations. In addition, ESMA sets annual Europe-wide common enforcement priorities to be examined at national level. ESMA is due to commence undertaking peer reviews of its Guidelines to assess the extent of compliance by national accounting enforcers.

Therefore, issuers can expect IAASA enforcement activity to continue 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 an ESMA enforcement priority.

2 OBSERVATIONS ON SELECTED FINANCIAL REPORTING ISSUES

2.1 Brexit – the financial reporting challenges

Because of the large amount of trade between Irish and UK entities, it is widely accepted that the UK decision to leave the European Union could have a disproportionate and negative impact on Irish entities trading in the UK or with operations in the UK. In preparing financial statements, entities must take account of the increased risk and uncertainty through the exercise of subjective judgements and the use of estimates.

Entities are required to disclose information about the assumptions made 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 [IAS 1.125 refers].

Calculating the carrying amounts of assets, liabilities, income and expenses may, in certain instances, require estimating the effects of uncertain future events at the reporting date.

Brexit has resulted in increased uncertainty and has resulted in greater volatility in markets. The impact of Brexit will differ from entity to entity.

Financial reporting impacts of Brexit may include:

(a) the impact on the issuer's principal risks and uncertainties [Regulations[4] 5 and 8 refers];

(b) the impact on the assumptions made about the future and the major sources of uncertainty [IAS 1.125 refers] e.g. market assessments of growth, interest rates, market liquidity, discount rates and other key assumptions;

(c) the impact on the recoverable amounts of assets – changed circumstances may have impacted impairment assessments and issuers may need to consider whether financial and non-financial assets, including goodwill and other intangible assets, have been impaired,

(d) volatility in the quoted prices for financial assets;

(e) hedge accounting effectiveness, where the timing of cash flows being hedged is changing or are no longer occurring following Brexit;

(f) valuation of pension assets may be impacted by volatility in discount rates and other assumptions e.g. fair value volatility, inflation rates;

(g) provisioning implications, where issuers are anticipating restructurings;

(h) additions to the risk disclosures provided in the notes to the financial statements where necessary; and

(i) whether or not there are changed implications for the recovery of deferred tax assets and or uncertain tax positions following Brexit.

In July 2016, IAASA published an Information Note *Consideration of the impact of Brexit for issuers' half-yearly financial reports* which sets out factors that IAASA suggested should be considered by issuers when preparing half-yearly financial reports for the six months ended 30 June 2016.

Message for Directors and Audit Committees

Directors and Audit Committees should carefully evaluate the impact of the risks and uncertainties

[4] Defined in Glossary of Terms at item 3 of this document

arising from Brexit on the recognition, measurement and disclosure of income, expense, assets and liabilities in the financial statements together with the risk disclosures in the notes and the qualitative information in Management Reports.

The level of disclosure provided in annual reports regarding the risks and uncertainties facing the entity should be entity-specific and should be re-evaluated this year given the changing economic landscape.

2.2 New accounting standards not yet effective – IFRS 9, IFRS 15 and IFRS 16

It is expected that for certain issuers some aspects of the new Standards, specifically:

(a) IFRS 9 *Financial Instruments;*

(b) IFRS 15 *Revenue from Contracts with Customers;* and

(c) IFRS 16 *Leases*

will represent a significant change compared to the existing Standards and, therefore, the recognition, measurement and presentation of assets, liabilities, income, expenses and cash flows may be affected.

IAS 8 *Accounting Policies, Changes in Accounting Estimates and Errors* requires disclosure of an impending change in accounting policies when an issuer has yet to implement a new IFRS that has been issued but not yet come into effect (irrespective of whether or not it has been endorsed by the EU). In addition, it requires disclosure of '*known or reasonably estimable information relevant to assessing the possible impact that application of the new IFRS will have on the entity's financial statements in the period of initial application*' [IAS 8.30 – 31 refer].

IFRS 9 *Financial Instruments*
IFRS 9 was issued 22 July 2014 and is effective for accounting periods commencing on or after 1 January 2018. IFRS 9 is expected to be endorsed for use in the EU in quarter 4 of 2016. IFRS 9 replaces the guidance in IAS 39 *Financial Instruments: Recognition and Measurement* and includes requirements on:

(a) the classification and measurement of financial assets and liabilities;

(b) the expected-loss impairment model which will require more timely recognition of expected credit losses. Specifically, IFRS 9 requires entities to account for expected credit losses from when financial instruments are first recognised and to recognise full lifetime expected losses on a more timely basis; and

(c) a substantially-reformed model for hedge accounting, with enhanced disclosures about risk management activity.

IFRS 9 removes the volatility in profit or loss caused by changes in the credit risk of liabilities elected to be measured at fair value. This change in accounting means that gains caused by the deterioration of an entity's own credit risk on such liabilities are no longer recognised in profit or loss.

IFRS 9 is expected to have a major impact on the financial statements of financial institutions and insurance entities, mainly because of the expected material increase in the level of impairment losses, which will affect performance and will require major changes in IT systems (ESMA report on *Enforcement and Regulatory Activities of Accounting Enforcers* of 29 March 2016 refers). For non-financial institutions, IFRS 9 may have consequences for their KPIs and covenants.

Issuers are expected to disclose the following IFRS 9 information in their 2016 annual reports:

(a) detailed description and explanation on how key IFRS 9 concepts will be implemented, if known;

(b) explanation of the timeline for implementing IFRS 9, including expected use of any of the transition practical expedients;

(c) if known or reasonably estimable, quantification of the possible impact of the application of IFRS 9; and

(d) when the quantitative information is not disclosed because it is unknown or not reasonably estimable, additional qualitative information enabling users to understand the magnitude of the expected impact on the financial statements of the issuer.

IFRS 15 *Revenue from Contracts with Customers*
Given the expected impact of IFRS 15 *Revenue from Contracts with Customers* on many issuers' financial statements, ESMA has issued a Public Statement *Issues for consideration in implementing IFRS 15: Revenue from Contracts with Customers* which sets out ESMA's expectations as to the factors to be considered in the implementation of IFRS 15 and, in particular, the nature and extend of disclosure of the impact of the adoption of IFRS 15. ESMA expects that, where relevant, the quality of the implementation of IFRS 15 will be closely monitored by issuers' Audit Committees. IFRS 15 is effective for accounting periods commencing on or after 1 January 2018.

Where the impact of the adoption of IFRS 15 is expected to be significant, issuers are expected to:

(a) provide information about the accounting policy choices to be taken on first application of IFRS 15 (e.g. the accounting policy to apply a full retrospective approach, the cumulative catch-up transition method or the use of practical expedients);

(b) disaggregate the expected impact depending on its nature (i.e. whether the impact will affect the amount of revenue to be recognised, the timing of recognition or both) and by revenue streams;

(c) explain the nature of the impacts so that users of financial statements understand the changes to existing practices and their key drivers when compared with the existing principles on recognition and measurement in IAS 11, IAS 18 and related interpretations; and

(d) provide an explanation of the timeline for implementing IFRS 15, including expected use of any of the transition practical expedients.

IFRS 16 *Leases*
IFRS 16 is effective for accounting periods commencing on or after 1 January 2019. IFRS 16 introduces a single lessee accounting model where the lessee is required to recognise in its statement of financial position:

(a) assets and liabilities for all leases with a term of more than twelve months, unless the underlying asset is of low value; and

(b) the right of use asset representing its right to use the underlying leased asset and a lease liability representing its obligation to make lease payments.

During 2016, IAASA published the results of a desk-top survey[5] it undertook into the operating lease commitments of twenty eight issuers' disclosures in their 2015 financial reports. The survey identified that the selected issuers' have a total of €6.6bn of operating lease commitments. Therefore, 'operating lease' commitments which are currently off-balance sheet are substantial.

Message for Directors and Audit Committees
Directors and Audit Committees should carefully consider the level of disclosure provided regarding IFRSs issued and yet to be adopted. In particular, IFRS 9, IFRS 15 and IFRS 16 have the potential to most significantly impact users understanding of financial statements.

[5] Available at: http://www.iaasa.ie/getmedia/a51f37f7-d271-4ad1-8bec-a2afb911226a/Operating-leases-survey-July-2016.pdf

Disclosures should avoid a “boilerplate” repetition of the new Standards and issuers should provide entity specific information of the impact of the new Standards.

2.3 IFRS 13 *Fair Value Measurement*

During 2016 IAASA undertook a desk-top survey of the fair value judgements made by twenty eight issuers in measuring the fair value of

(a) intangible assets acquired; and

(b) financial assets acquired and financial liabilities assumed.

The following extract of the survey’s findings reveal:

Intangible assets acquired as part of a business combination at fair value

(a) 11 out of 28 issuers’ reported business combinations during the year and of these 7 out of 11 issuers’ recognised intangible assets at fair value (amounting to c. €1,363m) and 9 out of 11 recognised goodwill;

(b) in 4 out of 11 cases the Auditors’ Report identified the fair value of intangibles as a risk of material misstatement;

(c) for 8 out of 11 issuers’ that had business combinations during 2015, the average percentage of intangible assets acquired to total net assets acquired amounted to 23% (Hi 139%/Low 6%);

The survey also looked at other aspects of issuers’ application of IFRS 13 fair value measurement including:

(a) the fair value measurement basis used and the valuation techniques applied;

(b) valuation techniques used to fair value liabilities acquired;

(c) unobservable inputs to valuation techniques;

(d) highest and best used of assets;

(e) whether the fair value of liabilities reflects non-performance risk and credit enhancements;

(f) fair value measurement of deferred contingent consideration;

(g) valuation techniques used for financial assets and financial liabilities and related disclosures;

(h) disclosure of collateral pledged/held; and

(i) disclose for fair value measurements at Level 3 prices, whether or not reasonably possible alternative assumptions would change fair value significantly.

The results of the fair value measurement survey, in full, will be published by IAASA on its website in due course.

Message for Directors and Audit Committees

Directors and Audit Committees should give further consideration to the measurement and disclosure of fair value measurement (IFRS 13) and should:

(i) provide more entity-specific disclosure that informs users of the measurement bases used in the fair value measurement of intangible assets;

(ii) provide clearer disclosure of the key fair value judgements and assumptions that management has made and that have the most significant effect on the amounts of intangible assets recognised in the financial statements;

(iii) provide more disclosure of how material liabilities are fair valued; and

(iv) provide fair value disclosures by class of assets and liabilities where appropriate.

Financial assets and financial liabilities:

(v) provide improved disclosure of collateral pledged and held; and

(vi) provide improved disclose of whether or not reasonably possible alternative assumptions would change fair value significantly.

2.4 Retirement benefit obligations

2.4.1 Characteristics of defined benefit plan

Paragraph 139(a)(i) to (a)(iii) of IAS 19 *Employee Benefits* states:

'*An entity shall disclose:*

(a) Information about the characteristics of its defined benefit plans including:

(i) the nature of the benefits provided by the plan (e.g. final salary defined benefit plan or contribution-based plan with guarantee).

(ii) a description of the regulatory framework in which the plan operates, for example the level of any minimum funding requirements, and any effect of the regulatory framework on the plan, such as the asset ceiling (see paragraph 64).

(iii) a description of any other entity's responsibilities for the governance of the plan, for example responsibilities of trustees or of board members of the plan ....'

It is IAASA's expectation that issuers provide a complete disclosure of the characteristics of their defined benefit plans as required by IAS 19.139(a)(i) to (a)(iii). IAASA has obtained undertakings in this regard for improvements in future financial reports

2.4.2 Pension liability – asset-liability matching strategies

IAS 19.146 states:

'*An entity shall disclose a description of any asset-liability matching strategies used by the plan or the entity, including the use of annuities and other techniques, such as longevity swaps, to manage risk*'

IAASA has challenged issuers on asset-liability matching strategies used by their defined benefit plans and IAASA has also received undertakings for improvements in future financial reports.

2.4.3 Survey of defined benefit pension scheme assumptions

IAASA has published *Survey of Issuers' Defined Benefit Pension Scheme Assumptions* setting out the results of a desk-top survey it undertook into the principal assumptions used by issuers' in measuring the assets and liabilities of their defined benefit pension schemes.

This survey has focused on the four actuarial assumptions that issuers most frequently address in pension accounting, namely the discount rate, the rate of increase in salary, the rate of increase of pensions in payment, and inflation.

IAASA's desk-top survey identified that the aggregate total present value of the defined benefit liability for the issuers included in this survey was €23.7bn while the aggregate fair value of the plan assets amounted to €20.7bn. This results in an aggregate net pension liability (shortfall) for the issuers included in this survey of €3bn (2014/15: €4.7bn).

Of the seventeen issuers that have defined benefit pension schemes, eight issuers did not disclose the information required by IAS 19.147(c) (i.e. information about the maturity profile of the pension obligation).

Message for Directors and Audit Committees

Directors and Audit Committees should:

(a) continue to carefully assess the assumptions used by actuaries in preparing actuarial valuations; and

(b) carefully consider the disclosure requirements of IAS 19 and ensure that all required information is disclosed in the financial statements.

2.5 Classification of financial instruments – debt or equity

Some financial instruments (e.g. convertible bonds or other complex financial instrument) can exhibit characteristics of both equity and liabilities and, therefore, the entity-specific terms on which these instruments are issued can significantly alter the accounting treatment to be applied.

Paragraph 22 of IAS 32 *Financial Instruments: Presentation* states that a '*… a contract that will be settled by the entity (receiving or) delivering a fixed number of its own equity instruments in exchange for a fixed amount of cash or another financial asset is an equity instrument*'.

IAASA has examined whether or not certain financial instruments with characteristics of both equity and liabilities have been correctly classified in issuers' financial statements. For example, when issuing convertible bonds, anti-dilution clauses (or 'conversion price adjustments') are a feature of convertible instruments. Common conversion price adjustments include takeover related adjustments, capital distributions by a parent and increases in share capital by means of the capitalisation of reserves.

Judgement is required to assess whether or not the entity specific terms of conversion price adjustments could breach the fixed-for-fixed criteria of IAS 32.22 and thereby alter the debt or equity classification of financial instruments. Debt v. equity issues are currently being considered in conjunction with the Financial Instruments with Characteristics of Equity ('FICE') research project being undertaken by the IASB which aims to improve and simplify the financial reporting requirements for financial instruments with characteristics of equity.

Issuers are reminded that when convertible instruments are issued that include conversion price adjustments they should ensure the fixed-for-fixed rule of IAS 32.22 has not been breached and the instrument is correctly classified as debt or equity. Issuers should ensure transparency with regard to disclosing the accounting policy adopted and the judgements made by the management in relation to the characteristics of these instruments.

Message for Directors and Audit Committees

Directors and Audit Committees should ensure transparency in:

(a) the judgements made by the management as to whether or not conversion price adjustments for convertible instruments breach the fixed-for-fixed criteria of IAS 32.22; and

(b) disclosing the accounting policy adopted.

2.6 Deferred tax assets – recognition, measurement and disclosure

IAASA's messages regarding the recognition, measurement, re-measurement and disclosure of Deferred Tax Assets ('DTAs') is contained in our *Observations on selected financial reporting issues issuers' financial years ending on or after 31 December 2015* (item 2.4 refers) and *Observations on selected financial reporting issues issuers' financial years ending on or after 31 December 2014* (item 2.2 refers) publications.

IAASA has challenged issuers as to the basis on which they have determined that there is '*convincing other evidence*' that sufficient taxable profit will be available against which the unused tax losses can be utilised. IAASA also challenged issuers' judgements where the DTA is forecast to be recovered over an extended period of time. Our assessment as to whether or not there is sufficient '*convincing other evidence*' of the recoverability of DTAs included an assessment of a range of factors including:

(a) the historic pattern of recent trading losses;

(b) the assumptions underpinning the forecast future taxable profits;

(c) the identifiable causes of the tax losses which are unlikely to recur;

(d) the issuer's record of successfully achieving recent budgets or other convincing evidence; and

(e) period of time forecast as necessary to recover deferred tax assets in full and the level of uncertainty over a longer period;

IAASA has concluded that, dependant on the issuer's specific circumstances and following engagement with other European accounting enforcers, together with, representatives of the IASB and IFRS Interpretations Committee, there is insufficient clarity in IAS 12 to enable it to require issuers to apply alternative recognition and measurement criteria in respect of DTAs. However, IAASA will continue to examine the nature of the evidence that is relied upon by issuers for DTA purposes and assess the disclosures on a case-by-case basis.

Message for Directors and Audit Committees

Directors and Audit Committees should:

(a) continue to carefully re-evaluate the nature of the evidence supporting recognition of deferred tax assets in situations where the issuer has a history of recent losses;

(b) review the extent of disclosures provided in this regard to meet the requirements of IAS 12.82 and IAS 1.112(c) so that it provides users of the financial report with relevant financial information; and

(c) disclose in more granular detail a quantification of the key assumptions and changes in assumptions during the year applied by management.

2.7 Current interest rate environment: discount rates in financial statements

Item 2.2.1 of IAASA's Observations on selected financial reporting issues issuers' financial years ending on or after 31 December 2015 drew issuers' attention to the determination of discount rates.

IAASA reminds issuers that the measurement of discount rates (IAS 36 refers) must comply, in full, with the requirements of IAS 36 and, in particular, with IAS 36.A18 - A19.

IAASA reminds issuers to ensure that the current interest rate environment is taken into account when determining the fair valuation of assets and liabilities in accordance with IFRS 13 *Fair Value Measurement*, when measuring the recoverable amount required by IAS 36.55, when determining the discount rate under IAS 37.47 and when measuring defined benefit pension plan obligations (IAS 19.83 refers).

IAASA has noted the discount rate(s) used by certain issuers in determining the recoverable amounts of assets appear not to have changed for a number of years when a change in the issuer's circumstances, financial position, financial performance and cash flows indicate that the discount rate(s) or component parts therein would have been expected to change.

IAASA will continue to examine the discount rate(s) used by issuers in their financial statements where the discount rate(s) have the potential to have a material impact on the financial statements.

Message for Directors and Audit Committees

Directors and Audit Committees should ensure that discount rates used reflect the issuer's current circumstances.

2.8 Presentation of the financial performance and the quality of disclosures

The reporting of financial performance and the quality of disclosures in financial reports has been the source of debate and criticism over recent years.

Disclosures in financial statements may be "boilerplate" in nature rather than entity-specific, or may not be relevant in so far as they refer to transactions that are not undertaken by the entity or relate to immaterial items. How issuers choose to present their financial performance has led to calls for improvements in presentation of financial performance and in the quality of disclosures.

IAASA considers it timely to remind issuers that in 2013 it performed a thematic review of equity issuers' application of the requirements of IAS 1 *Presentation of Financial Statements* and published a *Commentary on the application of certain aspects of IAS 1* Presentation of Financial Statements *by selected Irish equity issuers*.

IAASA has also encouraged users of financial statements to critically evaluate reported headline items and the Income Statement presentation adopted by issuers. Users have been encouraged to consider the related explanatory note disclosures including the definitions used and the accounting policy adopted in respect of items including "exceptional items" and "operating result".

In IAASA's 2015 *Observations* document (item 2.8 refers) and the 2013 *Observations* document (item 10 and Appendix IV refer), IAASA has drawn issuers' attention to the requirement to provide high quality disclosures in financial reports.

IAASA re-iterates its calls to issuers to:

(a) disclose information about the assumptions made about the future and other major sources of estimation uncertainty at the reporting date that have a significant risk of resulting in a material adjustment to the carrying amount of assets and liabilities within the next financial year [IAS 1.125 refers];

(b) provide information in the notes to the financial statements that is not presented elsewhere but is relevant to users' understanding of the financial statements [IAS 1.112(c) refers];

(c) avoid "boilerplate" disclosures and tailor disclosures to the specific circumstances of the issuer;

(d) apply the ESMA Guidelines on Alternative Performance Measures (APMs) to the fullest extent possible [see item 2.11 below];

(e) ensure consistency between information provided in the front end report with the audited financial statements and in a manner that is transparent to users of the Report

Issuers may wish to refer to ESMA's public statement issued 27 October 2015 '*Improving the quality of disclosures in the financial statements*' which sets out to promote the improvement of the quality of disclosures in IFRS financial statements including, but not limited to providing relevant information in the financial statements in an easily accessible way and promoting readability of the financial statements.

Subtotals
Issuers shall present line items, headings and sub-totals in the statement of financial position and in the statement(s) of profit or loss and other comprehensive income only when these lines, headings or sub-totals are relevant to an understanding of the entity's financial position or the entity's financial performance [IAS 1.55 and IAS 1.85 refer].

Issuers are reminded that amendments to IAS 1 (IAS 1.30A refers) requires that issuers shall not reduce the understandability of financial statements by obscuring material with immaterial information or by aggregating material items that have a different nature or function.

Message for Directors and Audit Committees

Directors and Audit Committees should reassess how financial performance and key components of that performance is being presented to the market to ensure the effects of transactions, events and conditions and the key components its performance is understood by users of the financial statements.

2.9 Company only financial statements – notification to shareholders

For an issuer required to prepare consolidated financial statements, its annual financial report shall comprise:

(a) consolidated financial statements prepared in accordance with IFRS as endorsed by the EU ('IFRS-EU'); and

(b) parent company financial statements prepared in accordance with the national law of the EU member state in which the issuer is incorporated.

In practice, this has the effect that issuers' parent company financial statements are prepared in accordance with either IFRS-EU or in accordance with Irish/UK GAAP.

Issuers may elect to adopt FRS 101 *Reduced Disclosure Framework* for the parent company financial statements.

The election to adopt the disclosure exemptions within FRS 101 for the parent company financial statements requires the issuer to notify all shareholders of the proposed adoption of the FRS 101 disclosure exemptions. Any shareholder, or shareholders, holding in aggregate 5% or more of the total allotted shares in the issuer may serve an objection [FRS 101.5(a) refers].

The Financial Reporting Council ('FRC') has made limited amendments to FRS 101 and has issued Financial Reporting Exposure Draft '(FRED') 65 that proposes amendments to remove the requirement for a qualifying entity to notify its shareholders in writing that it intends to take advantage of the disclosure exemptions in FRS 101. A similar consequential amendment is proposed for FRS 102.

Until these amendments are implemented, entities should ensure they continue to notify all shareholders of the proposed adoption of the FRS 101 disclosure exemptions.

Message for Directors and Audit Committees

Directors and Audit Committees of issuers applying FRS 101 should ensure compliance with the requirements of FRS 101.5.

2.10 Cash Flow Statements – 'operating, investing and financing' cash flows

The Statement of Cash Flows enables users to evaluate an entity's ability to affect the amounts and timing of cash flows that it generates. It also enhances the comparability of the reporting of operating performance by different entities.

Paragraph 6 of IAS 7 *Statement of Cash Flows* defines ‘operating’ activities as: *‘… the principal revenue-producing activities of the entity and other activities that are not investing or financing*’. IAS 7 allows some flexibility in the presentation of cash flows on the basis of the issuer’s business model and the particular facts and circumstances (IAS 7.15 refers). However, the principle of the separate disclosure of cash flows arising from financing activities and investing activities is important (IAS 7.16 to 17 refers).

A divergence in the classification of cash flows as operating, investing and financing by selected debt issuers has been noted. Some debt issuers examined by IAASA have classified most cash flows as operating and major classes of cash flows are netted in the Statement of Cash Flows. This practice could impair the ability of users to understand the cash flows of the entity. The foregoing could lead to a divergence of practice amongst similar issuers Cash Flow Statements and would limit the comparability of issuers Statements of Cash Flows.

Message for Directors and Audit Committees

Directors and Audit Committees of selected Debt issuers and closed ended funds should:

(a) ensure that the Statement of Cash Flows has correctly classified and presented cash flows as operating, investing and financing;

(b) report separately major classes of gross cash receipts and gross cash payments arising from investing and financing activities, except to the extent that cash flows are permitted to be reported on a net basis (IAS 7.21 refers); and

(c) disclose investing and financing transactions that do not require the use of cash or cash equivalents in a way that provides all the relevant information about these investing and financing activities.

2.11 ESMA *Guidelines on Alternative Performance Measures*

In January 2015 IAASA published its findings on Alternative Performance Measures – A Survey of their Use together with Key Recommendations: An Update. The Paper outlined best practice with regard to the presentation of APMs and was an update to a November 2012 survey Alternative Performance Measures – A survey of their use together with key recommendations.

The APM updated survey found that amongst other matters:

(a) certain issuers distinguish between “key” APMs and other APMs;

(b) there is still scope for further improvements in order to aid users’ understanding of the financial results;

(c) differing definitions of apparently similar APMs are used by different issuers; and

(d) there is a tendency for issuers to “flatter” their results by the exclusion of certain items from performance measures.

IAASA reiterates to issuers its 2015 recommendations regarding the presentation of APMs’ and encourages issuers to redouble their efforts to meet users’ needs and comply with IAASA’s recommendations on APMs.

ESMA published its Guidelines on Alternative Performance Measures (‘ESMA APM Guidelines’) for issuers on 30 June 2015. The ESMA APM Guidelines became effective in relation to any APMs disclosed on or after 3 July 2016.

The ESMA APM Guidelines apply to issuers with securities traded on regulated markets and persons responsible for drawing up a prospectus. IAASA reminds issuers that APMs included in preliminary announcements are governed by the ESMA APM Guidelines.

An APM is a financial measure of historical or future financial performance, a financial position, or cash flows. However, APMs disclosed in financial statements are out of scope of the ESMA APM Guidelines (as such measures are already governed by financial reporting standards). Examples of the more common APMs used by Irish issuers in financial reports include earnings measures (such as EBITDA, EBIT and underlying profits), free cash flow, net debt and adjusted earnings per share measures.

Compliance with the ESMA Guidelines will be supervised by competent authorities and other bodies in the EU with responsibilities under the Transparency Directive (in Ireland's case, IAASA), Prospectus Directive or Market Abuse Regulation (in Ireland's case, the Central Bank of Ireland).

Message for Directors and Audit Committees

Directors and Audit Committees should reassess whether or not compliance to the fullest extent possible with the ESMA APM Guidelines has been achieved. The directors should also refer to IAASA's earlier publications on Irish equity issuers' use of APMs.

2.12 Recognition of intangible assets and scale of acquisition activity

IAASA has published Recognition of Intangible Assets and Scale of Acquisition Activity – A Survey setting out the results of a desk-top survey it undertook into the nature of intangible assets recognised by twenty eight issuers in their statement of financial position (balance sheet) and the scale of acquisition activity undertaken by those issuers as recognised in their 2015/16 financial reports.

IAASA's desk-top survey identified that €5.7bn of intangible assets together with €18.6bn of goodwill is recognised on the twenty eight issuers' statements of financial position.

IAASA will continue to focus and will engage with issuers on:

(a) directors' judgements as to why certain intangible assets have not been recognised in a business combination;

(b) directors' key assumptions used in determining the fair value measurement of intangible assets;

(c) significant factors used to determine the useful lives of material intangible assets;

(d) methods used to amortise intangible assets;

(e) required disclosures for intangible assets with indefinite useful lives; and

(f) acquisition related liabilities including debt like items and contingent consideration.

Message for Directors and Audit Committees

Directors and Audit Committees should:

(a) give careful consideration to the key judgments applied in the recognition and measurement of the fair value of intangible assets, together with the disclosures related to same; and

(b) closely examine the basis upon which intangible assets acquired in a business combination are recognised and measured.

3 GLOSSARY OF TERMS

APM(s)	Alternative Performance Measure(s)
DTA(s)	Deferred tax asset(s)
EECS	European Enforcement Coordination Sessions
ESMA	European Securities and Markets Authority
EU	European Union
FRED	Financial Reporting Exposure Draft
FRC	Financial Reporting Council (UK)
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	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)
UTP(s)	Uncertain tax position(s)

APPENDIX I – 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 at http://www.iaasa.ie/Publications/FRSU, including:

Category	Document
Observations documents	Observations on selected financial reporting issues issuers' financial years ending on or after 31 December 2015 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
Financial reporting decisions	Financial Reporting Decision – 10 March 2016 Financial Reporting Decisions – 13 January 2016 Financial Reporting Decisions – 8 December 2015 Financial Reporting Decision – 25 November 2015
Surveys and commentaries	RECOGNITION OF INTANGIBLE ASSETS AND SCALE OF ACQUISITION ACTIVITY – a survey SURVEY OF ISSUERS' DEFINED BENEFIT PENSION SCHEME ASSUMPTIONS OPERATING LEASE COMMITMENTS - A Survey of Operating Lease Commitments by Irish Equity Issuers Snapshot of IAASA's financial reporting enforcement activities in 2015 Survey of Directors' Critical Accounting Judgments and Auditors' Assessed Risks of Material Misstatement Alternative Performance Measures – A Survey of their Use together with Key Recommendations: An Update Review of the application of IAS 7 *Statement of Cash Flows* by selected Irish equity issuers

Category	Document
	Commentary on the application of certain aspects of IAS 1 *Presentation of Financial Statements* 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	Consideration of the impact of Brexit for issuers' half-yearly financial reports Financial reporting considerations relevant to the disclosure requirements of the European Communities (Takeover Bids (Directive 2004/25/EC)) Regulations 2006 Information Note: Financial reporting considerations relevant to the making of distributions
Annual Reports	2015 Annual Report 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 II – USEFUL LINKS

	Link
Companies Act 2014	http://www.irishstatutebook.ie/eli/2014/act/38/enacted/en/html
Central Bank of Ireland	http://www.centralbank.ie/Pages/home.aspx
Transparency Rules (November 2015)	http://www.centralbank.ie/regulation/marketsupdate/Documents/Transparency%20Rules%20November%202015.pdf
European Financial Reporting Advisory Group (EFRAG)[6]	http://www.efrag.org/
Endorsement status	http://www.efrag.org/Endorsement
European Securities and Markets Authority	https://www.esma.europa.eu/
ESMA Guidelines on Alternative Performance Measures (October 2015)	https://www.esma.europa.eu/sites/default/files/library/2015/10/2015-esma-1415en.pdf
ESMA Guidelines on enforcement of financial information (October 2014)	https://www.esma.europa.eu/sites/default/files/library/2015/11/2014-esma-1293en.pdf
List of decisions published in the Extracts from the EECS's Database of Enforcement (updated July 2016)	https://www.esma.europa.eu/sites/default/files/library/2016-1209_list_of_decisions.pdf
19th Extract from the EECS's Database of Enforcement (July 2016)	https://www.esma.europa.eu/sites/default/files/library/2016-1208_19th_extract.pdf
Issues for consideration in implementing IFRS 15 Revenue from Contracts with Customers (July 2016)	https://www.esma.europa.eu/sites/default/files/library/2016-1148_public_statement_ifrs_15.pdf
International Accounting Standards Board	http://www.ifrs.org/Pages/default.aspx

[6] EFRAG provides technical expertise to the European Commission concerning the use of IFRS within Europe