OBSERVATIONS ON SELECTED FINANCIAL REPORTING ISSUES

ISSUERS' FINANCIAL YEARS ENDING ON OR AFTER 31 DECEMBER, 2009

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MISSION

To support and enhance public confidence in the accountancy profession and in financial reporting through the exercise of effective, independent oversight and the promotion of adherence to high standards

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1. INTRODUCTION

1.1 Context for IAASA's financial reporting supervision activities

The Transparency (Directive 2004/109/EC) Regulations 2007 ('the Regulations')[1] provide that the Irish Auditing & Accounting Supervisory Authority ('IAASA') has responsibility for examining whether the annual and half-yearly financial reports (collectively referred to as 'periodic financial reports') of certain entities whose securities have been admitted to trading on a regulated market, situated, or operating, within the EU[2] (referred to as 'issuers') have been drawn up in accordance with the 'relevant reporting framework'. IAASA's review constituency under the Regulations extends to approximately 220 issuers, comprising issuers of equity and debt and closed ended funds. Constituent issuers publish approximately 300 periodic financial reports per annum.

1.2 Reviewed periodic financial reports forming the basis for this document

For the majority of issuers, the first annual financial reports to come within scope of the Regulations were those in respect of the year ended 31 December, 2008 (which, in accordance with the Regulations, were required to be published before 1 May, 2009). For that reason, annual financial reports in respect of the year ended 31 December, 2008 and half-yearly reports in respect of the six months ended 30 June, 2009 formed the basis of the majority of IAASA's financial reporting review activity during 2009.

The majority of issuers that are required to make public their periodic financial reports in compliance with the Regulations apply either International Financial Reporting Standards ('IFRS') (such issuers being referred to as 'IFRS issuers') or accounting standards issued by the Accounting Standards Board ('ASB'), (such issuers being referred to as 'Irish GAAP[3] issuers').

While IAASA does also examine and, where considered necessary, take appropriate enforcement action in respect of the periodic financial reporting of issuers that use other codes of accounting standards (e.g. US GAAP), a large majority of issuers coming within remit use either IFRS or Irish GAAP and, for that reason, the observations offered in this document are confined to the requirements as they apply to IFRS and Irish GAAP issuers.

1.3 Purpose of this document

The purpose of this document is twofold, namely to:

i. seek to assist issuers' Boards and Audit Committees in preparing high quality financial reports by offering observations on selected financial reporting issues to coincide with the preparation of issuers' 2009 financial statements; and

ii. provide those charged with issuers' governance and other interested parties with an understanding of IAASA's likely approach to selecting periodic financial reports for examination during 2010.

1.4 Context in which this document is published

In presenting their results and financial positions in respect of financial years ending on or after 31 December, 2009, issuers continue to report against a background of ongoing market uncertainty, reduced access to credit, weak economic activity and potentially impaired asset values. Each of these factors gives rise to increased risk and uncertainty in the recognition, measurement, classification, presentation and disclosure of revenues, expenses, assets and liabilities in periodic financial reports. The aforementioned increased risk and uncertainty places an increased focus on the critical importance of estimates and judgements in preparing financial reports and on the importance of the

[1] The Regulations can be accessed at http://www.iaasa.eu/legislation/si277_2007.pdf
[2] 'EU' should be read as including all EEA States i.e. EU member States and Norway, Iceland and Liechtenstein
[3] Generally Accepted Accounting Principles

role played by Boards and Audit Committees in considering and approving issuers' periodic financial reports.

1.5 January 2009 Observations document

Certain of the issues referred to in IAASA's Observations document published in January 2009[4] continued to be relevant throughout 2009. Accordingly, certain issues referred to in that document remain relevant and equally applicable in the current reporting season, e.g.:

- valuation and impairment of assets;
- retirement benefits;
- going concern;
- principal risks and uncertainties;
- judgements;
- deferred tax assets; and
- earnings per share.

Consequently, readers may find it helpful to read this document in conjunction with the January 2009 document.

1.6 Other relevant guidance and feedback material

Readers may also find it helpful to read this document in conjunction with other relevant material available on the IAASA website, including previous annual reports[5], a Commentary on issuers' half yearly financial reporting[6] and periodically published summaries of enforcement decisions taken by EU financial reporting supervisory authorities[7].

1.7 Enforcement

Periodic financial reports are public documents which are required to give a true and fair view of issuers' assets, liabilities, financial position and profit or loss and to provide a fair review of the development and performance of issuers' business and position. Where information published in a periodic financial report contains an infringement of the relevant reporting framework, this may lead to users of periodic financial reports:

- not being provided with information relevant to their decision-making; or
- being misled in respect of the issuer's financial position and prospects.

It is important, therefore, that infringements, once identified, are addressed in an appropriate manner in users' interests. In that context, IAASA's approach to date has been to seek to ensure that:

- infringements of a less serious nature do not recur, i.e. by seeking and obtaining directors' undertakings to effect necessary improvements in future reports; and
- infringements of a more serious nature are corrected by way of the timely publication of revised financial information. In seeking to ensure that, where appropriate, revised information is

[4] Available at http://www.iaasa.ie/publications/FRSUobs_Jan09.pdf
[5] Chapter 2 of IAASA's 2006 Annual Report, Chapter 4 of IAASA's 2007 Annual Report and Chapter 4 of IAASA's 2008 Annual Report refer. These Annual reports are available at http://www.iaasa.ie/publications/index.htm
[6] The Commentary is available at http://www.iaasa.ie/publications/TD_Commentary2008.pdf
[7] These summaries can be accessed at http://www.iaasa.ie/publications/index.htm in the 'Third-party Publications' section

provided to the market, IAASA's practice is to engage with affected issuers' directors with a view to securing the voluntary publication of such revised information.

IAASA determines the most appropriate approach to each identified infringement by reference to the individual circumstances of each case and having formed a judgement as to whether the size, nature or circumstances of the identified infringement is such that users' interests are best served by the publication of revised information or, alternatively, whether undertakings to ensure that the infringement does not recur are sufficient.

As a consequence of the above approach, IAASA has, to date, been able to secure the necessary improvements to issuers' financial reporting without having had to invoke its statutory powers, which under the Regulations are considerable. The foregoing approach is, in IAASA's assessment, the most time and cost effective from both IAASA's and issuers' perspectives. It remains, therefore, IAASA's preferred means of securing required improvements to issuers' statutory financial reporting.

Notwithstanding the foregoing, IAASA will continue to carefully monitor and assess issuers' responses to identified infringements and to consider whether, having regard to all relevant factors, it is necessary or otherwise appropriate in users' or the wider public's interest to exercise its statutory enforcement powers. For readers' ease of reference, the provisions of Regulations 44 and 45 are summarised in the Appendix to this document. The full text of the Regulations can be accessed at http://www.iaasa.eu/legislation/si277_2007.pdf.

2. OBSERVATIONS ON SELECTED FINANCIAL REPORTING ISSUES

2.1 Impairment of goodwill

Given the prevailing economic conditions and the associated continuing downward pressure on asset values, careful attention to the requirements of those accounting pronouncements relating to the impairment of assets, and in particular goodwill[8], continues to be important in the context of the potential impact on profit for the period.

Paragraph 96 of IAS 36 *Impairment of Assets*[9] requires that goodwill should be tested annually for impairment. To test for impairment, goodwill must be allocated to each of the acquirer's Cash Generating Units ('CGUs'), or groups of CGUs, that are expected to benefit from the synergies of the combination, irrespective of whether other assets or liabilities of the acquiree are assigned to those CGUs or groups of CGUs. Each CGU or group of CGUs to which the goodwill is so allocated shall:

(a) represent the lowest level within the entity at which the goodwill is monitored for internal management purposes; and

(b) not be larger than an operating segment determined in accordance with IFRS 8 *Operating Segments*[10].

In an environment in which issuers' performance is likely to be under increased pressure given reduced levels of economic activity, the potential impact of any misstatement of goodwill impairment charges on an entity's results is perhaps more likely to be material. In this context, IAASA's review activity has identified instances in which it is not apparent that the financial reports concerned have made it sufficiently clear to users as to the basis upon which goodwill had been monitored during the period and, as a consequence, how goodwill had been allocated to CGUs for the purposes of impairment testing.

It is IAASA's expectation that the allocation of goodwill to the lowest level within an entity at which goodwill is monitored for internal management purposes will be performed at a granular level and that, in most cases, this would be at a lower level than operating segments identified in accordance with IFRS 8.

2.2 Hedging instruments[11]

2.2.1 Recognition and measurement

Paragraph 88 of IAS 39 specifies the conditions that must all be met in order for a hedging relationship to qualify for hedge accounting, as detailed in paragraphs 89 to 102 of IAS 39.

In summary, these conditions are:

(a) formal designation and documentation;

(b) hedge expected to be highly effective;

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[8] IAS 16 *Property, Plant and Equipment* dealing with the recognition and measurement of tangible assets, IAS 19 *Employee Benefits* dealing with the recognition and measurement of pension scheme assets, IAS 36 *Impairment of Assets* dealing with goodwill and other assets, IAS 39 *Financial instruments: Recognition and Measurement*, and IAS 40 *Investment Property*. For Irish GAAP issuers, the equivalent FRSs are FRS 15 *Tangible fixed assets*, FRS 17 *Retirement benefits*, FRS 11 *Impairment of fixed assets and goodwill,* FRS 26 *(IAS 39) Financial Instruments: Recognition and measurement* and SSAP 19 *Accounting for investment properties*

[9] Irish GAAP equivalent FRS 11 *Impairment of Fixed Assets and Goodwill* refers

[10] Paragraph 80 of IAS 36 refers. For Irish GAAP issuers, refer to paragraphs 27 to 31 of FRS 11 *Impairment of fixed assets and goodwill*

[11] IAS 39 *Financial Instruments: Recognition and Measurement* provides that, where there is a risk that a hedged item's *fair value* will change in response to some variable, such as interest rates, foreign exchange rates or market prices, gains and losses on the hedging instrument and the offsetting losses and gains on the hedged item are both recognised in profit or loss (*fair value* hedge). Furthermore, where there is a risk that a future hedged item's *cash flows* will change in response to such variables, the gains and losses on the hedging instrument are initially recognised in equity and subsequently recycled to profit or loss as the hedged item affects profit or loss (*cash flow* hedge)

(c) for cash flow hedges, forecast transaction is highly probable;

(d) reliable measurement; and

(e) on-going assessment as to effectiveness.

Failure to meet these conditions could potentially have a major impact on the timing of the recognition of gains and losses and thus on the reported profit or loss of an issuer. Consequently, Boards and Audit Committees should ensure that they understand, continue to carefully review and, as appropriate, challenge the assumptions employed by management in their assessment of whether a hedging relationship qualifies for hedge accounting. An area of particular focus in this regard should be that of hedge effectiveness, i.e. the degree to which changes in the fair value or cash flows of a hedged item are offset by changes in the fair value or cash flows of the hedging instrument.

As part of its review activity IAASA has sought additional explanations of directors regarding the use of hedge accounting – up to and including having requested hedge documentation for more detailed examination. It is expected that this will be an area of continued focus in 2010.

2.2.2 Disclosure
Paragraph 23(a) of IFRS 7 *Financial Instruments: Disclosure*[12] requires an entity to disclose the periods in which hedged cash flows are expected to occur and when they are expected to impact on profit or loss. Paragraph 23(d) of IFRS 7 provides that an entity should disclose the amount that was reclassified from equity to profit or loss, showing the amount included in each line item in the Statement of Comprehensive Income. Paragraph 23(e) of IFRS 7 requires disclosure of the amount that was removed from equity during the period and included in the carrying amount of a non-financial asset or non-financial liability whose acquisition or incurrence was a hedged highly probable forecast transaction. Paragraph 24(a) of IFRS 7 requires an entity to disclose separately, for fair value hedges, gains or losses on the hedging instrument and on the hedged item attributable to the hedged risk.

As part of its review activity, IAASA has identified instances in which it was not apparent that the foregoing provisions of IFRS 7 had been correctly applied. Findings of this nature resulted in the directors of certain issuers having to provide undertakings to provide the necessary disclosures in future periods' financial reports.

2.3 Bank covenants
In the current economic climate, the risk of issuers breaching the terms of bank covenants, or having to renegotiate finance facilities with their banks, is heightened. That being the case, Boards and Audit Committees should ensure that appropriate consideration is given to accounting pronouncements of relevance to this area.

Paragraph 72 of IAS 1 *Presentation of Financial Statements* states that:

> '*An entity classifies its financial liabilities as current when they are due to be settled within twelve months after the reporting period even if …..*
>
> *(b) an agreement to refinance, or to reschedule payments, on a long-term basis is completed after the reporting period and before the financial statements are authorised for issue.*'

Paragraph 74 of IAS 1 states that:

> '*When an entity breaches a provision of a long-term loan arrangement on or before the end of the reporting period with the effect that the liability becomes payable on demand, it classifies the liability as current, even if the lender agreed, after the reporting period and before the authorisation of the financial statements for issue, not to demand payment as a consequence of the breach. An entity classifies the liability as current because, at the end of the reporting period, it does not have an unconditional right to defer its settlement for at least twelve months after that date.*'

[12] The Irish GAAP equivalent is FRS 29 *(IFRS 7) Financial instruments: Disclosures*

Paragraph 76 of IAS 1 states that:

> '*… if the following events occur between the end of the reporting period and the date the financial statements are approved for issue, those events are disclosed as non-adjusting events in accordance with IAS 10 Events after the Reporting Period:*
>
> *(a) refinancing on a long term basis;*
>
> *(b) rectification of a breach of a long-term loan arrangement; and*
>
> *(c) the granting by the lender of a period of grace to rectify a breach of a long-term loan arrangement ending at least twelve months after the reporting period.*'

Furthermore, in the context of an entity which has a concentration of funding sources and/or, is in breach of bank covenants, IFRS 7 requires such an entity to disclose how it manages the liquidity risk arising therein[13].

In circumstances where an entity is facing challenges in this regard, the presentation of liabilities as current or non-current on the face of the Balance Sheet is an area that will likely warrant careful consideration by Boards and Audit Committees in the preparation of periodic financial reports. It is also likely that, in users' interests, the necessity for additional disclosures addressing the risks and uncertainties facing the issuer will require careful consideration. In addition, the requirements of IAS 10 *Events after the Reporting Period* will need to be considered along with consideration of any going concern implications.

2.4 Related party transactions and balances

Transactions with related parties and associated disclosures have been the subject of much media and public comment over the past year. Also of relevance is that there have been amendments to both the relevant accounting pronouncements and legislation governing this area during the year. As a result, disclosures relating to transactions with related parties continue to be considered to be an area of heightened risk in the current reporting season.

Boards and Audit Committees are reminded that the materiality threshold for such disclosures is not determined by a simple quantitative comparison to primary statement totals, but, rather, is dependent on the size and nature of the transaction, judged in the particular circumstances of its omission or misstatement. Given the importance of adequate related party disclosures to users' understanding of financial reports in the context of, amongst other considerations, management's stewardship and accountability, IAASA will, as considered necessary or otherwise appropriate, continue to robustly challenge issuers' assertions that related party transactions are immaterial on the grounds of the quantum of the underlying transactions alone. Readers are advised to refer also to Section 2.6 of this document for a further discussion on materiality which is of particular relevance in this context.

The objective of IAS 24 *Related Party Disclosures* is to ensure that an entity's financial statements contain the disclosures necessary to draw users' attention to the possibility that its financial position and profit or loss may have been affected by the existence of related parties and by transactions and outstanding balances with such parties[14]. Paragraphs 12, 16, 17 and 18 of IAS 24 specify the disclosures to be provided regarding related parties.

Issuers' compliance with the accounting standards in this regard continue to raise issues and examinations conducted during the year identified a number of infringements, including, for example:

(a) omission of disclosures required by IAS 24 regarding related party transactions and balances in respect of parties which the entity had identified as being related parties;

(b) correction of errors in prior period related party amounts without disclosing the nature of the errors and the amounts of the corrections[15];

[13] Paragraphs 39(c) and B11F of IFRS 7 refer
[14] Paragraph 1 of IAS 24 refers. For Irish GAAP issuers, paragraph 1 of FRS 8 *Related party disclosures* refers
[15] Paragraph 49 of IAS 8 refers. For Irish GAAP issuers, paragraph 29 of FRS 3 *Reporting financial performance* refers

(c) cross referencing from audited financial statements to elements of the annual report not subject to audit with the consequence that it was not apparent as to whether the associated information had been subject to third party review; and

(d) failure to identify and disclose all related party relationships and, consequently, failure to disclose associated transactions and balances.

In response to review related enquiries, issuers' directors provided:

- undertakings to include additional disclosures in future periodic financial reports; or
- the requisite disclosures in periodic financial reports published during 2009 on foot of previously provided undertakings.

2.4.1 Banks
Following the provision of State support to certain banks, the Government became a party related to those institutions and, consequently, that relationship falls within the scope of IAS 24 and the various disclosure requirements set out in that Standard. Readers should also note that the accounting pronouncements on Government assistance outlined in section 2.5 of this document may also be relevant to the disclosures required in respect of such related party relationships with Government. In this regard, IAASA will continue to adopt a proactive approach towards monitoring financial institutions' compliance with applicable financial reporting standards, an approach that has previously identified inconsistencies in the approach adopted by individual institutions.

A revision to IAS 24, which simplifies the disclosure requirements for Government-related entities[16] and amends the definition of a related party, was issued in November, 2009 and is effective for annual reporting periods beginning on or after 1 January, 2011. While earlier adoption is permitted, it has yet to be endorsed by the EU and, accordingly, the revised Standard does not constitute part of the relevant reporting framework. Consequently, as of the date of publication of this document the revised Standard cannot be early adopted and used by issuers in preparing their periodic financial reports[17].

In respect of transactions with directors and connected persons, the Companies (Amendment) Act 2009[18] ('the 2009 Act') amended the provisions of the Companies Act, 1990 regarding the level of disclosure that is required to be provided by licensed banks in respect of loans to directors. The 1990 Act, as amended by the 2009 Act, requires the disclosure by licensed banks on a director by director basis of:

(a) the amount of directors' loans at the end of the accounting period;

(b) the maximum amount of directors' loans outstanding during the accounting period;

(c) the number of directors with loans outstanding at the end of the accounting period; and

(d) the maximum number of directors with loans outstanding during the accounting period.

Affected issuers should also be cognisant of the amended disclosure provisions concerning connected persons.

2.5 Accounting for Government grants and disclosure of Government assistance
IAS 20[19] *Accounting for Government Grants and Disclosure of Government Assistance* is required to be applied in accounting for, and in the disclosure of, Government grants and in the disclosure of other forms of Government assistance. The Standard requires several disclosures in an entity's financial reports, including the nature and extent of Government grants recognised in the financial

[16] Paragraph 9 of IAS 24 (revised) definition: '*A* government-related entity *is an entity that is controlled, jointly controlled or significantly influenced by a government.*'
[17] Current indications are that the revised IAS 24 may be considered for endorsement in Q2 of 2010
[18] Available at http://www.attorneygeneral.ie/eAct/2009/a2009.pdf
[19] For Irish GAAP issuers, SSAP 4 *Accounting for government grants* refers

statements and an indication of other forms of Government assistance from which the entity has directly benefited, along with unfulfilled conditions and other contingencies attaching to Government assistance that has been recognised.

In the current economic environment, the scale of Government support to businesses has increased. Issuers in receipt of State support through, for example, NAMA[20], the Employment Subsidy Scheme or the Credit Institutions (Financial Support) Scheme 2008 / the Credit Institutions (Eligible Liabilities Guarantee) Scheme 2009 (i.e. the 'Bank Guarantee') will, therefore, need to carefully assess the accounting and disclosure requirements of IAS 20.

In particular, in the case of financial institutions, the importance of transparency of disclosure in respect of transactions with NAMA and the implications of same for their financial position will be of major importance. In this regard, the accounting treatments to be adopted and the associated disclosures – including accounting policy disclosures – in respect of, for example, impairments of assets, valuation of proceeds, related party disclosures and subsequent event disclosures will require very careful consideration by the Boards and Audit Committees of affected issuers.

2.6 Materiality

Materiality[21] is an important concept in the context of the preparation of a set of financial statements. For example, materiality is relevant to the consideration of whether particular information requires disclosure within the financial statements, whether assets, liabilities or items of income or expense should be presented separately on the face of a primary statement and whether a prior year error requires correction and disclosure. Assessing the materiality of an item is primarily a judgemental process requiring evaluation of whether particular information might reasonably influence users' economic decisions. Materiality judgements involve both quantitative and qualitative considerations, including assessments of size, nature and the surrounding circumstances.

In particular, information provided for stewardship and accountability purposes, such as disclosures of directors' remuneration and other related party disclosures are usually assessed primarily on the basis of qualitative considerations. Thus, while such amounts are often relatively insignificant in comparison with the overall results of the entity, they will nonetheless be highly qualitatively material to a user seeking to assess the performance of management and the appropriateness of their continued stewardship of the entity. In that regard, it should also be noted that there are many stakeholders with an interest in an entity's financial reports, including investors, employees, lenders, Government agencies and the public and directors should give consideration to each of their needs in evaluating the necessary disclosures.

Another aspect of materiality meriting note is that, while accounting policies need not be applied when the effect of applying them is immaterial, it is inappropriate to make, or leave uncorrected, immaterial departures from IFRSs in order to achieve a particular presentation of an entity's financial position, financial performance or cash flows[22]. Therefore, IAASA will continue to challenge issuers' directors in circumstances where they propose to leave uncorrected an identified misapplication of, and non-compliance with, an accounting standard, particularly in circumstances where such an error is easily rectified.

In view of the foregoing, Boards and Audit Committees should critically assess, and, as appropriate, challenge, the materiality judgements made by management in the course of the preparation of the financial statements, particularly where it appears that qualitative aspects may not have been sufficiently assessed. In particular, careful consideration of the circumstances surrounding a materiality judgement is required where management do not propose to correct an identified error.

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[20] National Asset Management Agency

[21] Paragraph 7 of IAS 1 (revised) defines '*material*'' as: '*Omissions or misstatements of items are material if they could, individually or collectively, influence the economic decisions that users make on the basis of the financial statements. Materiality depends on the size and nature of the omission or misstatement judged in the surrounding circumstances. The size or nature of the item, or a combination of both, could be the determining factor*.' For Irish GAAP issuers, paragraph 3.30 of *Statement of principles for financial reporting* states that '*An item of information is material to the financial statements if its misstatement or omission might reasonably be expected to influence the economic decisions of users of those financial statements, including their assessments of management's stewardship.*'

[22] Paragraph 8 of IAS 8

2.7 Financial Instruments – risk disclosures

2.7.1 General

Against the background of the prevailing economic environment, risk disclosures have assumed increased significance in periodic financial reports. In that context IFRS 7 *Financial Instruments: Disclosures*[23] requires that disclosures relating to an entity's exposure to risks arising from financial instruments should be based on how the entity views and manages its risks, i.e. using the information provided to key management personnel.

Both the IASB and the ASB have issued amendments to their applicable Standards (and, in particular, to IFRS 7 and FRS 29 respectively) in response to the financial crisis. It follows, therefore, that in preparing and approving financial statements for accounting periods beginning on or after 1 January, 2009, Boards and Audit Committees should be cognisant of the impact of these changes.

IAASA's examinations to date have identified certain deficiencies in issuers' disclosures in this area. In that context, and having regard to the prevailing economic conditions, issuers' Boards and Audit Committees are encouraged to pay particular attention to the disclosures provided in the following areas:

(a) the methods, and, where a valuation technique is used, the significant assumptions applied in determining the fair values of financial assets and financial liabilities[24];

(b) issuers' exposure to liquidity risk, credit risk including credit quality and counterparty risk, and concentration risk (both of assets and funding)[25];

(c) the carrying amount of financial assets pledged as collateral including the terms and conditions of same[26] and a description of collateral held as security and other credit enhancements[27]; and

(d) quantitative disclosures[28] including, but not limited to, liquidity risk[29], concentration risk, sensitivity analysis or value-at-risk analysis[30].

In agreeing upon the disclosures to be provided, Boards and Audit Committees should ensure that those disclosures are comprehensive and meaningful, with non-specific, boilerplate narrative being avoided. It is, however, equally important to ensure that disclosures are not drafted in a manner that serves to obscure important information.

Review activity to date has resulted in instances in which issuers have provided undertakings to substantially improve disclosures in this area. While this is a matter that requires attention by all issuers, it is an area of particular relevance for fund and debt issuers as well as for financial institutions.

2.7.2 Certain fund and debt issuers – disclosure of the fair value of financial instruments

Based on examinations undertaken, IAASA has noted that certain issuers have determined fair values using prices provided by brokers, third party arrangers or other pricing sources. In a number of cases examined, however, insufficient detail had been provided as to how fair value had been determined and/or, where relevant, the significant assumptions upon which fair values had been based[31]. That being the case, IAASA has, in certain cases, found it necessary to require issuers to enhance future disclosures regarding the manner in which fair values have been arrived at and the significant assumptions applied in arriving at those values.

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[23] FRS 29 *(IFRS 7) Financial Instruments: Disclosures* is the equivalent Standard for issuers applying Irish GAAP
[24] Paragraph 27(a) of IFRS 7 refers
[25] Paragraphs 36 and 39 of IFRS 7 refer
[26] Paragraph 14 of IFRS 7 refers
[27] Paragraph 36(b) of IFRS 7 refers
[28] Paragraph 34 of IFRS 7 refers
[29] Paragraph 39 of IFRS 7 refers
[30] Paragraphs 40 and 41of IFRS 7 refer
[31] Paragraph 27 of IFRS 7 / FRS 29, and paragraphs 48, 48A, 49 and AG69 to AG82 of IAS 39 / FRS 26

2.7.3 Limited recourse entities
Certain debt issuers are structured as bankruptcy remote special purpose entities ('SPEs') which issue Notes/raise borrowings that are listed on recognised exchanges and which are structured as limited recourse loans. If a loan is *'limited recourse*', the borrower is only obligated to use certain designated assets and income that are identified in the loan documents to repay that debt. IAASA has observed that such entities typically issue Notes in separate series, with the assets attributed to any particular series of Notes held separately from those relating to any other series and used as collateral for the relevant series of Notes. These entities typically alter the risk profile of each series of Notes by using derivatives such as interest rate swap contracts, currency swap contracts and or credit default swap contracts to eliminate, or significantly reduce, the risks of the underlying collateral investments such that the holders of each series of Notes bear the remaining risks of ownership, i.e. price risk of the underlying collateral assets. In this way, the issuer is effectively profit neutral with gains and losses on investments being offset by losses and gains on the related series of Notes and on related derivative contracts. Notwithstanding the structure of such entities, there remain risks to which such entities are exposed by virtue of the instruments that they hold. Such risks include, but are not limited to, counterparty risk, concentration risk and price risk.

Consequently, the limited recourse nature of these entities does not exempt them from the requirement to comply in full with IFRS 7's risk disclosure requirements. In that regard, IAASA's examinations to date have resulted in instances in which debt issuers' directors have provided undertakings to substantially enhance risk disclosures in this area in future periodic financial reports.

2.8 Operating profit

Paragraphs BC55 and BC56 of IAS 1 (revised) state that, while there is no requirement in the Standard to disclose the results of operating activities as a line item in the Income Statement, entities may elect to provide such a line item. The Standard goes on to provide that in such cases, the entity should ensure that the amount disclosed '… *is representative of activities that would normally be regarded as 'operating' … it would be misleading and would impair the comparability of financial statements if items of an operating nature were excluded from the results of operating activities, even if that had been industry practice*'[32].

During the year, IAASA considered it necessary to enter into correspondence with a number of issuers where it appeared that items of an operating nature had been presented outside of '*operating profit'*. In certain instances, the aforementioned correspondence resulted in the provision of directors' undertakings to amend the accounting treatment applied in future periodic financial reports.

In instances where issuers present items outside of the results of operating activities, IAASA's clear expectation is that such issuers will provide a sufficiently detailed narrative explaining their analysis of what constitutes '*operating activity*' and the basis upon which amounts have been presented outside the results of operating activities. In the coming year, IAASA will continue to focus on this matter and on issuers who do not provide such narrative.

2.9 Key performance indicators ('KPIs')

Transparency Rule 6.1[33] requires the inclusion in annual financial reports of a fair review of the development, performance and position of the business using key performance indicators, both financial and non-financial.

In presenting such analyses, issuers typically make reference to financial KPIs, such as, '*return on capital employed*', '*sales growth*', '*free cash flow*', '*EBITDA*'[34], '*adjusted earnings*', '*cash earnings per share*', and performance indicators based on '*constant currency*' measures. It is often the case, however, that issuers refer to such measures without explaining the way in which the KPI ratio or percentage has been calculated and, in particular, without providing details of the numerator and denominator being used or their relationship to the amounts presented in the financial statements. For

[32] Paragraph BC56 of IAS 1 (revised) refers
[33] Section 13 of the Companies (Amendment) Act 1986 contains a similar requirement in relation to the information to be included in the Directors' Report
[34] Earnings before interest, tax, depreciation and amortisation

example, there can be a lack of clarity as to whether profits before/after exceptional items or amortisation have been used in calculating KPIs. Such confusion (and inconsistency between amounts used in a management report and the financial statements) detracts from users' ability to evaluate the position and performance of an issuer. Therefore, where issuers use specific KPIs, it is important to ensure that such measures are clearly explained, and where amounts used to calculate such KPIs have been adjusted from those shown in the financial statements, that any reconciliations necessary to aid users' understanding are provided.

On a related point, and as noted in previous publications, Boards' and Audit Committees' attention is drawn to the CESR Paper entitled '*Recommendation on Alternative Performance Measures*'[35] which encourages entities using such measures to:

(a) define and explain the measures used;

(b) use such measures in a manner that is appropriate and decision-useful; and

(c) adhere to the four qualitative characteristics (i.e. understandability, relevance, reliability and comparability).

2.10 Management reports

Section 13 of the Companies (Amendment) Act, 1986 and Regulations 4 to 8 set out the requirements regarding the content of Management Reports to be included in issuers' periodic financial reports. In summary, the general principle is that Management Reports should present a balanced and comprehensive analysis of the period, using KPIs (both financial and non-financial) and include information to the extent necessary for an understanding of the development, performance and position of the issuer's business and consistent with the size and complexity of the business.

The Management Report should give an indication of, amongst other matters:

(a) any important events that have occurred since the end of the reporting period;

(b) likely future developments;

(c) in relation to issuers' use of financial instruments, and where material for the assessment of its assets, liabilities, financial position and profit or loss, issuers' risk management objectives and policies; and

(d) issuers' exposure to price risk, credit risk, liquidity risk and cash flow risk.

Examinations of certain issuers' Management Reports have identified the use of generic (i.e. non issuer-specific) and boilerplate language, which does not provide users with any particular insight into those entities' business activities or the risks attaching thereto. This, in turn, has led to a number of issuers providing undertakings to effect the necessary improvements in future periodic financial reports.

In current market conditions, entities need to give a renewed focus to the ways in which they can effectively communicate how the business has performed during the period. Boards and Audit Committees are, therefore, encouraged to carefully consider the content of their Management Reports with a view to ensuring that they are comprehensive, balanced, and specific to the business.

2.11 Additional disclosures

The objective of financial statements is to provide information about the financial position, performance and changes in financial position of an entity that is useful to a wide range of users in making economic decisions[36]. Attention is also drawn to paragraph 112(c) of IAS 1 (revised) which

[35] Available at http://www.cesr-eu.org/index.php?page=document_details&from_title=Documents&id=3601

[36] Paragraph 12 of the *Framework for the Preparation and Presentation of Financial Statements*

states that the notes to the financial statements shall '... *provide information that is not presented elsewhere in the financial statements, but is relevant to an understanding of any of them*'. Boards and Audit Committees are reminded that the exercise of judgement is necessary in identifying the key information which, although not specifically required to be disclosed by a Standard, is nonetheless information which users may find decision-useful. It is acknowledged that such judgement must also be applied in striking the balance between providing useful information for a wide range of users and not obscuring key information by including excessive detail. The *Framework* provides useful guidance to the preparers of periodic financial reports in this respect[37].

2.12 Reliance on '*industry practice*'

IAASA has noted that certain issuers seek to rely on '*industry practice*' when determining the accounting treatment and disclosure to adopt in their periodic financial reports. While '*accepted industry practice*' is a relevant consideration in the selection of an accounting policy, this applies only in the absence of an IFRS that specifically applies to a transaction, other event or condition[38]. Moreover, the approach adopted by a peer entity may be based on either its own unique circumstances or even on an incorrect interpretation of the relevant requirements. Therefore, while an issuer may find the approach adopted by a peer entity of interest, it should not be considered to be the most important indicator of the most appropriate accounting treatment.

2.13 New accounting pronouncements applicable for 2009 year end financial reports

Based on IAASA's examination of periodic financial reports during 2009, it is clear that many issuers – particularly equity issuers – invest significant resources with the objective of ensuring that their periodic financial reports are of a high quality and have been prepared in compliance with the relevant reporting framework. However, it is also apparent that certain issuers, including a number of equity issuers, dedicate too few resources to their financial reporting responsibilities and obligations. Given the complexity of extant financial reporting pronouncements and their ongoing revision, it is essential that issuers remain conversant with the requirements of all aspects of the relevant reporting framework.

Based on IAASA's continuing engagement with issuers, it is not uncommon for the cause of issues raised to be issuers' lack of awareness and/or understanding of applicable financial reporting pronouncements. Given that issuers' directors are legally responsible for preparing financial statements which give a true and fair view, Boards and Audit Committees should ensure that adequate resources are devoted to issuers' financial reporting functions. It would be expected that the allocation of sufficient resources would, amongst other benefits, lead to a lesser level of engagement with IAASA on review related matters.

In the context of the foregoing, Boards' and Audit Committees' attention is drawn to the fact that a number of revised and new financial reporting Standards are applicable for 2009 year end financial reports. The principal matters of relevance are outlined briefly below.

The ASB periodically issues amendments to FRSs (e.g. '*Improvements to Financial Reporting Standards 2009*') so as to maintain the existing levels of convergence between Irish/UK GAAP and IFRS. These amendments typically arise as a consequence of the IASB's annual improvements process. In April 2009 the IASB issued an International Financial Reporting Standard, '*Improvements to IFRSs*', which made amendments to a number of IFRSs. The improvements to ASB Standards are the same as those made to IFRS where the FRS is an IFRS-based Standard. In addition, the ASB amended FRS 11 '*Impairment of fixed assets and goodwill*' to strengthen the disclosure requirements in that FRS. The amendments are similar in nature to those made by the IASB to IAS 36 '*Impairment of Assets*' as part of its '*Improvements to IFRS*' issued in 2008. Irish GAAP issuers are directed to the ASB website for additional information[39].

[37] Paragraphs 24 to 46 of the *Framework* refer
[38] Paragraphs 10 to 12 and BC16 to BC18 of IAS 8 refer. For Irish GAAP issuers, FRS 18 *Accounting policies* refers
[39] http://www.frc.org.uk/asb/

2.13.1 IAS 1 (Revised) Presentation of Financial Statements
IAS 1 (revised) is effective for annual accounting periods beginning on or after 1 January, 2009. This revised Standard will be applicable to the majority of issuers' annual financial statements for 2009. Key considerations arising from the adoption of IAS 1 (revised) include:

(a) Complete set of financial statements[40] – a complete set of financial statements comprises:

- a Statement of Financial Position as at the end of the period;
- a Statement of Comprehensive Income for the period;
- a Statement of Changes in Equity for the period;
- a Statement of Cash Flows for the period;
- notes to the financial statements, comprising a summary of significant accounting policies and other explanatory information; and
- a Statement of Financial Position as at the beginning of the earliest comparative period whenever an entity retrospectively applies an accounting policy, or makes a retrospective restatement of items in its financial statements, or when it reclassifies items in its financial statements.

(b) Statement of Financial Position – the revised Standard introduces a requirement to include a Statement of Financial Position as at the beginning of the earliest comparative period whenever an entity retrospectively applies an accounting policy, or makes a retrospective restatement of items in its financial statements, or when it reclassifies items in its financial statements.

In those limited circumstances, an entity is required to present, as a minimum, three Statements of Financial Position (and related notes), i.e. as at:

- the end of the current period;
- the end of the previous period (which is the same as the beginning of the current period); and
- the beginning of the earliest comparative period.

In addition to providing the three Statements of Financial Position and related notes as required by paragraph 39 of the revised Standard, issuers who change the presentation and classification of items are also required to provide the disclosures required by paragraph 41 of the revised Standard[41, 42] which include details of the nature, amount and reason for the reclassification. Consequent to examinations undertaken in 2009, IAASA has identified several instances in which issuers changed the presentation or classification of items in their financial statements without providing the disclosures required by paragraph 41 (paragraph 38 under current IAS 1). In the context of the new requirements for an additional comparative, IAASA will continue to focus on issuers' compliance with these requirements.

(c) Statement of Comprehensive Income – the revised Standard requires that all items of income and expense (including those accounted for directly in equity) be presented either:

[40] Paragraph 10 of IAS 1 (revised) refers
[41] The equivalent of paragraph 41 of IAS 1 (revised) was paragraph 38 of IAS 1. For Irish GAAP issuers, FRS 3 *Reporting financial performance* and FRS 28 *Corresponding amounts* are relevant
[42] Paragraph 41 of IAS 1 (revised): '*When the entity changes the presentation or classification of items in its financial statements, the entity shall reclassify comparative amounts unless reclassification is impracticable. When the entity reclassifies comparative amounts, the entity shall disclose:*
(a) the nature of the reclassification
(b) the amount of each item or class of items that is reclassified; and
(c) the reason for the reclassification.'
For Irish GAAP issuers, FRS 3 *Reporting financial performance* is relevant

- in a single statement (a ‘*statement of comprehensive income*’); or

- in two statements (a separate ‘*income statement*’ and ‘*statement of comprehensive income*’).

2.13.2 IFRS 8 Operating Segments
IFRS 8 *Operating Segments*, effective for annual accounting periods beginning on or after 1 January, 2009, replaced IAS 14 *Segment Reporting* and defines an operating segment as ‘*a component of an entity:*

(a) that engages in business activities from which it may earn revenues and incur expenses (including revenues and expenses relating to transactions with other components of the same entity),

(b) whose operating results are reviewed regularly by the entity's chief operating decision maker to make decisions about resources to be allocated to the segment and assess its performance, and

(c) for which discrete financial information is available.’[43]

The financial and descriptive disclosure requirements of IFRS 8 are based on the information regarding the components of the entity that management uses to make decisions about operating matters (a ‘management approach’). The requirements of IFRS 8 are broadly similar to those of US GAAP[44]. Experience in the US has shown that deciding on who is the Chief Operating Decision Maker (‘CODM’) is the most problematic area in applying this Standard and that time and careful consideration are needed in order to ensure that the right person or persons have been identified. The CODM’s identity will not always be obvious and will depend on the entity’s structure.

The application of IFRS 8 will require the exercise of judgement by Boards and Audit Committees. In many cases, application of IFRS 8 will result in a greater number of reportable operating segments than had previously been the case under IAS 14. Where this has not been determined to be the case by issuers whose periodic financial reports have been selected for examination, IAASA has engaged with those issuers with a view to seeking to better understand the rationale underpinning their identification of the CODM and the consequent identification of reportable segments.

Boards and Audit Committees of closed ended funds and debt issuers are, in particular, reminded that IFRS 8 applies to an entity that files, or is in the process of filing, its financial statements with a securities commission or other regulatory organisation for the purpose of issuing any class of instruments in a public market[45]. Issuers are further encouraged to note that minimum disclosures may be required for entities having only one reportable segment, including investment funds that were not, in the past, required to disclose segmental information, owing to the broader scope of IFRS 8.

2.13.3 Other pronouncements
In addition to the changes brought about as a result of IAS 1 and IFRS 8, other developments that may impact upon issuers’ 2009 periodic financial reports include[46]:

(a) IFRS 1 (revised) *First-time Adoption of International Financial Reporting Standards*;

(b) IFRS 2 (amended) *Share-based Payments*;

(c) IAS 27 (amended) *Consolidated and Separate Financial Statements*;

(d) IAS 32 (revised) *Financial Instruments: Presentation*;

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[43] Paragraph 5 of IFRS 8. For Irish GAAP issuers, SSAP 25 *Segmental reporting* is the relevant Standard
[44] FASB Statement No. 131 *Disclosures about Segments of an Enterprise and Related Information* (‘SFAS 131’)
[45] or whose debt or equity instruments are traded in a public market (paragraph 2(a)(i) of IFRS 8 refers)
[46] Details of improvement to FRS including *‘Improvements to Financial Reporting Standards 2009’* issued by the ASB can be found at http://www.frc.org.uk/asb/technical/projects/project0075.html

(e) IAS 39 (amended) *Financial Instruments: Recognition and Measurement*;

(f) IFRIC[47] 13 *Customer Loyalty Programmes*;

(g) IFRIC 15 *Agreements for the Construction of Real Estate*;

(h) IFRIC 16 *Hedges of a Net Investment in a Foreign Operation*;

(i) IFRIC 17 *Distributions of Non-cash Assets to Owners*; and

(j) IFRIC 18 *Transfers of Assets from Customers*.

[47] International Financial Reporting Interpretations Committee

3. RISK ASSESSMENT & SELECTION OF ISSUERS FOR FINANCIAL STATEMENT REVIEW

In determining which issuers' periodic financial reports to select for examination, IAASA has heretofore adopted a mixed model, i.e. whereby such selections are based on risk assessments, supplemented by cyclical and/or random selections (thereby ensuring that entities that might not be selected as a consequence of a risk-based approach nevertheless stand to be selected for examination). Details of the assessment and selection model, and various risk factors used in that process, have been published in previous publications[48].

Examinations of issuers' periodic financial reports can broadly be classified into one of three categories, namely:

(a) Full scope reviews – these reviews comprise an examination of all aspects of the selected report for compliance with the recognition, measurement, classification, presentation and disclosure requirements of relevant Standards, legislation and regulations;

(b) Focussed reviews – this type of review focuses on the examination of a single or limited number of aspect(s) of the selected report (e.g. where the selected issuer has undergone a business combination during the period under review); and

(c) Follow-up review – these are reviews which examine a previously reviewed issuer for the purpose of ascertaining and assessing the issuer's responses to previously raised issues (e.g. with a view to determining whether directors have honoured previously provided undertakings).

During the course of 2010, the aforementioned categories of examination are likely to be augmented by a further category – thematic reviews. Unlike the reviews referred to above, which relate to an individual issuers' reports, thematic reviews will involve the selection of multiple issuers' reports, with selected reports being examined by reference to a selected theme, for example:

(a) accounting for pensions and disclosures associated therewith[49];

(b) accounting for impairments (intangible assets, tangible assets, financial assets);

(c) compliance with the requirements of IFRS 7 *Financial Instruments: Disclosures*;

(d) hedging – accounting treatment, documentation and disclosures[50];

(e) accounting for the impact of issuers' relationships with NAMA;

(f) Operating Segments – IFRS 8;

(g) implementation of IAS 1 *Presentation of Financial Statements* (revised September 2007) (effective for accounting periods beginning on or after 1 January, 2009); and

(h) related party disclosures[51].

The purpose of thematic reviews will be to augment current review activity to monitor and assess the standard of issuers' financial reporting.

[48] 2008 Annual Report is available at http://www.iaasa.ie/publications/Annual_Report2008.pdf
[49] IAS 19 *Employee Benefits* and FRS 17 *Retirement benefits* are the applicable accounting standards in this regard
[50] IAS 39 *Financial Instruments: Recognition and Measurement* and IFRS 7 *Financial Instruments: Disclosures* for issuers applying IFRS; FRS *26 (IAS 39) Financial instruments: recognition and measurement* and FRS 29 *(IFRS 7) Financial instruments: disclosures* for issuers applying Irish GAAP
[51] IAS 24 *Related Party Disclosures* and FRS 8 *Related party disclosures* are the applicable accounting standards in this regard

Irish Auditing & Accounting Supervisory Authority
15 January, 2010

APPENDIX

SUMMARY OF REGULATIONS 44 AND 45 OF THE TRANSPARENCY (DIRECTIVE 2004/109/EC) REGULATIONS 2007

Regulation 44
Regulation 44 provides that, where it appears to IAASA that there is, or may be, a failure by an issuer whose home Member State is Ireland to ensure that a published periodic financial report complies with the relevant reporting framework, IAASA may give notice to the issuer and the directors of such issuer specifying:

- the matters in respect of which it appears to IAASA that the information fails to comply with the relevant reporting framework; and
- a period of not less than 30 days within which the issuer shall either:
    - provide IAASA with a written explanation of the information; or
    - prepare revised information,
- that, in the absence of written explanation or the issuance of revised information, IAASA may:
    - give a direction requiring the issuer to revise the information in accordance with its instructions, as specified in the direction;
    - seek an order of confirmation from the Court of its direction; and
    - recover its costs from the issuer,
- that, in the event that IAASA seeks an order of the Court to enforce its direction, IAASA may publish notice of such application in such manner as it sees fit.

Regulation 45
Regulation 45 provides that:

- if, at or before the end of the period referred to in a notice issued under Regulation 44, the issuer prepares revised information as directed in the notice, IAASA may, taking into account the circumstances of the matter, require the issuer to pay some or all of the costs incurred by IAASA in examining the published information and performing its functions under the Regulations;
- if, at the end of the period referred to in the notice:
    - the issuer has not issued revised information; and
    - IAASA, having considered any explanations provided by the issuer or its directors or both and considered any information or documents or both provided by the issuer in response to requests, IAASA remains of the opinion that the information does not comply with the relevant reporting framework,

  IAASA may give a direction to the issuer requiring the issuer or its directors or both to do one or more of the following:

- revise the periodic financial report in accordance with instructions of IAASA as specified in the direction;
- publish the revised information in the same manner as required by Regulations 4 to 8 and to make any consequential amendments to the relevant report(s) published in accordance with instructions of IAASA as specified in the direction;
- pay costs specified in the direction, being costs incurred by IAASA in examining and reviewing the financial reports.

GLOSSARY OF TERMS

AFS	Available for Sale
ASB	Accounting Standards Board
CESR	Committee of European Securities Regulators
CODM	Chief Operating Decision Maker
EECS	European Enforcer Co-Ordination Sessions
FASB	Financial Accounting Standards Board
FRS	Financial Reporting Standard
GAAP	Generally Accepted Accounting Principles
IAASA	Irish Auditing & Accounting Supervisory Authority
IAS	International Accounting Standard
IASB	International Accounting Standards Board
IFRIC	International Financial Reporting Interpretations Committee Interpretation
IFRS	International Financial Reporting Standard
KPI	Key Performance Indicator
NAMA	National Asset Management Agency
Regulations	Transparency (Directive 2004/109/EC) Regulations 2007 (S.I. No. 277 of 2007)
SFAS	Statement of Financial Accounting Standard
SPE	Special Purpose Entity
Transparency Rules	Financial Regulator Transparency Rules, September 2009

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