

## Report on IFRS enforcement in 2012

### Key conclusions of the IFRS enforcement

The effects of the euro crisis and the weaker economic environment for companies were reflected in the IFRS enforcement. Among other things, FIN-FSA surveyed the risk indicators of the proactive enforcement more carefully and extensively than before. On the basis of them, companies are selected as subjects of enforcement. In the selection criteria, the risk indicators displaying companies' financial position were emphasised. In its enforcement FIN-FSA paid special attention to companies' financial position and disclosures about going concern. FIN-FSA considers it essential that sufficient disclosures about going concern are provided in the financial statements and that the information is easily discernible from the rest of their contents.

At the same time, the significance of disclosures of financial instruments in the financial statements has grown. FIN-FSA monitored listed companies' disclosures of financial risk, particularly of liquidity risk and covenants and of classification of debts into short-term and long-term debts. According to FIN-FSA, there was a need for improvement in the notes to the financial statements. FIN-FSA also examined valuation issues concerning banks' loan receivables and financial reporting information thereon as part of a project of national IFRS enforcers coordinated by the European Securities and Markets Authority (ESMA).

As regards the enforcement by theme, FIN-FSA has for several years monitored goodwill impairment testing both from the viewpoint of disclosures and testing. The deteriorating economic situation raised questions on the reliability of listed companies' goodwill testing on a broader basis in Europe, because the recognised amount of impairment losses has been small. The results of an ESMA survey on deficiencies in the disclosures on impairment testing correspond with FIN-FSA's earlier view. In particular, unclear and vague descriptions as well as standard phrasing regarding the test assumptions and their sensitivity to changes are of no use to the investors.

Related party disclosures were a new priority of the IFRS enforcement. A study by FIN-FSA showed that listed companies' related party disclosures regarding key management

personnel needed to be improved. The reporting deficiencies hampered comparisons of management compensation between companies. Reporting of related party transactions is essential, particularly because listed company holdings in Finland are relatively concentrated. Related parties may perform exceptional transactions that unrelated parties would not enter into.

### New IFRS enforcement procedures

Enforcement procedures were further developed in 2012. FIN-FSA increased its communication with the audit committees of company boards. In connection with the full review of listed companies' financial statements, the opening and closing letters on the full review were provided to the audit committee for the first time. FIN-FSA may also pose questions directly to the audit committee and ask for copies of committee minutes. The purpose is to improve the access by audit committees to information on the FIN-FSA enforcement and make the enforcement more efficient.

Regarding the full review, in 2012 FIN-FSA also started a new procedure, according to which FIN-FSA asks for a copy of the written representation where the management confirms that the effect of the unadjusted audit differences are immaterial to the financial statements. The purpose of the new procedure is to make the IFRS enforcement in listed companies more efficient as unadjusted audit differences revealed in the audit are also communicated to FIN-FSA. In addition, FIN-FSA gets an impression of how companies and auditors have treated materiality in the financial reporting.

European supervisory cooperation has an increasing impact on IFRS enforcement. ESMA introduced a new operational approach under which IFRS enforcers will jointly decide on the priorities of the following year. In November 2012, ESMA published a set of priority issues for 2013.<sup>1</sup> The purpose is to harmonise European enforcement and perform analyses assessing the application of IFRS standards at European level.

<sup>1</sup> Link: [ESMA announces enforcement priorities for 2012 financial statements \(12.11.2012\)](#).



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## Scale and priorities of the IFRS enforcement

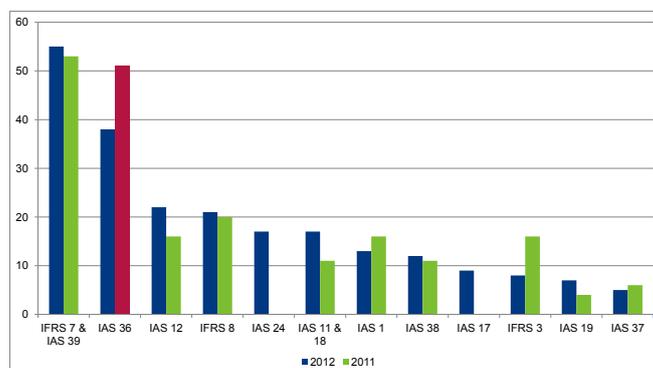
The table below describes the scale of the 2012 and 2011 IFRS enforcement by type of enforcement.

Type of enforcement	Number of enforcement events in 2012	Number of enforcement events in 2011
Full review	14	16
Enforcement by theme	4	4
Reactive enforcement	9	8
IFRS enforcement in prospectuses	7	6
<b>Sum total</b>	<b>34</b>	<b>34</b>

The table shows that 14 companies received a total of 40 full review letters (2011: 36 letters). 13 letters in all were sent on selected themes (2011: 7 letters). Theme enforcement stands for a thorough review of a certain sub-area of the financial statements, in which many detailed questions are posed to the companies. In 2012 the theme enforcement was rather performed as part of the full review than as a separate enforcement. In addition, FIN-FSA sent 12 reactive enforcement letters (2011: 11 letters). Reactive enforcement means measures taken on the basis of, for example, stock exchange announcements or complaints.

The chart below shows the focus of the IFRS enforcement by IFRS standard in 2012 and 2011.

## Focus of enforcement by standard in 2012 and 2011 (number of questions/observations)



As in 2011, due to the market situation the majority of the enforcement observations focused on the application of the standards on financial instruments (IFRS 7 and IAS 39). In addition to financial institutions, questions were also increasingly posed to other listed companies. The application of the standard on Impairment of Assets (IAS 36) was also subject to extensive enforcement for the same reason.<sup>2</sup> The enforcement of the following standards also involved several observations: Income Taxes (IAS 12), Operating Segments (IFRS 8), Related Party Disclosures (IAS 24), Revenue standards (IAS 11 and IAS 18), Presentation of Financial Statements (IAS 1), Intangible Assets (IAS 38), Leases (IAS 17) and Business Combinations (IFRS 3). Appendix 1 to this report comprises a summary of some questions posed in the 2012 IFRS enforcement.<sup>3</sup> As regards related party disclosures, FIN-FSA not only performed the full review but also a separate survey of 20 listed companies.

## Measures required by companies as a result of enforcement observations

In addition to the technical solutions for applying the IFRS standards, EECS<sup>4</sup> also deals with the enforcement

<sup>2</sup> The IAS 36 enforcement observations of 2012 and 2011 are not mutually comparable, as the method of keeping statistics of observations related to this standard was changed in 2012.

<sup>3</sup> Link: [Corresponding summary of some IFRS enforcement observations by FIN-FSA in 2011.](#)

<sup>4</sup> European Enforcers' Coordination Sessions (EECS) is an ESMA working group formed by the European IFRS enforcers.



# Report on IFRS enforcement in 2012

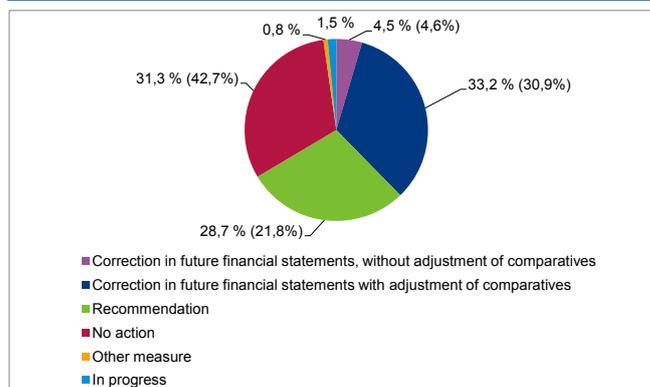
3 (8)

measures by the national IFRS enforcers. The purpose of the procedure is to make the measures by the IFRS enforcers as harmonised as possible. However, the enforcement decisions are made by the national IFRS enforcers. A database maintained by EECS contains the enforcement decisions approving a company's annual financial reporting and also enforcement decisions requiring the company to take corrective measures. The corrective measures required by the IFRS enforcers are attributable to the policies in IAS 8 Accounting Policies, Changes in Accounting Estimates and Errors. Depending on the materiality of the errors, the corrective measures can be categorised as follows:

- issuance of new financial statements, which also requires a new audit and approval of the restatement by the Annual General Meeting
- retrospective correction and, in addition, communication to the market by issuing a corrective note immediately after discovery of an error
- correction in the next financial statements with adjustments of comparatives
- correction in the next financial statements without adjustments of comparatives
- as regards minor errors, assessment by the preparer of the financial statements of the need to alter or develop the succeeding financial statements on the basis of a FIN-FSA recommendation.

FIN-FSA monitors the enforcement measures and keeps statistics thereof by the above-mentioned EECS categories. The below pie chart shows the distribution of measures required by FIN-FSA in 2012 and 2011. Companies performed retrospective restatements based on some observations. Due to one third of all enforcement observations, FIN-FSA urged compliance with IFRS requirements in the succeeding financial reports. FIN-FSA recommended additional disclosure as a result of one fourth of all enforcement observations. As regards a few observation events, the treatment has not yet been completed. As to the rest of the events, FIN-FSA required no measures.

## Distribution of measures required of companies based on individual enforcement observations in 2012 and 2011



## International activities

International activities focused on the financial instruments in the banking sector. In cooperation with the national IFRS enforcers, ESMA examined the reporting of Greek government bonds in the 2011 financial statements. According to ESMA's assessment, there is reason to further improve the disclosures to investors.<sup>5</sup> In late 2012 ESMA further published a public statement on concessions due to borrowers' financial difficulties, so-called forbearance practises and treatment thereof in IFRS financial statements.<sup>6</sup> FIN-FSA participated in preparing the statement.

Under the management of ESMA, European IFRS enforcers also examined disclosures of goodwill impairment testing in the financial statements of 235 European listed companies. FIN-FSA participated in the analysis and the preparing of the report. The report was published in January 2013 and the findings of the report support FIN-FSA's earlier view that there is still need for improvement of the notes on impairment testing.<sup>7</sup>

The Corporate Reporting Standing Committee (CRSC) coordinates all work related to financial reporting, auditing,

5 Link: [ESMA has monitored the IFRS reporting of government debts – further efforts need to be devoted to the notes provided](#) (FIN-FSA news release 15/2012, 27.7.2012).

6 Link: [ESMA's public statement on treatment of forbearance practices in IFRS financial statements](#) (78/2012, 31.12.2012).

7 Link: [ESMA calls for improvements in disclosures related to goodwill impairment](#) (21.1.2013).



disclosure of periodic information and storage of regulated information. A consultative working group is also assembling in connection with CRSC. The group is formed by representatives of the market participants and its task is to hear their views and ideas. The Finnish representative of the group has for the last two years been a member representing the preparers of the financial statements. The members will change in 2013.

In 2012, eight EECS meetings were held and FIN-FSA participated in all of them. Finland submitted seven enforcement decisions to the ESMA databank, and in addition two enforcement events (so-called emerging issues) of FIN-FSA were discussed in EECS prior to FIN-FSA's decision. The Markkinat bulletin 3/2012 (Markets, in Finnish only) contains a more detailed summary of four Finnish enforcement decisions, which were discussed in a meeting of IFRS enforcers in Helsinki.<sup>8</sup>

In 2012, ESMA published its 12th Extract from the EECS's Database of Enforcement.<sup>9</sup> 128 enforcement decisions in all have been published. The aim is to promote a consistent application of IFRS standards and transparency of enforcement in Europe. FIN-FSA prepared Finnish summaries of the most significant new enforcement decisions and published them in the Markkinat bulletin 4/2012.<sup>10</sup>

The IFRS Project Group is an ESMA working group that prepares ESMA's comments on new IFRS standards and interpretations and changes thereof to IASB and IFRIC. In its comments it considers both investor information and standard enforceability. As a member of the IFRS Project Group, FIN-FSA participated in ESMA's preparation of consultation letters. According to its strategic policies<sup>11</sup>, the IFRS Project Group also discussed some proposals with the investor organisations. Issues brought up by the investors have been taken into account in ESMA's final consultation letter. In 2012, the IFRS Project Group also updated ESMA's

alternative performance measures guidelines, which will probably be published for consultation in 2013.

In addition, Finland participated in the work of ESMA's Materiality Working Group concerning financial reporting. Comments on the document *Considerations of Materiality in Financial Reporting*<sup>12</sup> received for consultation were analysed and discussed. ESMA prepared a feedback statement to the consultation.<sup>13</sup>

## National cooperation

FIN-FSA participated in the supervision of auditors through its membership in the Auditing Board of the Central Chamber of Commerce. The cooperation with the Secretariat of the Auditing Board that started in 2010 has continued and FIN-FSA and the Auditing Board have focused their supervision on a few common financial statements. FIN-FSA focused on how the financial statements have been drawn up and the Auditing Board on how the auditors have audited the financial statements. In addition, FIN-FSA has together with the Secretariat of the Auditing Board analysed the companies' summaries of unadjusted audit differences discovered in the audit. The purpose of the cooperation is to enhance the coverage of supervision pursued by competent authorities regarding financial reports and so promote confidence in financial reporting.

Good accounting practice in the national accounting legislation was promoted by participating in the work of the Accounting Board of the Ministry of Employment and the Economy.

## Communication of IFRS enforcement results and other information

In early December FIN-FSA, according to an established practice, arranged two events on the subject of listed companies' financial reporting for a total audience of about 140 participants. The primary purpose of the events was to communicate the 2012 IFRS enforcement observations

8 Link: [European IFRS enforcers assembled in Helsinki](#) (Markkinat bulletin 3/2012).

9 All published decisions are available on FIN-FSA's website at <http://www.finanssivalvonta.fi/fi/Listayhtiolle/IFRS/Julkaisut/EECS/Pages/Default.aspx>.

10 Link: [European IFRS enforcers have published new enforcement decisions](#) (Markkinat bulletin 4/2012).

11 Link: [ESMA's strategic policies for influencing IFRSs provide means for more consequent consultation](#) (Markkinat bulletin 1/2012).

12 Link: [ESMA document Considerations of Materiality in Financial Reporting received for consultation](#) (Markkinat bulletin 4/2011).

13 Link: [ESMA publishes the feedback statement to the consultation on considerations of materiality in financial reporting](#) (14.2.2013).

14 The presentation material used at the events is available on FIN-FSA's website at <http://www.finanssivalvonta.fi/fi/Listayhtiolle/IFRS/Julkaisut/Esitykset/Pages/Default.aspx>.



# Report on IFRS enforcement in 2012

5 (8)

to the listed companies and auditors, so that the companies can take FIN-FSA's messages into account in their future financial reports.<sup>14</sup> It is also essential to inform about IFRS enforcement processes, priorities in next year's IFRS enforcement and possible changes in the enforcement in advance.

Not only the IFRS enforcement was presented at the 2012 events but also the quality control by the Auditing Board, the materiality considerations by ESMA, the operation of the IFRS Project Group, the effects of the renewed securities market legislation on disclosure of prospects and insider registers and the EMIR regulation.

In the Markkinat bulletin, twelve articles in all were published on the topic of IFRS enforcement in 2012. Appendix 2 to this report contains a more detailed summary of the articles.

## **For more information, please contact**

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## Appendix 1: Questions asked in the 2012 IFRS enforcement

For example, FIN-FSA posed the following questions and made the following observations in its enforcement:

### ■ IFRS 7 *Financial Instruments: Disclosures*

Has the company recognised impairments of loans or other receivables?

What is the extent of the company's unused credit limits or other financial arrangements and in what other way does it manage its liquidity risk?

The company is urged to add to its future financial statements the missing information on the maturity distribution of its financial debt.

### ■ IAS 36 *Impairment of Assets*

Which are the realised and forecasted margins used in impairment testing?

Why are the turnover forecasts and margins used in the company's impairment testing higher than the realised figures?

How are the long-term growth assumptions defined? Which sources of information have been used?

Which sources of information have been used in determining the discount rate components?

### ■ IAS 12 *Income Taxes*

How has the change of the corporate tax base been taken into account?

What evidence does the company have to support recognition of deferred tax assets?

### ■ IFRS 8 *Operating Segments*

How have the operating segments been defined and have they been aggregated into reporting segments?

Who has the company selected as its chief operating decision maker (CODM)?

### ■ IAS 24 *Related party disclosures*

Who has the company designated as members of its key management personnel according to IAS 24.9?

Why has the company not included members of its management group in its key management personnel according to IAS 24.9?

### ■ IAS 1 *Presentation of Financial Statements*

Several questions have been posed about going concern and disclosure thereof.

Has the company during the reporting period failed to meet some loan covenant terms and what were the possible results?

If failure to meet loan covenants had occurred, had the company, by the end of the reporting period, received a waiver from the lender covering at least twelve months after the reporting period?

### ■ IAS 39 *Financial Instruments: Recognition and Measurement*

Have derivatives been treated in the same way in the parent company's separate financial statements as in the consolidated IFRS financial statements?

What are the company's hedging relationships at the balance sheet date and have they been documented according to the IAS 39 requirements?

### ■ IAS 11 *Construction Contracts*

Which business areas can partial income recognition be applied to?

To what extent does the turnover include the return on construction contracts?

Request for calculation of gross receivables and debts related to construction contracts

# Report on IFRS enforcement in 2012

7 (8)

- IAS 17 *Leases*

Why do the balance sheet values of leases differ from the values specified in the notes?

- IFRS 3 *Business Combinations*

How has the contingent consideration been recognised?

How have intangible assets been defined?

- IAS 18 *Revenue*

To what extent does the turnover include revenue from the sale of goods and rendering of services?



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## Appendix 2: The Financial Reporting Division's news items in 2012–2013<sup>15</sup>

8 (8)

### Presentations

- December 2012 Events for listed companies – Presentation material

### News releases

- ESMA has monitored the IFRS reporting of government debts – further efforts need to be devoted to the notes provided (15/2012, 27.7.2012)
- Report on IFRS enforcement in 2011: Towards improved quality and reliability of financial statements (8/2012, 11.4.2012)

### Markkinat bulletins and other articles

- European IFRS enforcers have published new enforcement decisions (Markkinat bulletin 4/2012)
- ESMA's report on goodwill impairment testing (Markkinat bulletin 4/2012)
- Banks' concessions due to borrowers' financial difficulties (Markkinat bulletin 4/2012)
- European IFRS enforcers assembled in Helsinki (Markkinat bulletin 3/2012)
- Materiality in IFRS reporting – summary of feedback on ESMA's consultation (Markkinat bulletin 3/2012)
- IFRS standard on segment reporting sent for consultation – IASB assesses the effects of the implementation of the standard (Markkinat bulletin 3/2012)
- ESMA has assessed the financial statement recognition of Greek government bonds on 31 December 2011 – financial instruments still a priority in 2013 operations (Markkinat bulletin 3/2012)
- Uncertainty about business continuity calls for relevant investor information (Markkinat bulletin 2/2012)
- New IFRS enforcement procedure for increased efficiency of the enforcement process – deficiencies discovered in audit also to be disclosed to the enforcer (Markkinat bulletin 2/2012)
- Entry into force of new standards IFRS 10, 11 and 12 on consolidation (Markkinat bulletin 2/2012)
- ESMA's strategic policies for influencing IFRSs provide means for more consequent consultation (Markkinat bulletin 1/2012)
- Enhanced financial stability the purpose of the European Commission's proposals for audit legislation (Markkinat bulletin 1/2012)

### Enforcement releases

- ESMA's public statement on treatment of forbearance practices in IFRS financial statements (78/2012, 31.12.2012)

### Releases by the European Securities and Markets Authority (ESMA)

- ESMA publishes the feedback statement to the consultation on considerations of materiality in financial reporting (14.2.2013)
- ESMA calls for improvements in disclosures related to goodwill impairment, ESMA Report: Review of 2011 IFRS financial statements related to impairment testing of goodwill (21.1.2013)
- ESMA issues statement on forbearance practices (20.12.2012)
- ESMA announces enforcement priorities for 2012 financial statements (12.11.2012)
- ESMA publishes 12th Extract from the EECS's database of enforcement (10.10.2012)
- ESMA publishes review of accounting treatment of Greek sovereign debt (26.7.2012)
- ESMA publishes Activity Report on IFRS Enforcement in the European Economic Area in 2011 (28.6.2012)

### IFRS reports

- Report on IFRS enforcement in 2011

<sup>15</sup> <http://www.finanssivalvonta.fi/fi/Listayhtiolle/IFRS/Julkaisut/Pages/Default.aspx>.

