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PRESS RELEASE

A CESR analysis sees room for better compliance with IFRS disclosures

CESR publishes today an analysis (Ref. CESR/09-821) of the compliance of European financial institutions with disclosure requirements related to financial instruments. For the purposes of the analysis, CESR reviewed the 2008 year-end financial statements of 96 listed banks and/or insurers, including 22 companies from the FTSE Eurotop 100 index. The findings revealed that, in some areas, a significant proportion of companies failed to comply with mandatory disclosure requirements relating to financial instruments, for example regarding the use of valuation techniques and on relationships with special purpose entities (SPEs).

The purpose of the exercise was to see how the detailed requirements of IFRS 7 - *Financial Instruments: Disclosures* and certain additional recommendations, had been applied (see notes for editors). Information contained in such statements is key to understanding a company's financial position and performance and its omission might consequently affect the ability of investors to make decisions regarding their investment.

CESR's analysis also identified that a significant number of companies provided additional disclosures in-line with recommendations published in late 2008 by various organisations such as the Senior Supervisors Group and the IASB Expert Advisory Panel in.

Fernando Restoy, Vice-Chair of the Spanish Comisión Nacional del Mercado de Valores (CNMV) and Chair of CESR-Fin, CESR's group on accounting and enforcement issues, said:

> "*The financial crisis that existed during the second half of 2008 and the beginning of 2009 has had a major impact on the financial position and performance of publicly traded companies, particularly those in the financial sector. Strengthening investor confidence requires improved transparency on the actual situation of financial companies in their financial statements. Consequently, CESR would have expected a higher level of compliance with mandatory requirements, although that a significant number of companies provided additional disclosures in-line with recommendations, published in late 2008, is to be welcomed.*"

A good level of compliance with disclosures on categories of financial assets or liabilities

CESR found a good level of compliance with disclosure requirements on the classification of financial assets and liabilities and their carrying amounts under IFRS 7. Many entities enhanced their fair value disclosures on certain instruments they believed to be of importance for users and provided additional information to help users to better understand the financial statements. IFRS 7 requires extensive disclosures regarding financial assets and liabilities held at fair value. If the market for a financial instrument is not active, an entity is required to establish fair value by using a *valuation technique*, which should be explained.

Although most entities disclosed the methods they had applied when using a valuation technique to determine fair values for classes of financial assets and/or liabilities, around 20% of all companies and almost 10% of FTSE Eurotop-companies did not make such disclosures. Around 40% of all companies (10% of FTSE Eurotop-companies) did not disclose the sensitivity of the fair values recognised in the financial statements to changes in the various assumptions.

In addition, around half of all companies reviewed, and about 15% of FTSE Eurotop-companies, did not provide either the aggregate difference in *fair value estimates yet to be recognised*, or reconciliation between the opening and closing balances.

By contrast, around one third of all companies (half of the FTSE Eurotop-companies) followed recommended practices and disclosed whether valuation techniques were based on significant unobservable inputs and if relevant, a description of the sources of those unobservable inputs into the valuation techniques. Furthermore, although disclosures based on the *fair value hierarchy* were non-mandatory at the time, more than half of the financial entities CESR examined applied the hierarchy in their financial statements. In addition, more than half of the companies followed CESR's recommendation (Ref. CESR/08-713b) to disclose a summary of their valuation procedures.

Risks arising from financial instruments

Proper disclosure of risk is crucial for investors and other users of financial statements, particularly during more difficult market conditions. CESR's analysis showed that for the three types of risk analysed, credit risk, liquidity risk and market risk, the general qualitative and quantitative disclosure requirements of IFRS 7 had been provided by almost all companies. However, some of the more detailed disclosure requirements for credit risk were not provided to the same extent.

CESR's analysis also notes that, overall, a relatively high proportion of companies had chosen to adopt the amendments to IFRS 7 (which were still at the proposal stage in 2008) relating to liquidity risk in their financial statements early.

20% of financial institutions have not disclosed criteria used to determine impairment loss

In its analysis, CESR noted that around 80% of all companies analysed (90% of the FTSE Eurotop-companies) had impairment losses for financial instruments in 2008. Five per cent of the companies however, did not disclose a summary in their accounting policies of the criteria they use to determine that there is objective evidence that an impairment loss has occurred relating to equity instruments classified as available for sale.

20 % of entities did not disclose how special purpose entities (SPEs) were controlled

The analysis showed that 20% of companies with SPEs did not disclose details of how the SPE is controlled by that entity. FTSE-companies, which tend to have both more transactions and SPEs, complied better with the requirements.

In addition, around 20% of the companies having SPEs did not disclose details of how they had decided that all the significant risks and rewards of ownership of financial assets had been transferred to other entities. CESR would have expected that the number of companies providing adequate disclosures regarding their activities with off balance sheet entities to have been much higher.

The study conducted by CESR revealed areas where further compliance with disclosure requirements on financial instruments is needed. CESR and its Members believe that this information is key for users of financial statements in understanding the financial position and performance of a financial institution and will further assess compliance with disclosure requirements related to financial instruments.

Notes for editors:

1. CESR-Fin, CESR's group made up experts on accounting and enforcement issues from member authorities, conducted the study published today. CESR-Fin is one of CESR's permanent working groups.

2. CESR's analysis deals with the application of the mandatory disclosure requirements of IFRS 7 – *Financial Instruments: Disclosures* and with additional recommendations and guidance on disclosure in the following areas:
    1. Categories of financial assets and financial liabilities
    2. Financial assets or financial liabilities at fair value and their carrying amounts
    3. Risks arising from financial instruments
    4. Special Purpose Entities (SPEs)
    5. Impairment for financial instruments

    Since the onset of the financial crisis, a number of parties have issued recommendations and guidance for issuers to consider when applying the requirements of IFRS 7. In addition to the mandatory disclosures required by IFRS 7, CESR has analysed the implementation of the following recommendations and guidance:
    - The Financial Stability Forum Statement on Enhancing Market and Institutional Resilience, 7 April 2008;
    - The Senior Supervisors Group Leading-Practice Disclosures for Selected Exposures, 11 April 2008;
    - The CESR statement on Fair Value Measurement and related disclosures for financial instruments in illiquid markets, 3 October 2008;
    - The IASB ED[1] *Improving Disclosures about Financial Instruments,* 15 October 2008;
    - The Report from the IASB Expert Advisory Panel, 31 October 2008; and
    - The IASB ED 10 *Consolidated Financial Statements*, 18 December 2008.

3. CESR is an independent Committee of European Securities Regulators. The role of the Committee is to:

    - Improve co-ordination among securities regulators;
    - Act as an advisory group to assist the EU Commission, in particular in its preparation of
    - draft implementing measures in the field of securities;
    - Work to ensure more consistent and timely day to day implementation of community legislation in the Member States.
    - The Committee was established under the terms of the European Commission's decision of 6 June 2001 (2001/1501/EC). It is one of the two committees envisaged in the Final Report of the Group of Wise Men on the regulation of European securities markets. Baron Alexandre Lamfalussy chaired this group. The report itself was endorsed by the European Council and the European Parliament. The relevant documents are available on the CESR website.

[1] Exposure Draft (ED)

4. Each Member State of the European Union has one member in the Committee. The members are nominated by the Member States and are the heads of the national public authorities competent in the field of securities. The European Commission has nominated as its representative the Director General of the DG MARKT. Furthermore, the securities authorities of Norway and Iceland are also represented at a senior level.

Further information:

Carlo Comporti
Secretary General of CESR

Victoria Powell
Director of Communications

Tel: +33 (0) 158 36 43 21
Fax: +33 (0) 158 36 43 30
Email: communications@cesr.eu
Website: www.cesr.eu