



European Securities and
Markets Authority

Report

Activity Report on IFRS Enforcement in 2010

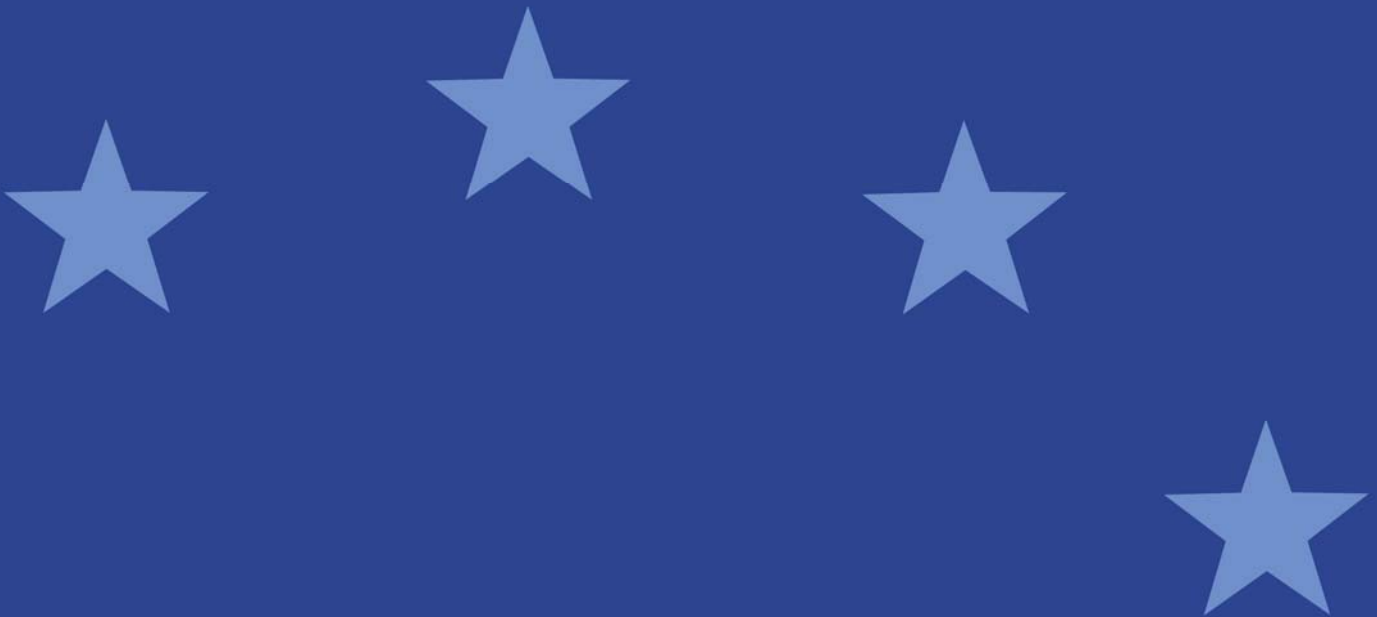


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Annex I: List of European Enforcers

List of abbreviations and acronyms used in this report

CA	Competent Authority
CESR	Committee of the European Securities Regulators
EEA	European Economic Area
EECS	European Enforcers Coordination Sessions
EU	European Union
IASB	International Accounting Standards Board
IFRS	International Financial Reporting Standards
IFRS IC	International Financial Reporting Standards Interpretation Committee
US SEC	United States Securities Exchange Commission
JFSA	Japanese Financial Services Authorities

Executive Summary

This report provides an overview of the monitoring of compliance of financial information with International Financial Reporting Standards (IFRS) and the taking of appropriate enforcement action in the European Economic Area (EEA) in the year to 31 December 2010. The report is based on the activities of the European Enforcers Co-ordination Sessions (EECS) which operates under the oversight of the Corporate Reporting Standing Committee of the European Securities and Markets Authority (ESMA). The main objective of EECS is to co-ordinate the enforcement activities of Member States in order to increase convergence amongst European enforcer's activities which should contribute to fostering investor confidence.

ESMA is pleased to report that European enforcers have maintained a similar level of review of accounts as in previous years. The economic conditions have continued from 2009 into 2010, posing some challenges to issuers in their preparation of financial information and have indicated the need to pay increased attention to specific complex areas. An example is the disclosures on financial instruments which have been the subject of a specific follow-up review which has indicated that there has been improvement in some areas previously considered unsatisfactory by European enforcers.

As a result of IFRS enforcement activities in 2010, around 20% of the approximately 700 actions taken in Europe have been subject to coordination at EECS level. The accounting issues giving rise to actions arose in all areas covered under IFRS, and most frequently related to: recognition, measurement and disclosures of financial instruments, application of new requirements for operating segments, disclosure on impairment of non-financial assets, measurement and presentation of non-current assets held for sale and discontinued operations or aspects related to share-based payments. A range of topics has also been discussed with representatives of the IFRS Interpretations Committee (IFRS IC), as part of the regular feedback EECS is providing to the IFRS IC.

In its continuing efforts to contribute to the quality of future financial reporting under IFRS on a global basis, ESMA has maintained its regular dialogue with third country authorities which have adopted or are in the process of adopting IFRS, such as the US Securities and Exchanges Commission (US SEC) and Japanese Financial Services Authority ("JFSA"). It is also pleased to report that a second seminar of global IFRS enforcers has been arranged to be held in December 2011 which will allow European Enforcers to continue to share experience with fellow regulators outside Europe.

ESMA will continue to communicate with the market on matters relating to the future development of European enforcement activities.



Following the passing into law of European Regulation No 1095/2010 of the European Parliament and of the Council, the Committee of the European Securities Regulators (CESR) became the European Securities and Markets Authority (ESMA) with effect from 1 January 2011. As the successor organisation to CESR, ESMA will complete all engagements entered into by CESR in existence at the transition date.

I INTRODUCTION

1. The aim of this report is to provide a review of the activities of accounting enforcers within the European Economic Area (European enforcers), during the year to 31 December 2010.
2. The report is intended to be of interest to all market participants, including European issuers, investors on European markets, auditors, other regulators and the general public.
3. This report aims to:
 - provide an overview of enforcement activities in the EEA and the coordination of enforcement through EECS;
 - present the outcome and some tentative conclusions relating to the enforcement of IFRS; *and*
 - provide a summary of EECS engagement with third country accounting enforcers.
4. The report draws on EECS activities during 2010 and additional information provided by European enforcers relating to:
 - Ex-ante activities incurred as part of the preparation of the annual review process;
 - Findings in respect of reviews conducted in 2010;
 - Actions taken to improve the quality of future financial reporting;
 - Decisions and emerging issues discussed during EECS meetings in the year;
 - Details of reports published by national enforcers on their enforcement activities; *and*
 - The range of actions available to them.
5. This document also reports on the programme of co-operation between ESMA's Corporate Reporting Standing Committee and third country authorities in the enforcement area. The content of this section is largely derived from the outcome of meetings held between ESMA, competent authorities (CAs) and the US SEC, reports by CAs about progress made in signing individual protocols of cooperation with the US SEC and the extent to which these protocols have facilitated co-operation between regulatory authorities. In addition new contacts have been established with other third country authorities such as the Japan FSA.

II DESCRIPTION OF ENFORCEMENT IN EUROPEAN ECONOMIC AREA

6. This section provides a description of the main features of the European enforcement system, the coordination of which at European level takes place through EECS. Enforcement activity refers to the monitoring of compliance of financial information with the applicable reporting framework and the taking of appropriate measures in respect of infringements discovered in the course of compliance reviews.

A) ESMA's European enforcers' coordination sessions (EECS)

Objectives

7. EECS is a forum organised by ESMA in which national enforcers exchange views and discuss experiences relating to the enforcement of financial reporting standards. Currently 38 organisations from 29 countries are represented in EECS.
8. EECS aims to promote a high level of consistency amongst enforcers in the decisions they take in respect of their reviews of financial statements. Consistency is achieved through analysis and discussion of decisions taken, or to be taken, by European enforcers relating to the application of IFRS. Through EECS, European enforcers are also able to share and compare their practical experiences on the enforcement of the IFRS financial information provided by companies who have or who are in the process of having securities admitted to trading on a regulated market in Europe.
9. The framework of enforcement activity was established by ESMA (at that time, CESR) by issuing two principles based standards: Standard No. 1 – Enforcement of standards on financial information in Europe (CESR/03-0731) and Standard No. 2 – Co-ordination of enforcement activities (CESR/03-317c2), accompanied by Guidance for implementation of co-ordination of enforcement of financial information (CESR/04-257b3), see also section 1.3. CESR decided in 2010 to review the CESR Standards on Enforcement of Financial Information to take into account experience gained in using the standards over the last 5-6 years.
10. EECS also aims to contribute to the harmonization of the application of IFRS in Europe by identifying areas which are not covered by financial reporting standards or which may be open to widely diverging interpretations for referral to the IASB or the IFRS IC, as appropriate.

¹ <http://www.esma.europa.eu/popup2.php?id=192>

² <http://www.esma.europa.eu/popup2.php?id=2046>

³ <http://www.esma.europa.eu/popup2.php?id=2557>

Enforcer decisions and emerging issues discussed during EECS meetings

11. To facilitate the sharing of enforcement decisions and experiences, Standard No 2 provides for the establishment of an internal database to which European enforcers are obliged to submit decisions they have taken as part of their national enforcement processes according to established submission criteria. The criteria are set out in full in the “Guidance for implementation of co-ordination of enforcement of financial information” and include material misstatement, general interest, complexity of facts and circumstances and potential to conflict with other decisions taken by European enforcers.
12. EECS met 8 times during 2010, with a significant part of the meetings being dedicated to the discussion of decisions submitted by national enforcers. As of 31 December 2010, around 420 decisions had been entered onto the EECS database, 120 of these being entered in 2010, of which the most complex were analysed in meetings held during the year.
13. The agenda for EECS meetings also provides for discussion of emerging issues where enforcers can summarise the facts and circumstances relating to cases they are currently considering and look for guidance and assistance from other enforcers in advance of deciding on the case in hand. Other enforcers may have dealt with similar issues or be able to offer advice about how to approach an issue or to help expand the basis on which a decision might be made. These discussions enable enforcers to better analyse, explain and refine their rationale for making decisions on the basis of what they may learn from other enforcers. Where emerging issues are urgent, perhaps because of the issuer’s reporting timetable, EECS may also discuss matters on an ad-hoc basis between meetings.
14. At the end of 2010, the EECS database contained around 140 emerging issues, of which 34 were submitted and discussed in 2010.

Publications

15. In line with Standard No 2, ESMA regularly publishes enforcement decisions to contribute to the promotion of market confidence and the convergence of the application of IFRS. As of 31 December 2010, a total of 110 decisions had been published, spread across 9 packages, 2 of which, containing 32 decisions, were published during 2010 (CESR 10-8344, and 10-11585). ESMA plans to publish further packages on a regular basis. Published decisions are also communicated to IOSCO and are included in the IOSCO database.
16. If particular issues arise during the year, EECS may undertake specific targeted reviews. In 2010, due to its particularly high importance in a period of financial crisis, ESMA performed a follow-up review exercise on mandatory disclosures under IFRS 7 – Financial instruments: Disclosures. In October 2010, CESR published a Follow-up Statement on Application of Disclosure requirements related to financial instruments in the 2009 Financial Statements (CESR/10-11836). The purpose of the statement was to provide an update on the CESR Statement Application of disclosure requirements related to financial instruments in the 2008 financial statements of financial institutions (hereafter CESR Statement 09-8217), in accordance with CESR’s commitment to report to the market on subsequent

⁴ <http://www.esma.europa.eu/popup2.php?id=6979>

⁵ <http://www.esma.europa.eu/popup2.php?id=7293>

⁶ <http://www.esma.europa.eu/popup2.php?id=7297>

⁷ <http://www.esma.europa.eu/popup2.php?id=6156>

developments in this area. The study presented the main enforcement actions taken by European regulators with respect to 2008 IFRS financial instruments disclosures and the effects those actions had on the 2009 financial statements of European issuers. For further detail see paragraph 43.

Meetings with IFRS IC

17. In 2010, EECS organised 2 meetings with IFRS IC representatives in order to discuss complex issues identified by European enforcers for which either there is no specific IFRS guidance or where widely diverging interpretations appeared to exist. 13 issues were addressed in these meetings and included:
 - specific issues related to the application of the new standards IFRS 8 – *Operating segments*;
 - aspects of recognition of impairment losses related to loans of financial instruments;
 - impairment testing of goodwill in the case of complex organisational structures (matrix);
 - aspects of the application of the criteria related to service concession agreements; *and*
 - issues related to the classification of current/non current debt in the specific case of a re-negotiation of loans granted to the issuer.
18. The meetings also gave enforcers the opportunity to provide the IFRS IC with feedback on how standards are being applied in practice and to indicate where there might be a degree of uncertainty as to how they are being interpreted.

Working groups

19. In addition to discussing decisions and emerging issues, EECS provides national enforcers with the opportunity to discuss other matters relevant to their enforcement activities and to develop a better understanding of processes and procedures within enforcement authorities across Europe through reviews or working groups. In 2010, supporting the continuous development of optional tools available to European enforcers, a working group updated and improved the internal IFRS checklist to assist enforcers with their review processes.
20. *Revision of enforcement standards:* In 2009, a group was set up to investigate the range of actions available to European enforcers and to identify the circumstances in which these had been used since the establishment of EECS in 2005 based on decisions submitted to the database. The outcome of the investigation has been used as input for the work on the revision of enforcement standards which started in 2010 (see also section II.A).
21. *Materiality concept:* A group that would work on materiality issues in financial reporting and enforcement was established in 2010. The main objective of the work is to prepare a paper analysing and identifying common principles related to establishing materiality as understood under IFRS.
22. *Enforceability issues:* A group within EECS is in charge of identifying tools to be used in the enforcement of specific areas and initiating discussion on practical enforcement issues that might arise in the future application of new standards. The group then selects issues and addresses them to the IFRS IC, if appropriate. In 2010, issues related to the identification of the chief operating decision maker and aggregation of operating segments under IFRS 8 were communicated to the IFRS IC. As

indicated in its work priorities for 2011, ESMA will undertake a post-implementation review of the application of IFRS 8 by European issuers.

23. EECS also provides enforcers with the means of sharing their national publications with fellow enforcers – e.g. enforcers' Activity Reports and other announcements to national markets on issues relating to the monitoring of IFRS. These papers are often tabled for presentation during EECS meetings.

B) General information about European enforcers

24. The harmonisation of enforcement in Europe is desirable in order to contribute to the creation of an efficient single capital market within the context of evolving EU legislation.
25. In accordance with article 24.1 of the Transparency Directive, a Competent Authority for enforcement of financial information is designated in each Member State within the European Economic Area. Other bodies are allowed to carry out enforcement either in their own right or on behalf of the competent administrative authorities, providing that these bodies are supervised by, and responsible to, the relevant competent administrative authority. Only Germany and Sweden made use of that option to delegate enforcement from the competent authority. In most countries enforcement is carried out by one single authority. In the United Kingdom and Ireland two authorities are involved: one authority deals with periodic financial reports; the other with financial information in prospectuses. In Denmark there is one authority which deals with financial information in prospectuses as well as periodic financial information of financial entities and one authority which deals with periodic financial reporting by non-financial entities. Portugal has a similar system as Denmark.
26. Irrespective of the different structures adopted by national enforcers which can lead to different processes and scopes of activity, all national enforcers serve a single and common objective – to promote market confidence and protect investors by contributing to the transparency of financial information relevant to investors' decision making processes. A key focus of enforcers' work is the application of IFRS in financial statements.
27. While the scope of enforcement under the Transparency Directive covers all reporting frameworks that might be applicable to listed issuers, including national GAAPs when applied to non-consolidated financial statements or third country accounting standards for non-European issuers, this report focuses only on enforcement activities related to IFRS financial statements, and takes no account of any other monitoring activity.

C) Enforcement in Europe

28. Standard No. 1 refers to a range of corrective and other actions that may be taken by enforcers in respect of infringements of relevant reporting requirements in annual or interim financial reports.

29. Enforcers also seek, more generally, to improve the quality of future financial reporting in Europe. In order to achieve this, many enforcers engage in ex-ante activities designed to provide helpful guidance to issuers in advance of the preparation of their financial information.

Ex-ante activities

30. Ex-ante activities may include the following:

- *Issuance of alerts indicating the main areas of examination for the forthcoming financial year:* many European enforcers announce their main areas of focus ahead of the next reporting period before issuers commence the preparation of their accounts. In 2010, a number of enforcers focused on the following areas: financial instruments, impairment of assets, presentation of financial statements and operating segments.
- *Pre-clearance:* in some jurisdictions, issuers may approach their enforcer for formal notification in advance of their accounts preparation for a decision on whether their proposed accounting treatment for a specific transaction or reporting area is in accordance with the relevant reporting framework. Pre-clearance takes different forms in different countries but may include a comprehensive written description of the specific facts and circumstances underlying the issue; a detailed analysis of the options available with respect to the accounting treatment and a rationale supporting the issuer's proposal. The benefit of pre-clearance is that it can help to ensure that non-compliant information is avoided in the preparation of IFRS financial statements.
- *Open seminars with issuers and auditors in advance of the interim or year-end financial reporting.*

Review of financial statements

31. A review of a set of financial statements refers to the process of analysing financial information for compliance with the requirements of the relevant reporting framework. Such a review may cover a company's full set of financial statements (full review) or only certain areas (partial review).
32. The selection of issuers whose accounts are subject to a full review is based on CESR Standard No.1 and its application guidance which advocates a risk-based approach combined with random selection or rotation. This approach depends on both the probability of a material misstatement in the financial statements and the potential impact of such a misstatement on market confidence and investor protection.
33. The partial review, by definition, does not involve the enforcer analysing all areas of the financial statements for compliance with the reporting requirements. Partial reviews might be prompted by a number of considerations including known areas of non-compliance by issuers in previous years, first time application of mandatory standards or areas of particular focus given the economic climate or trading conditions.
34. Where potential infringements of the reporting framework are identified on review, they are brought to the attention of the issuer. Following exchanges of correspondence and/or meetings with the issuer in which the enforcer may ask for additional information or explanation and, possibly, discussion at EECS, the enforcer makes a decision whether or not the treatment adopted by the issuer complies

with the relevant reporting framework. After taking into account the materiality of the issue, materiality being consistently defined for both reporting and enforcement purposes (CESR Standard no. 1) , if the enforcer concludes that the treatment is not acceptable, the case may result in one or more of the enforcement actions set out below.

35. If the infringement is considered material:

- *Issuance of new financial statements accompanied by a new audit opinion (where applicable):* this action entails the withdrawal of the original accounts and issuance of revised financial statements which may be subject to a new audit opinion;
- *Public corrective note or other type of communication to the public:* this may mean a press release either by the issuer or the enforcer informing the market of the error and the effect of the corrective action in advance of the issuance of the next annual or interim financial statements;
or
- *Correction in the next financial statements:* the issuer adopts an acceptable treatment in the next accounts and corrects the prior year by restating the comparative amounts through applying IAS 8 – *Accounting Policies, Changes in Accounting Estimates and Errors* or otherwise includes additional disclosures not requiring the restatement of comparatives.

36. If the infringement is found not to be material:

- *Notification of the issuer of the infringement* but normally no information is published to the market.

III ANALYSIS OF FINDINGS IN RESPECT OF THE APPLICATION OF IFRS

37. This section focuses on the main findings coming out of enforcement activities in 2010 and the areas where issuers were most often challenged by European enforcers.

A) Main results of the review process in 2010

38. In 2010, European enforcers performed full reviews of around 1,000 compared to 1,200 in 2009 companies' accounts (annual and interim), covering in the region some 15% of listed entities in Europe. The coverage from one country to another varies because of the very different number of issuers across jurisdictions and diversity in their size and risk profile.
39. In addition, some 700 accounts compared to 900 in 2009 were subject to partial review, representing coverage of 10% of the population of listed entities. The main themes arising from the sample of listed entities selected by European were:
- impairment of assets;
 - financial instruments disclosure;
 - operating segments;
 - going concern; *and*
 - current/non-current classification of liabilities.
40. In terms of enforcement actions taken by the enforcers as a result of their reviews, these can be split as follows:
- 22 (in 2009: 19) actions required issuance of revised financial statements;
 - around 220 (in 2009:160) actions required public corrective notes or other public announcement;
 - around 380 (in 2009:560) actions required corrections in future financial statements.

Enforcers also took other actions, such as a notice to the issuer, but without requiring any corrective action or public announcement.

B) Overall assessment of the quality of IFRS reporting in Europe

41. Since the first application of IFRS in Europe in 2005, issuers of financial information have developed significant experience in IFRS accounting which is reflected in the quality of their financial reporting which, generally, European enforcers have found to have improved year on year. Nevertheless, based on the number of actions taken during 2010, competent authorities consider there is still room for improvement in the quality of issuers' financial reporting.
42. In 2010, companies have continued to face risks to their businesses as a result of the continuing generally unfavourable economic climate. Within this context, the disclosure of the possible impact of risks and uncertainties faced by the issuers regarding judgements and estimates used in the preparation of financial information has gained even more importance. Nevertheless, there are still issuers that have not achieved a satisfactory level of transparency, mainly because of their continued use of

boiler-plate disclosures rather than attempting to accurately describe facts specific to the issuer and/or transaction.

43. An area to which enforcers paid particular attention was information related to financial instruments. As stressed in CESR's Follow-up Statement (CESR/10-11838), the results of the review performed on the 2009 IFRS financial statements of a sample of financial institutions indicated significant improvements in the level of compliance of disclosures related to: valuation techniques, own credit risk, credit risk, day one profit or losses and special purposes entities. Other areas, like the new requirements with respect to the fair value hierarchy and qualitative disclosures on risks arising from financial instruments still need to be given more attention by issuers.
44. Application of the new standard on segment reporting raised a number of issues. While the first reviews performed have indicated some concerns in the area of the aggregation of operating segments for reporting purposes and the identification of the chief operating decision maker, European enforcers will continue to monitor this area in future reviews in order to gain a global understanding of all potential issues related to the application of the new standard.

C) Recurring issues identified by European enforcers

45. The examples presented under this section reflect those areas that featured more commonly in decisions brought to EECS for discussion and where value is seen in sharing experiences and regulatory responses. In some cases, problems arose simply because of the alternative accounting treatments which might be acceptable under the relevant standard. Discussion at EECS was intended to raise the level of consistent application and enforcement of the standards subject to the specific facts and circumstances pertaining to the decisions under discussion. The following paragraphs reflect those areas which featured more frequently in approaches to companies and where relatively more infringements were detected which required corrective action.
46. The following examples are not intended to represent all types of issues discussed at EECS nor even all areas where application of IFRS had been challenged by national enforcers; they are merely illustrative of some of the more frequent questions raised.

Financial Instruments

47. Within the IFRSs, financial instruments are dealt with in IAS 32 – Financial Instruments: Presentation, IAS 39 – Financial Instruments: Recognition and Measurement and IFRS 7 – Financial Instruments: Disclosures. The following issues have been those most frequently observed by the enforcers during their enforcement process:
48. Impairment of financial assets available for sale: Issues relating to the impairment of equity instruments classified as assets available for sale and measured against the notion of a “significant or prolonged decline in fair value below cost” had been identified as part of the 2009 enforcement process. In 2010, this area continued to be one which caused issuers problems either in terms of how to de-

⁸ <http://www.cesr-eu.org/popup2.php?id=7297>

termine the criteria used by the entity to establish whether objective evidence existed or in terms of disclosure of the accounting policy applied.

49. Fair value hierarchy: The fair value hierarchy, as defined under IFRS 7 paragraph 27A focuses on the methods used to determine fair value and the inputs used in valuation techniques. Valuation techniques are affected by the availability of inputs used for valuation, requiring judgment and consideration of factors specific to the asset or liability being measured. Enforcers identified cases where the level of fair value hierarchy disclosed did not accurately reflect the nature of the inputs used.
50. Disclosure of risks arising from financial instruments: IFRS 7 identifies qualitative and quantitative disclosures to be provided by an entity regarding the nature of the risks to which the entity is exposed. There were cases where disclosures provided by the issuer tended to be boiler-plate, minimal in nature, and of limited usefulness to users of the financial statements other than shareholders. For example, financial statements did not adequately include information related to price risk, sensitivity analysis and counterparty risk disclosures.

Impairment of non-financial assets

51. Impairment testing remained of high importance in 2010 as economic conditions generally meant that many preparers would still be faced with potentially impaired assets. Impairment of non-financial assets is dealt with in IAS 36 – Impairment of Assets.
52. Measurement of impairment loss: The economic downturn which started in 2007, continued to have an impact on the capital markets throughout 2009 and there were issuers that had to recognise impairment losses on goodwill and other non-financial assets in their 2010 financial statements. As part of the review of the assumptions used by issuers in determining the recoverable amount related to cash generating units, enforcers challenged issuers regarding their business plans and the discount rates used. Some issuers were not able to justify and appropriately support assumptions used and in some cases adjustments were necessary.
53. Disclosures on impairment losses: Enforcers reviewed the disclosures made by the issuers to see whether adequate information had been provided with respect to the circumstances triggering recognition of an impairment loss. Some issuers did not explain the triggering event properly, as required by IAS 36 paragraph 130 (a), including boiler-plate language instead of providing specific information related to the facts and circumstances that had led to the recognition of an impairment loss. Other issuers had not provided the information required under IAS 36 paragraph 134 with respect to the key assumptions used for determining the value in use or any change in those assumptions compared to the previous year. Very often, the key assumptions disclosed would be those relating to long term growth rates and the selection of the pre-tax discount rates. These, however, are not key assumptions as they are applied to the cash flow forecasts that have been derived from the underlying budgets and forecasts. It follows, therefore, that the key assumptions that should be disclosed also are those made in preparing the budgets and forecasts that underpin the cash flow projections used to derive the value in use.

Operating segments

54. Although some issuers adopted IFRS 8 earlier, more widely the standards was first applied by issuers in the 2009 interim reports. ESMA has considered the need to analyse the application of IFRS 8 in more detail and will publish a post-implementation review later in 2011.
55. *Identification of operating segments:* The standard requires companies to identify the function of the Chief Operating Decision Maker (CODM), this being a critical step in the identification of operating segments. It appears in practice that issuers are of the view that allocating resources and assessing performance are not always carried out by the same person or using the same sets of information. The identification of a CODM at too high level in an entity, such as a board of directors (including non-executive directors), could lead to the identification of discrete financial information prepared at a high level of aggregation and, therefore, the disclosure of segmental information would not reflect that used by the entity to make operating decisions. Disclosure in the financial statements of the factors used for identifying operating segments was sometimes missing or insufficiently explicit to allow readers a proper and clear understanding of the relevant factors.
56. *Aggregation of operating segments:* The standard requires disclosure of the factors used to identify the entity's reportable segments including the basis of organisation which would include, for example, whether operating segments have been aggregated. Operating segments may be aggregated if all of the aggregation criteria specified in the standard are met. Neither the standard, nor the basis for conclusions provide any further guidance on what is meant by the term "similar economic characteristics" or on how this concept should be applied. There were cases where operating segments had been aggregated into one or several reporting segments but where no explanation had been provided as to which individual operating segments had been aggregated, or as to whether an assessment had been made that aggregation criteria in the standard had been met.

Share-based payments

57. Recognition, measurement and presentation of share-based payments is governed by IFRS 2 – *Share-based payments*.
58. *Scope of application and classification:* The scope of application of IFRS 2 has been clarified by IFRIC 8 – *Scope of IFRS 2* and IFRIC 11 – *Group and Treasury Share Transactions* in previous years and has recently been further clarified through additional amendments to the standard, including the incorporation of the provisions of IFRIC 8 and IFRIC 11. Nevertheless, enforcers have identified some cases where the requirements have been incorrectly applied which have led to misclassifications of transactions falling within the scope of the standard.
59. *Measurement of fair value of equity instruments granted:* Measurement of equity instruments granted under share-based payment arrangements requires a good understanding of the conditions attached to the transaction and particular attention needs to be paid to identifying the parameters to be considered as part of the valuation process. Enforcers found cases where inputs to option pricing models had not been carefully considered, notably in cases where a "discount" had to be applied. The determination of the impact of various vesting conditions also posed challenges in some cases to issuers.

Non-current assets held for sale and Discontinued Operations

60. The main requirements for the classification, measurement and presentation of non-current assets held for sale are dealt within IFRS 5 – *Non-current assets held for sale and discontinued operations*.
61. *Classification as non-current assets held for sale:* As a result of the difficult credit conditions, a number of transactions (acquisitions and disposals) suffered significant delays. Consequently management was confronted with situations where a delay of more than one year was exceeded and therefore, had to assess whether the conditions for classifying assets as non-current held for sale at the end of the reporting period were met.
62. *Measurement of the non-current assets held for sale:* The provisions under IFRS 5 refer only to the measurement of non-current assets held for sale, while the disposal group may contain current and non-current assets and liabilities. There were cases where a lack of additional guidance led to divergence in views over the recognition and measurement of items not within the scope of IFRS 5. These issues have been brought to the attention of the IFRS IC.
63. *Presentation of discontinued operations:* The need for a component of an entity that is disposed of or classified as held for sale, to be a separate “major line of business” as required under IFRS 5 has posed challenges due to interaction with the definition of an operating segment under IFRS 8. In the absence of any definition or interpretative guidance as to what constitutes a separate ‘major’ line of business an assessment of those items appears difficult to arrive at in certain cases.

Presentation of Financial Statements

64. The presentation of financial statements is dealt with by IAS 1 – *Presentation of Financial Statements* for full financial statements and IAS 34 – *Interim Financial Reporting* in the case of interim reports. IAS 7 – *Cash Flow Statements* prescribes the rules for the preparation and presentation of the statement of cash flows. The most common issues where enforcers reported non-compliance relating to presentation issues were as follows:
65. *Long term/ short term classification:* The effects of the financial crisis continued to be observable throughout last year. A number of entities were obliged to classify long-term loans as current financial liabilities because of breaches of covenants which rendered the loans technically repayable on demand. IAS 1 requires a liability to be classified as current if a provision of a long-term arrangement is breached on or before the end of the reporting period even if the lender, after the balance sheet date, agrees not to demand repayment. Enforcers found that some issuers had not complied with this requirement and required them to reclassify. As in the previous year, this area continued to be an area of concern for enforcers who identified cases of non-compliance in the classification of financial liabilities.
66. *Disclosure of information related to breach of covenants:* IAS 1 provides an overarching requirement for management to disclose their judgements underlying the application of accounting policies and major sources of estimation uncertainty. As noted above, the financial crisis increased focus on the judgments and estimates made by management in an unstable economic environment with users seeking to understand the extent to which the accounts were affected. Issuers often did not provide sufficient relevant disclosure on situations where there had been breaches of covenants.

67. *Use of alternative performance indicators:* IAS 1 provides that additional line items, headings and subtotals should be presented on the face of the income statement where such presentation is relevant to an understanding of the entity's performance. In its 2009 Activity Report on IFRS enforcement, CESR had already identified that issuers were unnecessarily including additional line items and headings, which impaired the comparability of common operating items. Similar cases have been found also as part of the 2010 IFRS enforcement process.
68. *Treatment of foreign exchange differences statement of cash flows:* The continuing volatility in foreign exchange rates seemed to cause difficulty for issuers in dealing with the effects of foreign exchange in their statements of cash flows. Examples were seen of foreign exchange differences being reported in the reconciliation of operating profit to cash flows from operations when the underlying exchange differences were not included in the income statement and the reporting of effect of foreign exchange differences on cash and cash equivalents on the face of the statement of cash flows included the foreign exchange differences on the re-translation of non-cash balances.
69. *Capital management:* IAS 1 requires entities to disclose information that enables users of its financial statements to evaluate the entity's objectives, policies and processes for managing capital. Paragraph 135 of the standard sets out the information that should be disclosed to meet the requirements of paragraph 134. Frequently, the disclosures in this area tended to be boiler-plate rather than tailored to the entity's specific situation. The main deficiencies were a failure to explain clearly what was managed as capital or how the disclosed objectives were met. On occasions, issuers reported financial measures such as gearing ratios without explaining what reflected an optimal level for their circumstances and the reasons for any variance from their target measure.

Investments in associates

70. *IAS 28 – Investments in Associates* deals with accounting for investments in associates.
71. *Impairment of investments in associates:* IAS 28 paragraph 33 makes reference to IAS 36 in setting out how to calculate impairment losses recognisable on investments in associates. Deterioration of market conditions in 2010 brought the need to assess whether impairment losses had to be recognised in respect of investments in associates. Enforcers identified cases in which issuers did not have access to the internal planning systems of the associate and had to use alternative methods for determining recoverable value which did not comply with the requirements of the standard.
72. *Accounting for changes from available for sale to investments in associates:* IFRS does not specifically deal with such changes and enforcers have found diversity in practice: issuers applied either a method similar to the step acquisition method under previous IFRS 3 – *Business Combinations*, or they used the fair value of the available for sale instrument on the date significant influence was obtained as the cost of the associate. The issue has been brought to the attention of the IFRS IC.

Revenue recognition

73. Revenue recognition is dealt with in IAS 18 – *Revenue recognition* and IAS 11 – *Construction contracts*. Revenue recognition principles under IFRS have not been changed for a number of years. The standard is currently under revision. Consequently, as permitted under IAS 8 paragraph 12, management may also consider the most recent pronouncements of other standard-settings bodies that use a similar conceptual framework for developing accounting standards.

74. *Multiple-element arrangement:* IAS 18 is very brief with regards to the recognition principles for multiple-element arrangements. Identification of all components of such arrangements has still been problematic for some issuers, resulting in inappropriate recognition of revenues over the period of the provision of the services. In addition, situations were identified where significant judgement had to be applied in order to analyse whether the changes in the substance of the transaction were sufficiently relevant to justify a change in the accounting policy of the issuer.



IV ESMA'S CO-OPERATION WITH THIRD COUNTRY AUTHORITIES

A) Co-operation with the US SEC

75. In 2006, CESR and the US SEC signed a work plan aimed at promoting high quality and consistent application of reporting standards and avoiding conflicting regulatory decisions on the application of both IFRS and US GAAP. In order to fulfil the objectives of the work plan, the two parties met twice in 2010 to discuss areas of common interest or concern. As part of the delegation, the Chair of EECS participated in both meetings.

Enforcement issues

76. As part of the dialogue on the outcome of accounting enforcement in 2010, the following areas were identified as causing problems in the application of both sets of standards: application of the management approach and of the aggregation criteria for operating segments; parameters used as part of the determination of impairment of non-financial assets, identification of components of multiple element arrangements, recognition of deferred tax assets.

Accounting issues - convergence

77. An important aspect discussed during the meetings with the SEC was the development of the IASB/FASB Memorandum of Understanding and in particular the standards the Boards are developing in the area of financial instruments accounting, revenue recognition and leases.

Exchange of information

78. At the end of 2010, about one third of European countries had signed individual protocols with the SEC relating to the exchange of confidential information relating to dual listed issuers. The SEC has indicated that it will continue to remain in contact with other European enforcers on a case by case basis.

B) Co-operation with other enforcers

79. As part of its objective to expand cooperation with enforcers from countries having adopted or in course of adopting the IFRSs, ESMA initiated contact with the Japanese Financial Services Authority which has led to various exchanges of information regarding the state of IFRS adoption and enforcement in Japan.

Appendix I – List of European enforcers

Member State	Competent Authority	
Austria	Financial Market Authority	FMSA
Belgium	Financial Services and Markets Authority	FSMA
Bulgaria	Financial Supervision Commission	FSC
Cyprus	Cyprus Securities and Exchanges Commission	CySEC
Czech Republic	Czech National Bank	CNB
Denmark	Danish Financial Services Authority Danish Commerce and Companies Agency	Finanstilsynet DCCA
Estonia	Estonian Financial Supervision Authority	EFSA
Finland	Finish Financial Supervisory Authority	FIN-FSA
France	Financial Markets Authority	AMF
Germany	German Federal Financial Supervisory Authority Financial Reporting Enforcement Panel	BaFin FREP
Greece	Hellenic Capital Market Commission	HCMC
Hungary	Hungarian Financial Supervisory Authority	HFSA
Ireland	The Central Bank of Ireland Irish Auditing and Accounting Supervisory Authority	CBI IAASA
Iceland	Financial Supervisory Authority	FME
Italy	Companies and Securities National Commission	Consob
Latvia	Financial and Capital Markets Commission	FCMC
Lithuania	Lithuanian Securities Commission	LSC
Luxembourg	Financial Markets Supervisory Commission	CSSF
Malta	Malta Financial Services Authority	MFSA
Netherlands	Netherlands Authority for the Financial Markets	AFM
Norway	Norway Financial Supervisory Authority	NFSA
Poland	Polish Financial Supervision Authority	PFSA
Portugal	Securities National Commission Bank of Portugal Insurance Portugal Institute	CMVM BP ISP
Romania	Romanian National Securities Commission	CNVMR
Slovakia	National Bank of Slovakia	NBS
Slovenia	Securities Market Agency	SMA
Spain	Spanish Securities Market Commission	CNMV
Sweden	Swedish Financial Supervisory Authority The Nordic Growth Market Nasdaq OMX Stockholm	Finansinspektionen NGM AB Nasdaq OMX
United Kingdom	Financial Services Authority Financial Reporting Review Panel	FSA FRRP