Special Interest Workshop

Regulatory update

JEROEN HOOIJER
Head of Unit of Financial Reporting Policy
DG Internal Market and Services
European Commission

SOPHIE BARANGER
Chief Accountant
French Autorité des Marchés Financières
Chair
IFRS Project Group, CESR

RICHARD THORPE
Accounting and Audit Policy Sector Leader and Head of
Accounting and Audit Policy Department
UK FSA

JULIE ERHARDT
Deputy Chief Accountant
US SEC

Chair:
AMARO GOMES
Member
IASB
Regulatory Update

24 June 2010—at the Hilton London Metropole (United Kingdom)

Programme

13:00  Registration

14:00  Introduction
Amaro Gomes
Member
IASB

14:05  European Commission
Jeroen Hooijer
Head of Unit of Financial Reporting Policy, DG Internal Market and Services
European Commission

14:30  CESR-fin
Sophie Baranger
Member EECS – European Enforcement Coordination Sessions and
Member, CESR-fin

14:55  United Kingdom
Richard Thorpe
Accounting and Audit Policy Sector Leader and Head of Accounting and Audit Policy Department
UK Financial Services Authority

15:20  United States of America
*Julie Erhardt
Deputy Chief Accountant
US SEC

15:45  Round-table Q&A
Chair:
Amaro Gomes, Member, IASB

Panellists:
- Jeroen Hooijer, Head of Unit of Financial Reporting Policy, DG Internal Market and Services
  European Commission
- Sophie Baranger, Member EECS and Member CESR-fin
- Richard Thorpe, Sector Leader and Head of Accounting and Audit Policy Department, UK FSA
- Julie Erhardt, Deputy Chief Accountant, US SEC

16:25  Concluding comments
Amaro Gomes
Member
IASB

*Subject to confirmation
Today’s presentation

- How CESRfin organises its activities concerning financial reporting by listed entities
- Focus on enforcement activities
CESR and its role in Europe

- **Committee of European Securities Regulators**
- **Established June 2001**
- **3 main objectives:**
  - Improve co-ordination among securities regulators
  - Act as an advisory group to assist the European Commission
  - Work to ensure consistent and timely day-to-day implementation of community legislation in the Member States
- **Most work proliferated through working groups and common consensus**
- **Will be transformed into an EU Agency – European Securities & Markets Agency - effective 1 January 2011**

http://www.cesr-eu.org/ « Standing committees » « Corporate Reporting »
Corporate Reporting Standing Committee (CESR-Fin)

- Responsible for Accounting, Auditing and Periodic Financial Reporting issues
- European Enforcement Coordination Sessions (EECS)
- IFRS Project Group
- CESR-Fin has observers at
  - ARC
  - EFRAG TEG Meetings
  - FEE’s Audit Standard Setters Meetings
  - IASB’s Standards Advisory Council
  - Financial Crisis Advisory Group

The European Enforcers Coordination Sessions

- The European Enforcers Coordination Sessions (EECS) are a forum, organised by CESR, in which CESR members and other EU enforcers, exchange views and discuss experiences on the enforcement of financial information.
- EECS aims to promote a high level of consistency amongst enforcers in their enforcement decisions.
- EECS meets regularly (approximately 7 meetings per year)
  - To analyse and discuss decisions made or about to be made by European enforcers relating to the enforcement of financial information requirements;
  - To identify areas which are not covered by financial reporting standards or which may be open to conflicting interpretations for referral to the IASB or IFRIC; and
  - To share and compare practical experience on the monitoring of the financial information of companies with securities offered to the public or in the process of having securities admitted to trading on a regulated market.
The European Enforcers Coordination Sessions

- Cases discussed at EECS are entered into a confidential CESR database which can be accessed only by all European enforcers.
- As of the end of May 2010, there are 341 decisions in this database (entered by 20 jurisdictions).

![Graph showing the number of decisions entered onto the database per year]

The European Enforcers Coordination Sessions

- These decisions deal with issues relating to almost all applicable standards, including IFRIC interpretations. Problems in terms of:
  - Application of the principles set by a standard or
  - Lack of (or inadequate) disclosures.
- Some standards have obviously created more difficulties or problems are more visible for enforcers as showed by the following graph, which provides the distribution of decisions per standard:
  - 1 out of 5 decisions relate directly to financial instruments;
  - 1 out of 6 decisions relate directly to Financial Statements presentation;
  - 1 out of 9 decisions relate directly to Business combinations.
Examples of disclosures that did not quite hit the mark can be sorted into two main categories:
- disclosures are not adapted to the specific situation of the issuer
- disclosures had not gone far enough

Examples where the standards themselves may have caused difficulties. For instance:
- Difficulties with IAS 39 where preparers struggled
  - (i) assessing the fair value of complex instruments which were no longer traded on a liquid market; or
  - (ii) understanding the meaning of "significant or prolonged decline" (IAS 39.61).
- Difficulties in identifying the acquirer in a business combination (IFRS 3).

CESR’s publications of enforcement decisions

- CESR intends that publishing enforcement decisions gives market participants an insight into how European enforcers analyse whether accounting treatments are within the acceptable range permitted by IFRSs or by IFRIC interpretations.
- CESR is of the view that publishing such decisions together with the rationale behind them also helps towards achieving consistent application of IFRS in the EU.
- In order for a decision to be published, there must be a large consensus on the nature of the decision amongst the enforcers attending a meeting where such publication is approved, and also at CESR-Fin level.
- Decisions dealing with straightforward accounting matters or whose technical merit is deemed low are not published, even when the enforcer has assessed the error to be material and sanctions have been taken.
CESR’s publications of enforcement decisions

- So far CESR has published 7 separate packages of enforcement decisions (the most recent dates from December 2009), containing a total of 88 decisions.
- The next package will be published in July 2010.
- The following graph provides an overview of the decisions published by CESR since 2007:
Examples of decisions published

Decision ref. EEC/ECS/1299-90: Classification of a loan

Financial year end: 31 December 2000 / Investia Financial Instruments
Category of issuer: Classification of loan
Standard reference: AAS 1
Date of the decision: 23 April 2000

Description of the issuer's accounting treatment
In November 2000, the issuer decided on an interest payment on an issued bond of USD 101 million. The loan agreement stipulates that such defaults can lead to an obligation to repay the whole of the loan immediately, including accrued interest and expenses. The bondholders, however, issued a waiver permitting the interest payment until 30 December 2000. On 17 December, the issuer announced a meeting of the bondholders and requested a further waiver of the interest payment to February 1 2000. The extension was granted by the bondholders at a further meeting held on January 8.

The issuer classified the loan as long term debt in its balance sheet as of 31 December (issued February 2001) on the basis that the loan was not in default at the balance sheet date as the bondholders had issued waivers and had not sought redemption.

The enforcement decision
The issuer stated that the loan should have been classified as short term debt as the issuer did not have unconditional right to defer payment for at least twelve months after the balance sheet date as required by IAS 1, paragraphs 60 and 69 to be classified as short term debt.

Rationale
According to IAS 1, paragraph 41, a liability should be classified as current if it is due to be settled within twelve months after the balance sheet date. Paragraph 41 states that, if an issuer breaches an underlying make a long term loan agreement as on the balance sheet date, such that the debt becomes payable on demand, the loan should be classified as current even if the issuer expects, when this is most likely to occur, to repay the debt within the specified period. Paragraph 54 says that a liability should also be classified as current if a waiver is issued before the balance sheet date, but does not give the issuer a period of grace ending at least twelve months after the balance sheet date.

In the author's opinion, the default on the interest payment in December represented a default that could have led to a claim from the bondholders to impair the value of the loan immediately, including accrued interest and expenses. As the waiver was issued after the balance sheet date, and only postponed payment for a short period, the issuer did not have an unconditional right to defer the payment for at least twelve months after the balance sheet date as required by the standard in order to be classified as long term debt.

---

The decisions are available at www.cesr.eu, in the category "Standing Committees/Corporate Reporting/EECS"
Dialogue with IFRIC representatives

- Since 2007 EECS has established a dialogue with IFRIC and has held several meetings with IFRIC representatives.

- The objective of these meetings is to discuss, on an informal basis, issues which have been raised by EECS members and for which the standards seem to be unclear.

Other CESRfin activities

- In 2009, CESR undertook a review of the application of the amendments to IAS 39 published by the IASB in October 2008. This review dealt with:
  - (i) the interim financial statements for the third quarter of 2008. The results were published in January 2009;
  - (ii) the annual financial statements for 2008. The results were published in July 2009.

- In November 2009, CESR published a review of the application of the disclosure requirements related to financial instruments (IFRS 7) in the 2008 Financial Statements of a sample of 96 financial institutions. CESR is currently undertaking an update of this review as of 31 December 2009.

- During these reviews, CESR has identified areas where the quality of disclosures could be improved and has therefore informed EU issuers that CESR members would focus more specifically on those areas in order to improve information provided to investors.

- The results of these reviews can be found on CESR’s website.
Other CESRfin activities – IFRS Project Group

- CESR-Fin also actively participates in the EU endorsement process by sending its comments to EFRAG on the IASB’s consultations and also by commenting IFRIC’s tentative agenda decisions. For instance:

<table>
<thead>
<tr>
<th>2009</th>
<th>2010</th>
</tr>
</thead>
<tbody>
<tr>
<td>Discussion Papers</td>
<td></td>
</tr>
<tr>
<td>• Preliminary Views on Leases</td>
<td>• Management Commentary</td>
</tr>
<tr>
<td>• Preliminary Views on Financial</td>
<td>• Measurement of liabilities</td>
</tr>
<tr>
<td>Statements presentation</td>
<td>The following projects are still in</td>
</tr>
<tr>
<td>• Credit risk in liabilities measurement</td>
<td>progress:</td>
</tr>
<tr>
<td></td>
<td>• Financial Instruments:</td>
</tr>
<tr>
<td></td>
<td>Classification and Measurement</td>
</tr>
<tr>
<td></td>
<td>• Fair Value Measurement</td>
</tr>
<tr>
<td></td>
<td>• Consolidated financial statements</td>
</tr>
<tr>
<td></td>
<td>• Derecognition</td>
</tr>
<tr>
<td></td>
<td>• Classification of right issues</td>
</tr>
<tr>
<td></td>
<td>• Relationships with the State</td>
</tr>
<tr>
<td></td>
<td>• Rate Regulated Activities</td>
</tr>
<tr>
<td></td>
<td></td>
</tr>
<tr>
<td>Exposure Drafts</td>
<td></td>
</tr>
<tr>
<td>• Financial Instruments:</td>
<td>• Conceptual Framework: The Reporting</td>
</tr>
<tr>
<td>Classification and Measurement</td>
<td>Entity</td>
</tr>
<tr>
<td>• Fair Value Measurement</td>
<td>• Fair Value option for financial</td>
</tr>
<tr>
<td>• Consolidated financial statements</td>
<td>liabilities</td>
</tr>
<tr>
<td>• Derecognition</td>
<td></td>
</tr>
<tr>
<td>• Classification of right issues</td>
<td></td>
</tr>
<tr>
<td>• Relationships with the State</td>
<td></td>
</tr>
<tr>
<td>• Rate Regulated Activities</td>
<td></td>
</tr>
<tr>
<td>Draft Interpretations</td>
<td></td>
</tr>
<tr>
<td>• Extinguishing Financial Liabilities</td>
<td></td>
</tr>
<tr>
<td>with Equity Instruments (D25)</td>
<td></td>
</tr>
<tr>
<td>IFRIC tentative decisions</td>
<td>• IFRS 5 – Reversal of disposal group</td>
</tr>
<tr>
<td>• Meaning of “significant or prolonged”</td>
<td>impairment losses relating to goodwill</td>
</tr>
<tr>
<td>Date</td>
<td>Subject</td>
</tr>
<tr>
<td>----------</td>
<td>-------------------------------------------------------------------------</td>
</tr>
<tr>
<td>03 May 10</td>
<td>Comment letter on IFRSAC’s amended draft response on the IASB’s Exposure Draft Measurement of Liabilities in IAS 37</td>
</tr>
<tr>
<td>23 Apr 10</td>
<td>Comment letter on IFRSAC’s Institute Agenda decisions on IFRS 7 Non-current Assets Held for Sale and Discontinued Operations – Measurment of Disposal group equipment (issues relating to goodwill)</td>
</tr>
<tr>
<td>23 Mar 10</td>
<td>Comment letter on IFRSAC’s draft response on the IASB’s Exposure Draft Measurement of Liabilities in IAS 37</td>
</tr>
<tr>
<td>18 Feb 10</td>
<td>Comment letter - IASB comments on IFRSAC’s draft response on the IASB’s ED Management Commentary</td>
</tr>
<tr>
<td>09 Dec 08</td>
<td>Comment letter - IFRSAC’s draft comment letter on the IASB’s Exposure Draft Rate-Based Regulated Activities</td>
</tr>
</tbody>
</table>

**Press releases – CESR by itself international supervisors to discuss worldwide enforcement of IFRS**

07 Dec 08: Press release – CESR by itself international supervisors to discuss worldwide enforcement of IFRS

05 Nov 2010: Comment letter to IFRSAC’s draft comment letter on the IASB’s Exposure Draft Improvements to IFRS

02 Nov 2010: Press release – CESR by itself international supervisors to discuss worldwide enforcement of IFRS

01 Nov 2010: Statement on application of disclosure requirements related to financial instruments in 2009 financial statements

21 Oct 2009: Comment letter on the consultation on the Adoption of International Standards on Auditing

02 Oct 2009: CESR’s comment letter to IFRSAC’s draft response on the ED Discount Rate for Employee Benefits

17 Sep 2009: CESR’s response to IFRSAC’s draft comment letter on the IASB’s Exposure Draft Rate-Based Regulated Activities

---

**IASC FOUNDATION IFRS CONFERENCE**

**REGULATORY UPDATE**

**CESRfin**

**Sophie BARANGER**

Chief Accountant - Autorité des Marchés Financiers

London - 24 June 2010
UK Regulatory Update

Richard Thorpe
Accounting & Audit Policy Sector Leader
Financial Services Authority

Topics

• Banks’ disclosures
  – FSA Discussion Paper and FSA Accounting Review Team
  – Other disclosure initiatives
  – The role of Auditors

• Fair values and financial stability
The financial crisis raised questions about banks’ disclosures

- Pre-crisis and in early stages of crisis: disclosures about financial instruments and related exposures were less comprehensive than more recently
- Market participants concerned that banks’ published accounts did not capture the reality of emerging problems - reduced market confidence

Turner Review DP stated that high-quality disclosures by banks is an important factor in fostering market confidence
A wide range of stakeholders have also commented on the topic of disclosures

- Treasury Select Committee criticised the length and complexity of banks' annual reports
- Bank of England has called for more standardised, comparable disclosures by banks
- International Monetary Fund view that UK banks should report quarterly with more comprehensive and comparable disclosures
- FRC paper on reducing complexity of corporate reporting
- FASB disclosure project to reduce disclosure overload and make disclosures more effective

These factors led the FSA to publish its discussion paper on banks’ disclosures

- ‘Enhancing financial reporting disclosures by UK credit institutions’ – published October 2009
- Comment period ended 30 April 2010 - allowed respondents to consider banks' 2009 year-end reports when responding to the paper
- Intended to add to the quality and usefulness of disclosures, not the quantity

The paper sets out the main issues affecting complexity and comparability of banks' disclosures
### FSA Discussion Paper on banks’ disclosures (4 of 7)

- **Main issues affecting complexity and comparability of banks’ disclosures**
  - Granularity / materiality;
  - Valuation uncertainty / impairment;
  - Period averages, highs and lows;
  - Use of non-defined terms;
  - Location and format of disclosures;
  - Boilerplate and formulaic disclosures;
  - Extensive disclosures of less significant items; and
  - Reconciliation to primary financial statements

### FSA Discussion Paper on banks’ disclosures (5 of 7)

- **The paper proposes two approaches to enhancing banks’ disclosures**
  - A template approach; or
  - A code approach (**BBA Code**)

- **The BBA Code has been developed with significant input from the FSA**
  - Contains key principles with explanatory text to highlight how the principles should be applied in practice.
  - At the FSA’s request, the UK’s 7 largest banks applied the Code in their 2009 year-end reports
The BBA Code commits the banks to:

- Actively consider comparability across the sector when considering new disclosure standards or practices
- Include a glossary of non-IFRS terms from 2009, and thereafter to seek to converge the meaning of such terms
- Actively consider topical and emerging issues and provide information to enable stakeholders to understand the effect on the banks’ business of such issues

Next steps:

- We will continue to closely monitor and analyse banks’ public reporting; we expect immediate, tangible enhancements in disclosures as a result of application of the BBA Code
- We are considering publication of our findings on 2009 disclosures
- Feedback statement mid-2010

Based on our analysis and responses to the paper, we will consider the need for further policy initiatives to strengthen disclosure
FSA Accounting Review Team

- Turner Review DP stated FSA’s intention to intensify its analysis of bank balance sheets and the oversight of accounting judgements
- Newly-established Accounting Review Team to lead this work – team of 7
  - Detailed analysis of banks published accounts, developing a deeper understanding of key accounting judgements
  - Thematic work on key aspects of accounting judgements
  - Support to Prudential and Supervision specialists

Other disclosure initiatives - CESR

- CESR analysis of annual reports for 2008
  - Carried out by national enforcers in member states
  - Sample of 96 large European listed banks/insurers including 22 from the FTSE-Eurotop 100 index
  - Looked at compliance with IFRS 7 disclosures and best-practice recommendations from IASB Expert Advisory Panel, CESR and others
- Some areas where compliance with best-practice recommendations was high…
  - E.g. around half of all companies disclosed a fair value hierarchy (non-mandatory in 2008)
Other disclosure initiatives - CESR

(2 of 2)

- ... but poor compliance with mandatory disclosures in some important areas
  - 20% did not disclose valuation methods used for determining fair values
  - 40% did not disclose sensitivities in fair values to changes in assumptions
  - 20% did not disclose the criteria used to determine impairment losses (separately, 20% did not have any impairment losses)
  - 20% did not disclose details of how SPEs were controlled, or judgements applied in assessing the transfer of all significant risks and rewards of ownership

Other disclosure initiatives - CEBS

(1 of 1)

- CEBS consultation paper on banks disclosures
  - ‘Disclosure guidelines: Lessons learnt from the financial crisis’ - High-level disclosure principles with a focus on matters to consider for periods or activities under stress
  - Based on findings from CEBS analyses of banks’ annual reports and Pillar 3 disclosures
  - Not intended to amend, duplicate or add to existing disclosure requirements
Other disclosure initiatives - FASB

- FASB Disclosure Framework project
  - Project to create an overarching principles-based disclosure framework for USGAAP - move away from disclosures being a compliance exercise
  - Intention to reduce ‘disclosure overload’ – aim is to make disclosures ‘more effective, coordinated and less redundant’
  - Consider ways to better integrate the various parts of the reporting package (e.g. financial statements, MD&A)
  - The FASB expects to issue a preliminary views document in the first half of 2010
  - The FSA would support the IASB undertaking a similar project, jointly with the FASB

Disclosure – Audit Issues

- Scepticism
- The ‘fair view’

Are Auditors doing enough?
### Disclosure – Audit Issues

**Scepticism**

Audit Standards require auditors to exhibit professional scepticism

**Includes**

- A questioning mind
- Being alert to possible misstatement due to error or fraud
- Critical assessment of audit evidence

**When looking at financial instrument valuations could auditors do more?**

---

### Disclosure – Audit Issues

**The fair view**

- **IASI**
  The application of IFRS with additional disclosure where necessary is presumed to result in financial statement that achieve a fair presentation

- **IFRS 7**
  Additional disclosures required about the future and other sources of estimation uncertainty that could result in a material adjustment of assets or liabilities. Covers the most difficult, subjective or complex adjustments
Disclosure – Audit Issues
(4 of 4)

True and Fair

ASB Statement of Principles
– A dynamic concept
– Accounts must contain information sufficient in quantity and quality to satisfy the reasonable expectations of users

It is not enough merely to meet the disclosure requirements of the standards.

FSA and FRC Discussion Paper to be published in late June.

“Enhancing the auditor's contribution to prudential regulation”
Fair value and financial stability

- There are links between accounting standards and financial stability – both require that the economic substance of firms’ activity is reflected in accounting.

- Is behaviour of the ‘market’ as whole influenced by accounting standards? If so, should financial stability be considered when setting such standards? The main areas to consider in practice include:
  1. Valuation principles (amortised cost vs. fair value), particularly for illiquid financial instruments.
  2. Provisioning for bank loans.
• 1. Valuation principles
  – Fair value accounting can be procyclical
  – Fair value gains & losses for illiquid instruments may be illusory

• 2. Provisioning for bank loans
  – Incurred loss model may not portray the economic substance of lending transactions
  – IASB’s work on developing an ‘expected cash flow’ approach is welcome

Any questions?