Federation of European Accountants
Fédération des Experts comptables Européens

Mr. Arnoud Vossen
Secretary General
CEBS
Tower 42 (level 18)
25 Old Broad Street
GB–LONDON EC2N 1HQ

E-mail: cp30@c-ebs.org

26 January 2010

Ref.: BAN/HvD/LF/SR

Dear Mr. Vossen,

Re: FEE Comments on CEBS Consultation Paper 30 Disclosure guidelines: Lessons learnt from the financial crisis

FEE (the Federation of European Accountants) appreciates the open consultation launched by CEBS allowing all interested parties to provide their views on Consultation Paper 30 Disclosure guidelines: Lessons learnt from the financial crisis.

We welcome the principles-based approach adopted by CEBS. In particular, we support CEBS' aim of encouraging enhanced quality of disclosures without amending, duplicating or adding to existing disclosure requirements. In this context, we would like to note that Pillar 3 and IFRS disclosure requirements are important global requirements.

FEE is strongly committed to robust, high quality global principle-based financial reporting standards and supports the objective of creating a single set of global standards. Global financial markets require financial information prepared in accordance with global standards for reasons of competitiveness and comparability and for capital raising purposes.

We are interested to learn how the disclosure requirements proposed by CEBS are envisaged to be communicated, where such disclosure needs to take place and what type of assurance is envisaged to be placed on the disclosures. It is the responsibility of management to prepare financial statements, but we believe that all parties in the financial reporting chain have a contribution to make in order to enhance the transparency of financial statements.

FEE has contributed to the debate on the crisis in various ways, notably in commenting on the IASB pronouncements on crisis related issues including financial instruments but also by publishing a series of policy statements in relation to the crisis. We would in particular like to raise your attention to our latest policy statement which was issued earlier this month.

In this Policy Statement, FEE calls attention to a number of key issues in the area of financial reporting and auditing that are relevant for the 2009 year end financial statements, highlighting the disclosure, measurement and recognition of financial instruments as a key issue for attention, in addition to going concern, fraud, and impairment.

We are looking forward to meeting you on 11 February to discuss the developments on financial instruments and would be willing to discuss any aspect of this letter at that time as well.

Yours sincerely,

Hans van Damme
President

Encl.:

FEE Policy Statement "Issues for management and auditors for the 2009 year-end financial reporting"

Avenue d'Auderghem 22-28 • B-1040 Brussels • Tel: +32 (0)2 285 40 85 • Fax: +32 (0)2 231 11 12 • secretariat@fee.be • www.fee.be
Association Internationale reconnue par Arrêté Royal en date du 30 décembre 1986

FEE
Federation of European Accountants
Fédération des Experts comptables Européens

Policy Statement

Standing for trust and integrity

January 2010

The Accountancy Profession's Contribution to the Debate on the Crisis (VI)

Key issues for management and auditors for the 2009 year-end financial reporting

FEE (Fédération des Experts comptables Européens - Federation of European Accountants) wishes to contribute its views and experience to the debate on the crisis, the ways to mitigate its effects and to speed-up recovery. This paper presents the views of FEE on issues that may require specific attention in the 2009 year-end reporting without thereby being comprehensive. Five other papers have been issued between December 2008 and July 2009, one presenting background information and analysis on the crisis (I), a second paper on the matters of specific relevance for statutory auditors during the financial crisis (and the 2008 year-end closing) (II), a third paper containing views of specific relevance to Small and Medium-sized Entities (SMEs) (III), a fourth paper on dynamic provisioning (IV) and a fifth paper on the financial crisis and sustainability (V).

Background

During the last months there have been first signs of economic recovery from the crisis but the general understanding is that there is still a long way to go: growth is still slow and in many sectors it is far from "business as usual". Recovery is still fragile. Financial reporting has been – and still is – high on the political agenda, notably of the G20 and the Financial Stability Board (FSB), calling for a global response and a drive for global high quality financial reporting and auditing standards. In response to these calls, the IASB has made several changes to IFRS[1]. Financial reporting continues to be crucial in providing and restoring market confidence.

In December 2008 FEE published three Policy Statements in order to contribute to the debate on the crisis, followed by two further credit crisis-related Policy Statements in March and July 2009. In its second Policy Statement of December 2008[2] matters of specific relevance for statutory auditors during the financial crisis were addressed by providing an insight into what may be expected of auditors in the crisis environment. This 2008 Policy Statement remains highly relevant since many of the risks faced by auditors last year also will be relevant for the 2009 year-end audit.

FEE underlines that management and auditors need to be attentive in the current market circumstances to a number of issues that are particularly relevant for the 2009 reporting season. A key area of focus is the evaluation of uncertainty associated with the entity's going concern assumption. Impairment of goodwill and other intangibles and financial instruments measurement and recognition require careful consideration.

The current Policy Statement reminds auditors and accountants in business of a number of key issues in the area of financial reporting and auditing, that are relevant for the 2009 reporting season, covering questions of ongoing relevance, as well as emerging accounting and auditing issues[3].

Although it is the responsibility of management to prepare financial statements, all parties in the financial reporting chain have a contribution to make in order to enhance the transparency of financial statements. The auditor has a significant role in communicating with management and reporting to the governance bodies, notably the Audit Committee and the Supervisory Board and, depending on the circumstances and nature of the activities of a particular entity, to the supervisory authorities. In this respect it is the responsibility of the Audit Committee to monitor the effectiveness of internal controls and risk management. Auditors need to understand and assess the appropriateness of management's responses to the market conditions that may give rise to new or increased risks in this period.

Policy Statement

Financial Reporting and Auditing Issues of particular relevance for the 2009 year-end reporting and related audit

General

Transparency remains of crucial importance for investors. Meaningful disclosures on risk exposures, on the way these risks are managed by an entity's management and on the key judgements and estimates made by management in preparing their financial statements will remain essential. Entities' management need to ensure that they properly and fairly estimate the value of the different elements in their entities' financial statements and prepare thoroughly for their assessment of the entity's ability to continue as a going concern and make appropriate disclosures. Both management and auditors should use experts where appropriate. This is currently particularly important in the areas of valuation and accounting for financial instruments in illiquid markets since the effects of these issues might have material effects on the financial statements presented during the crisis.

Attention is drawn to the recent CESR Statement[4] on Application of Disclosure Requirements Related to Financial Instruments in the 2008 Financial Statements. The findings of the CESR survey in which 96 European listed financial institutions were analysed for application of the requirements of IFRS 7 *Financial Instruments*: *Disclosures* and related public guidance, revealed that 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). In IFRS 7 the concept of disclosures through the eyes of management plays a significant role. Consequently management must be able to explain and provide evidence on what they consider as the best way of reporting following their business model (This so-called "through the eyes" management reporting is based on an entity's internal organisation). Auditors need to audit these disclosures by comparing them with information available in the entity's management reporting and discussing the constituent parts with management at senior levels in the entity.

Issues for attention

Without being comprehensive we wish to draw attention to issues that we believe require particular consideration in the 2009 year-end financial statements and related audit:

Going concern

In current market conditions, a key area of focus for both management and auditors of all entities is the evaluation of uncertainty associated with the entity's going concern assumption. Most financial reporting frameworks contain an explicit requirement for management to make a specific assessment of the entity's ability to continue as a going concern. Therefore, management has the primary responsibility for assessing whether the going concern assumption is appropriate. Questions have been raised during 2009 as to going concern issues: should entities and auditors not have better predicted the economic situation and the problems caused by the crisis due to which several entities have come into difficulties or went bankrupt? In this respect, the timing of the assessment by the entity is key to ensure that issues are identified as early as possible and properly discussed, also between management and the auditor. Financial positions of companies and opinions of auditors are applicable at a given point in time. The general economic situation at a certain point in time in itself does not necessarily mean that there is a material uncertainty related to events or conditions that may cast significant doubt on the entity's ability to continue as a going concern and thus justify auditors modifying their auditor's reports to draw attention to going concern. Nor are extensive disclosures, by themselves, indicative of the existence of a significant doubt on the company's going concern. Other factors may become more significant than before. In this respect the continued pressure on corporate cash-flows means that liquidity risk is likely to be a material risk for many more entities, resulting in an increased need for entities to present relevant disclosures concerning liquidity risk and other risks.

Auditors will need to examine the management's processes underlying the preparation of all of the above mentioned disclosures which provide useful evidence for them on the validity of the going concern assumptions. IAASB, the independent board setting international auditing standards, has already issued two useful IAASB Staff Audit Practice Alerts "Challenges in auditing fair value accounting estimates in the current market environment[5]" and "Audit considerations in respect of going concern in the current economic environment[6]". The reflection of going concern issues in the audit report continues to be important to consider in order to avoid any overreaction undermining the attempt to restore the economy. For a discussion of the considerations auditors are likely to take into account please refer to the 2008 Policy Statement.

Fraud

Fraud remains a serious issue of concern in the current fragile economic environment and can have a more detrimental impact on volatile businesses than in normal economic conditions. There could be increasing pressure on businesses to provide a more optimistic picture of the entity's performance and to meet short-term performance indicators or regulatory capital requirements. The responsibility for the prevention, deterrence and detection of fraud rests with both those charged with governance of the entity and its management. Fraud may involve sophisticated and carefully organised schemes designed to conceal it, deliberate failure to record transactions, or intentional misrepresentations being made to the auditor. When collusion is committed by management, it is even more difficult to detect as the audit evidence is falsified. However, the accountancy profession needs to approach all management representations with professional scepticism and address specifically this risk in all audits[7].

Financial Instruments

Financial instruments' recognition and measurement remain areas that need special attention[8]. Notably the measurement and disclosure of fair value of instruments in illiquid markets continue to be relevant and the guidance issued by the IASB and Financial Crisis Advisory Group[9] should be highly useful in this respect. It should also be noted that the assessment of fair value requires substantially more judgement and experts' input than the measurement at amortised cost. Impairment requirements need to be properly applied in relation to AFS (Available-for-Sales) instruments and assets measured at amortised cost. The CESR Statement as referred to above indicates that 80% of financial institutions analysed had impairment losses for financial instruments in 2008.

For equity financial assets classified as AFS, objective evidence of impairment includes the "significant **or** prolonged" decline of the fair value investment below its cost (IFRIC reminder of July 2009[10]).

Other issues of consideration in relation to financial instruments may include: application of IAS 39 to debt restructuring and effectiveness of hedge relationships.

Impairment

Impairment (and more particularly that of non-financial assets) remains a key attention point for 2009 year-end financial statements and the 2009 year-end audit, due to downward adjustments taking account of the general economic outlook. Not surprisingly, regulatory authorities took, and continue to take, an active interest in impairment calculations and disclosures. Many companies engaged in significant merger and acquisition activities before the financial crisis started. As a result, many entities have significant amounts of goodwill and other intangibles related to those acquisitions on their balance sheets.

In performing impairment tests, management needs to support their assertions with evidence. In many industries there is not yet a return to pre-crisis circumstances and compared to 2008 there may be more impairment losses that have to be recognised in 2009 for several entities. Management and their auditors need to properly assess the impairment risks and concerns. This involves not only the discount rate applied but also the cash flows used in the valuations and the selection of proper benchmark tools. Internal consistency between the assumptions and parameters used in the impairment calculations is important. In addition, proper disclosures as required under the specific IFRS need to be provided, in particular with regard to assumptions used and sensitivity analyses.

Other issues

Other issues for consideration may include: employee benefits (IFRIC 14); recognition of deferred tax assets; valuation of investment property; use of appropriate discount rates; accounting for government aid; and remuneration disclosures.

Several of the issues discussed in this policy statement can also, depending on the circumstances, type of business and size of the entity concerned, be relevant for entities that are not listed or more generic for smaller entities.

Closing observations

The crisis has highlighted the importance of ethical behaviour and integrity. The accountancy profession will continue promoting integrity, objectivity, professional competence and due care, confidentiality and professional behaviour amongst all of its members, who are all bound by the IESBA (International Ethics Standards Board for Accountants) Code of Ethics for Professional Accountants whether they are in audit practice or in business. ■

FEE

Policy Statement

Notes:

[1] The European Financial Reporting Advisory Group (EFRAG) publishes on a regular basis Updates of its Endorsement Status Report (http://www.efrag.org/content/default.asp?id=4090), providing an overview of IFRS and IFRIC interpretations that have been endorsed for use in the EU and the status of those in the process of EU endorsement.

[2] FEE Policy Statement II: Matters of Specific Relevance for Statutory Auditors during the financial crisis, December 2008 (http://www.fee.be/publications/default.asp?library_ref=4&content_ref=943)

[3] This Policy Statement provides a high level overview without aiming to be comprehensive.

[4] CESR Statement "Application of Disclosure Requirements Related to Financial Instruments in the 2008 Financial Statements", 30 October 2009 (http://www.cesr.eu/popup2.php?id=6156)

[5] IAASB Staff Audit Practice Alert of October 2008 "Challenges in auditing fair value accounting estimates in the current market environment" (http://web.ifac.org/download/Staff_Audit_Practice_Alert.pdf)

[6] IAASB Staff Audit Practice Alert of January 2009 "Audit considerations in respect of going concern in the current economic environment" (http://web.ifac.org/download/IAASB_Staff_Audit_Practice_Alerts_2009_01.pdf)

[7] The IAASB Staff Practice Alert of November 2009 "Emerging Practice Issues Regarding the Use of External Confirmations in an Audit of Financial Statements" provides examples relating to the characteristics of the entity that indicate an increased fraud risk and provides useful guidance on the factors to consider in these circumstances and procedures to be performed. (http://web.ifac.org/download/IAASB_Staff_Audit_Practice_Alert_External_Confirmations.pdf)

[8] International Auditing Practice Statement (IAPS) 1012 "Auditing Derivative Financial Instruments", 2001 (http://web.ifac.org/publications/international-auditing-and-assurance-standards-board/handbooks, page 796)

[9] http://www.iasb.org/Financial+crisis/Response+to+the+credit+crisis.htm

[10] IFRIC – Items not taken onto the agenda (with final decisions published) Starting from February 2005 (updated to November 2009 IFRIC Update) (http://www.iasb.org/NR/rdonlyres/33A3935E-CF6D-4B70-8592-01248F17B031/0/IFRICitemsnotontoagendaupdatedNovember09.pdf)

About FEE

FEE represents 43 professional institutes of accountants and auditors from 32 European countries, including all 27 EU Member States. In representing the profession, FEE recognises the public interest. FEE has a combined membership of more than 500.000 professional accountants working in different capacities in public practice, small and larger firms, business, public sector and education, who all contribute to a more efficient, transparent, and sustainable European economy. Based on the practical experience gained in this daily involvement in all aspects of the economy and the set of values underpinning the profession's practice, FEE believes it has a contribution to make in this public policy debate.

Federation European of Accountants
Fédération des Experts comptables Européens

THE MEMBERS OF FEE

Standing for trust and integrity

FEE is a Regional Organisation of IFAC, the International Federation of Accountants