Commission de Surveillance du Secteur Financier

PRESS RELEASE 17/03

ENFORCEMENT OF THE 2016 FINANCIAL INFORMATION PUBLISHED BY ISSUERS SUBJECT TO THE TRANSPARENCY LAW

Pursuant to the law of 11 January 2008 on transparency requirements for issuers (the "Transparency Law"), the CSSF is monitoring that financial information published by issuers, in particular their consolidated and non-consolidated financial statements, is drawn up in compliance with the applicable accounting standards.

In this context, the CSSF wishes to draw the attention of issuers and auditors on identified financial reporting topics they should particularly consider when preparing and auditing, respectively, the International Financial Reporting Standards (hereafter referred to as "IFRS") financial statements for the year ending 31 December 2016.

As in previous years, the European Securities and Markets Authority (hereafter referred to as "ESMA"), together with European national accounting enforcers, including the CSSF, identified common enforcement priorities for the 2016 financial statements[1] on which particular attention will be paid when monitoring and assessing the application of all IFRS requirements.

When establishing its enforcement campaign, the CSSF has assessed how to monitor these common priorities defined at European level and communicated by ESMA and considered the need to identify other items of interest. This analysis is based on the following criteria:

- the importance and relevance of these topics for issuers under its direct supervision;
- the importance of judgment and assumptions made by issuers in dealing with these topics;
- the experience and history of issues encountered by the CSSF during previous campaigns.

The campaign will thus be governed by the following priorities:

Presentation of financial performance

The presentation of financial information of an entity, in particular of its financial performance, is a key driver to influence its users when they make economic decisions. The CSSF's examination will take into account that:

- ESMA has stressed again the importance of providing investors with clear and high quality information on financial performance, and urges issuers to ensure transparency and consistency when presenting their performance in the primary financial statements, notes and in the documents accompanying their financial statements; and
- Amendments to IAS 1 "Presentation of Financial Statements" took effect on 1 January 2016. These amendments are part of the International Accounting Standards Board's overall Disclosure Initiative and aim at clarifying IAS 1 to address perceived impediments to preparers exercising their judgement in presenting their financial reports. Disclosure Initiative (Amendments to IAS 1) introduces the following main changes:
    - Materiality: the amendments clarify that information should not be obscured by aggregating or by providing immaterial information; and

[1] ESMA/2016/1528

- Statement of financial position and statements of profit or loss and other comprehensive income: the amendments introduce a clarification that the list of line items to be presented in these statements can be disaggregated and aggregated as relevant and also provide additional guidance on subtotals in these statements.

In addition, the CSSF will also pay special attention to the application of Circular CSSF 16/636 whose purpose is to implement the "ESMA Guidelines on Alternative Performance Measures" (hereafter referred to as the "Guidelines")[2] into Luxembourg regulations. In the second-half of 2016, the CSSF has carried out an examination of 2016 interim financial reports for a selection of issuers to ensure that the Guidelines have been complied with, and a series of misstatements and omissions have been identified[3]. The CSSF will pursue this examination as part of its diligence on 2016 financial reports.

Finally, the CSSF's examination on this first priority will cover other significant areas where financial performance is presented including segment information, movements in the statement of other comprehensive income, earnings per share, and presentation of information not specifically required by IFRS.

Financial instruments: distinction between equity instruments and financial liabilities

Due to the fact that there are cases where distinction between equity and liability requires significant judgement, ESMA reminded issuers that the general principle for distinguishing liabilities from equity issued by an entity is whether the entity has an unconditional right to avoid delivering cash or another financial asset to settle the contractual obligation.

The CSSF's examination in this context will mainly focus on areas where issues had been encountered in the past, including the review of the characteristics of compound financial instruments with equity and liabilities components and of clauses for rights attached to preference shares. In this respect, issuers should also carefully consider events surrounding the conversion of a financial instrument such as the application of the fixed-for-fixed criterion, the cash settlement options, the review of contingent settlement provisions, etc. and the particular events for instruments which mandatorily have to deliver a pro rata share in the net assets such as the evaluation of elements outside the control of the entity or the subordination clauses.

Business Combinations

Transactions involving business combinations remain critical when applying the key aspects of IFRS 3 "Business Combinations", notably the identification of a business combination itself (i.e. criteria defining a business) and the subsequent application of the acquisition method. As a result, the CSSF's examination in this context will be governed by the special focus that should be put on the recognition of assets acquired (and liabilities assumed), implying the identification of intangible assets previously not recognised, and their measurement at fair value in accordance with IFRS 13 "Fair value measurement", as well as the measurement method chosen to recognise non-controlling interests acquired.

From a financial reporting point of view, the CSSF will also emphasise on the most meaningful disclosures that have been omitted in the past by the preparers of financial information. The recurring observations in this context principally relate to omissions of (i) the qualitative description of the factors that make up a goodwill or a bargain purchase recognised, (ii) the description of the contingent liabilities not recognised including the estimate, timing and uncertainties of their financial effects, and (iii) the miscellaneous disclosures on the amounts of revenue and profit or loss of the acquiree. Comprehensive disclosures in this respect are provided by paragraphs 59 to 61 of IFRS 3.

[2] ESMA/2015/1415
[3] CSSF Press Release 16/46

Continued uncertainty in financial markets conditions

While ESMA set out “Impacts of the financial markets conditions on the financial statements” in the 2015 European common enforcement priorities, the financial reporting environment remains uncertain more than ever: there is still high volatility for commodities’ prices, interest rates are still at an historical low level, significant foreign exchange rate fluctuations are observed even in European currencies, as well as political factors such as the decision of the United Kingdom to leave the European Union or the result of the U.S. election.

These factors make it difficult for management to make judgements and assumptions about the future of their business. Likewise, it makes it harder for preparers of financial information to present and describe a comprehensive information for the users. Therefore, emphasis should be put not only on the description of the major sources of estimation uncertainty as required by IFRS, but on further quantitative and qualitative consideration given to a number of topics implying the use of assumptions as well as on the need to provide the disclosures relative to sensitivity analysis. The CSSF will make sure that an appropriate level of disclosure allows users of financial information to understand the challenges an entity faces when navigating uncertain times.

Finally, issuers potentially affected by the Brexit are encouraged to assess and disclose the associated risks and expected impacts that the referendum may have on their business activities.

Disclosures of the impact of the new standards on IFRS financial statements

ESMA highlighted the fact that some aspects of the new IFRS standards, notably IFRS 9 “Financial Instruments”, IFRS 15 “Revenue from Contracts with Customers” and IFRS 16 “Leases”, which will come into force at the beginning of 2018 and 2019, will represent a significant change to the current standards. These new standards may affect the recognition, measurement and presentation of assets, liabilities, income, expenses and cash flows. ESMA encourages issuers to work as soon as possible on the implementation of these standards. Accordingly, the CSSF will start closely monitoring how issuers start preparing for these new standards and how they provide already additional disclosures on expected impacts in accordance with IAS 8 “Accounting Policies, Changes in Accounting Estimates and Errors”.

More information on inspections and findings by the CSSF within the framework of its mission under Article 22 (1) of the Transparency Law are given under the section Supervision > Securities markets > Enforcement of financial information of the CSSF website and in its annual report, available under Documentation > Publications > Annual reports of the CSSF website.

Luxembourg, 16 January 2017