

ESMA'S REVIEW OF COMPARABILITY OF IFRS FINANCIAL STATEMENTS OF FINANCIAL INSTITUTIONS IN EUROPE INTERNATIONAL FINANCIAL REPORTING BULLETIN 2013/23



Background

The European Securities and Markets Authority (ESMA) has released a report outlining the findings of its 2012 financial statement review of the comparability of IFRS Financial Statements of Financial Institutions in Europe. The report evaluates the appropriateness of disclosures from 39 major European financial institutions from 16 jurisdictions.

This review was triggered by gaps in the application of IFRS 7 *Financial Instruments: Disclosures* that had been highlighted by ESMA's other recent review activity.

Areas focused on by ESMA in its review of Financial Institutions in Europe included:

1. The structure and content of the income statement
2. Liquidity and funding risk (including the effects of asset encumbrance)
3. Hedging and the use of derivatives
4. Credit risk (focusing on: credit risk management; forbearance practices; non-performing loans; and country concentration risk)
5. Impairment of available-for-sale equity instruments (criteria used).

As a result, ESMA has signalled that it expects issuers (and their auditors) to consider the findings of the report when preparing (and auditing) their current IFRS financial statements. ESMA and national competent authorities will focus on monitoring the level of impairment of financial assets and improving transparency in disclosures relating to forbearance, liquidity risk, asset encumbrance and fair value measurement.

Further, the findings and recommendations of the report will be incorporated into reviews carried out by each national authority, which will take corrective action (which may include a requirement for public restatement of financial statements) in the event that a material error is identified.

While ESMA is a European regulator, listed companies in other jurisdictions that apply IFRS (and their auditors) should be aware of, and take into account, the enforcement priorities raised in the statement, as they relate to financial reporting issues that are not isolated to the European financial reporting environment. It is also relevant that enforcers worldwide are increasingly sharing information that they collect in the process of their activities.

STATUS

Final

EFFECTIVE DATE

Immediate

ACCOUNTING IMPACT

Focus areas for European enforcers; also relevant for other jurisdictions due to global coordination among national enforcers.

Executive summary

An overview of the key recommendations raised by ESMA is:

- (i) **Structure and content of the income statement:** entities should enhance transparency in this area by providing sufficiently detailed disclosures.
- (ii) **Liquidity and funding:** entities should develop their disclosure on contingent funding needs and provide an assessment of their potential impacts.
- (iii) **Asset encumbrance:** entities should disclose sufficient (and sufficiently detailed) information to identify assets that are readily available for liquidity purposes or to meet funding needs, as well as providing definitions of industry terminology.
- (iv) **Hedging and the use of derivatives:** entities should enhance disclosures relating to measurement methodologies and the inputs used in fair value measurement (including counterparty and non-performance risk as required by IFRS 13 *Fair Value Measurement*).
- (v) **Credit risk:** entities should adapt disclosures related to concentration of credit risk so that the main changes of the credit risk profile over time can be identified.
- (vi) **Forbearance:** entities should provide more detailed quantitative information on the effects of forbearance so that credit risk exposure and the related impact on financial position and performance of assets subject to forbearance can be identified.
- (vii) **Impairment of available-for-sale equity instruments:** entities should exercise careful judgment in applying the significant or prolonged criteria in relation to the impairment of available for sale equity instruments, as well as disclosing both the positive and negative components of the reserve within equity.

(1) Structure and content of the income statement

Requirements of IFRS

IFRS requirements in respect of the structure and content of the income statement are generic in nature with very few industry specific requirements, and are spread across a number of IFRSs, including:

- IAS 1 *Presentation of Financial Statements*
- IAS 18 *Revenue*
- IFRS 7 *Financial Instruments: Disclosure*.

Key disclosure requirements include:

- Significant accounting policies (IAS 1.117, IFRS 7.21, IFRS 7.B5)
- Minimum line items to be presented in the income statement (IAS 1.82)
- Additional items of income and expense are to be presented where this assists in the understanding of the entities financial performance (IAS 1.84-86)¹
- Material items of income and expense are to be presented separately (IAS 1.97)¹
- Revenue is to be disaggregated into significant categories (IAS 18.35(b))¹
- The following items (IFRS 7.20)¹:
 - Net gains or net losses
 - Interest income and interest expense
 - Fee income and expense
 - Impairment losses.
- For financial instruments not at fair value through profit or loss:
 - Total interest income and total interest expense (calculated using the effective interest method) (IFRS 7.20(b))¹
 - Total fee income and expense (IFRS 7.20(c))¹.
- For trust and other fiduciary activities:
 - Total fee income and expense (IFRS 7.20(c))¹.
- For each category of financial instruments, the net gains/losses (IFRS 7.20(a))¹:
 - In addition, available for sale financial assets must separate the gain/loss between profit or loss and other comprehensive income (IFRS 7.20(a)(ii))¹.

¹ Indicates that presentation may be made either in the income statement or notes to the financial statements.

ESMA's findings

Disclosure area	Details of ESMA's findings
Structure of the income statement	<p>ESMA noted that there appears to be significant influence from national standard setters and prudential regulators in respect of the structure of the income statement.</p> <p>ESMA noted diversity in:</p> <ul style="list-style-type: none"> – The level of detail on the face of the income statement – Content and order of line items – Number of line items (including subtotals) – Gross vs. net basis of presentation.
Interest income and interest expense	<p>All entities presented gross amounts on the face of the income statement, with some also presenting a net figure. While some entities disclosed interest income/expense from individual financial instruments not measured at fair value through profit or loss (FVTPL), the total (as required by IFRS 7.20(b)) was not always disclosed.</p> <p>ESMA noted diversity in the components included or excluded within interest income/expense, including interest income/expense on:</p> <ul style="list-style-type: none"> – Non-derivative financial instruments of the trading portfolio (66% included within interest income/expense) – Financial instruments designated as at FVTPL (75% included within interest income/expense) – Funding and refinancing costs – Derivative financial instruments that do not qualify for hedge accounting. <p>There were also instances where amounts related to investment property were included within interest income/expense, although these were not material.</p>
Net fee and commission income	<p>All entities presented amounts on the face of the income statement, the majority presenting gross amounts and further disaggregation in the notes by activity type.</p> <p>Almost 75% of entities did not disclose total fee income and expense for financial instruments not at fair value through profit or loss (IFRS 7.20(c)).</p> <p>It was unclear whether disclosures relating to trust and other fiduciary activities would have been relevant for the 60% of entities that did not provide such disclosures.</p>
Net trading income	<p>ESMA noted diversity in components included or excluded within net trading income:</p> <ul style="list-style-type: none"> – Trading activities – Financial instruments held for trading – All financial instruments measured at FVTPL.
Dividend income	<p>ESMA noted diversity in whether dividend income:</p> <ul style="list-style-type: none"> – Information was presented at all – Was presented on the face of the income statement or the notes – Was disaggregated by category of financial instrument – Was presented as a separate line item in the income statement, or include within net investment income or Other aggregated line items, for both: <ul style="list-style-type: none"> – Available for sale equity instruments – Held-for-trading (FVTPL) financial instruments.
Repurchase of financial liabilities	<p>ESMA noted diversity in whether the gain on repurchase of financial liabilities carried at amortised cost was presented:</p> <ul style="list-style-type: none"> – Within other income – Within net trading income – Within interest income/expense – As a separate line item.
Net gains or net losses	<p>ESMA noted diversity in:</p> <ul style="list-style-type: none"> – Whether Impairment losses were included or excluded within Net gains or net losses – Whether net gains or net losses were defined – The disaggregation and identification of components that made up net gains or net losses – Whether net gains or net losses disaggregated by category of financial instrument were located within a single note – Consistent application of a components-based approach – The application of the IAS 1 implementation guidance in respect to the recognition pattern for net gains or net losses on AFS financial assets (i.e. directly in profit or loss, or via other comprehensive income).

Conclusions and recommendations

Overall, ESMA found there was limited direct comparability between the income statements of the entities selected for review, primarily related to diversity in the composition of:

- Interest income/expense
- Net interest margin
- Net trading income.

ESMA has noted that it will be suggesting to the IASB that additional guidance in IFRS on specifying the content of individual line items would be helpful in enhancing the comparability of financial statements.

ESMA recommends that in order to increase comparability, financial institutions should:

- Improve the link between the income statement and the statement of financial position by identifying the significant components included in individual line items and providing concise and comprehensive accounting policies in relation to these
- Present net gains or net losses in a single note and disaggregated by:
 - Category of financial instruments
 - Income statement line item.
- Disclose a clear accounting policy in respect to the recognition pattern for AFS instruments (i.e. directly in profit or loss, or via other comprehensive income
- Consider whether certain line items are material enough to warrant presentation as a separate line item in the income statement.

ESMA also noted that while comparability was highest in jurisdictions with specific reporting requirements for financial institutions, care is still required to ensure that the entity's business model is adequately reflected.

(2) Liquidity and funding risk (including the effects of asset encumbrance)

Requirements of IFRS

The requirements in respect of liquidity and funding risk are included within IFRS 7 *Financial Instruments: Disclosure*.

Key disclosure requirements include:

- General requirement for both qualitative and quantitative disclosures (IFRS 7.33)
- How liquidity risk arises, what the entity's objectives, policies and processes for managing the risk are, and how the entity measures the risk (IFRS 7.34(a))
- Ensuring that the qualitative and quantitative disclosures, when viewed together, enable an understanding of the entity's exposure to liquidity risk and how the entity manages it (IFRS 7.32A, 39(c))
- A contractual maturity analysis based on undiscounted cash flows, and description of how liquidity risk is managed for both (IFRS 7.39):
 - Non-derivative financial liabilities (IFRS 7.39(a))
 - Derivative financial liabilities (IFRS 7.39(b)).
- A maturity analysis for financial assets held to manage liquidity risk (IFRS 7.B11E).

Quantitative liquidity risk disclosures should be based on the information that is provided internally to key management personnel (IFRS 7.B11A).

ESMA's findings

Disclosure area	Details of ESMA's findings
Qualitative disclosures on liquidity risk	The quality of the disclosures varied between generic information to extremely detailed entity-specific information.
Maturity analysis of financial assets and financial liabilities	<p>All entities presented a contractual maturity analysis, however some omitted:</p> <ul style="list-style-type: none"> – Derivative financial liabilities – Off-balance sheet loan commitments and financial guarantee contracts. <p>Almost 33% of entities incorrectly presented discounted cash flows in the maturity analysis of financial liabilities, rather than undiscounted cash flows that are specifically required by IFRS 7.B11D.</p> <p>Not all entities that used time bands titled On demand and/or Undetermined maturity adequately explained how cash flows were categorised within them.</p> <p>ESMA also noted diversity in the time-band classification of:</p> <ul style="list-style-type: none"> – Trading derivative liabilities – Subordinated debts with repayment options held by the issuer. <p>Half of the sampled entities provided a maturity analysis for all financial assets, rather than for only those financial assets specifically used to manage liquidity risk as required by IFRS 7.B11E.</p>
Managing liquidity risk: liquidity reserves, funding sources and contingent funding needs	<p>ESMA also noted diversity in:</p> <ul style="list-style-type: none"> – Whether the definition and criteria for assets to qualify as liquidity reserves was disclosed – Disaggregation by asset type and currency – Disaggregation of concentration in the funding sources – Whether information regarding any funding restrictions within a consolidated group of entities was disclosed – Disclosure of entity-specific information regarding contingent liquidity and funding needs – Disclosure of the existence of margin requirements for derivatives – The link between quantitative and qualitative information – Disclosure of details relating to: <ul style="list-style-type: none"> – Instruments that include accelerated repayment terms – Additional collateral requirements in case of a downgrade by a rating agency – Quantitative information on the contingent needs – Off-balance sheet instruments they can access to meet contingent liquidity needs – The fair value of collateral held that was permitted to be sold or repledged, or had already been sold or repledged – The quality and liquidity of the collateral held.
Asset encumbrance	Only a few entities provided quantitative information related to encumbered or unencumbered assets detailed by asset type. Of those that did not, there was no clear distinction between encumbered and unencumbered assets.

Conclusions and recommendations

Overall, ESMA found that, while the entities reviewed generally provided some information regarding liquidity and funding, there was limited direct comparability between the income statements of the entities sampled, primarily due to the variation in the quality of the quantitative and qualitative information disclosed.

ESMA recommends that in order to increase comparability, financial institutions should:

- Provide comprehensive disclosures that link the maturity analysis of financial instruments with the entity's liquidity position and funding sources
- Use undiscounted contractual cash flows as required by IFRS 7.B11E
- Use and adequately define an On demand time-band
- Provide adequate information to enable users to determine their concentration of liquidity and funding sources
- Develop their disclosure on contingent funding needs as well as contingent funding sources
- Complement quantitative data with narrative disclosures, including:
 - Defining key terms
 - Disclosing inputs and assumptions for indicators used to assess liquidity and funding positions
 - Providing narrative commentary on contractual maturity
 - Linking the contractual maturity analysis with the entity's funding and liquidity strategy and objectives.

(3) Hedging and the use of derivatives

Requirements of IFRS

The disclosure requirements in respect of hedge accounting and those financial instruments designated as hedging instruments are included within IFRS 7 *Financial Instruments: Disclosure*.

Key disclosure requirements include:

- Information on each type of hedge, including (IFRS 7.22):
 - A description of the hedges
 - The nature of risks being hedged
 - The hedging instrument's fair value at the reporting date.
- The effect of hedge accounting on the income statement and other comprehensive income (particularly hedge ineffectiveness recognised in profit or loss)
- Separate presentation of gains/losses on the hedging instrument and the hedged item in a fair value hedge
- The period in which cash flows in a cash flow hedge are expected (IFRS 7. 23)
- The amounts recognised in, and recycled from, other comprehensive income in a cash flow hedge
- The use of derivatives (IFRS 7.33-42)
- General requirement regarding disclosure of how risks are managed.

ESMA's findings

Disclosure area	Details of ESMA's findings
Type of (accounting) hedges and derivatives used	<p>ESMA noted diversity in:</p> <ul style="list-style-type: none"> – Whether entities distinguished between OTC and exchange traded instruments – Whether derivative financial instruments were disaggregated by counterparty – The level of detail provided relating to how hedge accounting was applied by the entity.
Impact of hedge accounting on financial statements	<p>ESMA noted diversity in:</p> <ul style="list-style-type: none"> – Whether hedge ineffectiveness was disaggregated by type of hedge – Whether the effect of fair value hedges was presented gross or net – The presentation and disclosure of impacts related to derivatives not designated as hedging instruments – Whether information regarding the period in which cash flows in a cash flow hedge were expected was provided – Whether complementary narrative information was provided in relation to the quantitative disclosures was provided.
Use of 'macro hedging' and the EU carve-out	<p>ESMA noted diversity in:</p> <ul style="list-style-type: none"> – Whether cash-flow macro-hedging had been applied – Whether the EU carve-out had been applied. <p>Note: the EU carve-out is a modification to EU-endorsed IAS 39 <i>Financial Instruments: Recognition and Measurement</i> that relaxes the hedging effectiveness testing and allows portfolio hedging of core deposits.</p>
Derivative transactions	<p>ESMA noted diversity in:</p> <ul style="list-style-type: none"> – Whether complementary qualitative information was provided in relation to the quantitative disclosures was provided – The disclosure of separate risk management procedures for different derivative and/or hedging transactions – Whether definitions of key terms (i.e. trading book, banking book, economic hedging etc.) was provided – Disclosure of details relating to: <ul style="list-style-type: none"> – The impact of credit value adjustments (CVA) – The impact of debit value adjustments (DVA) – Valuation methodologies and inputs used.

Conclusions and recommendations noted by ESMA

Overall, ESMA found that while the entities generally provided information regarding hedging and the use of derivatives, the level and depth varied significantly and that a greater link between the quantitative and qualitative disclosures provided is required.

ESMA recommends that in order to improve this link, entities should:

- Provide more detailed qualitative information regarding derivatives used for different purposes, and link these to the accounting treatment
- Provide a sufficient level of detail to enable users understand the impact of hedging:
 - On financial performance
 - On financial position
 - In relation to the hedging strategy.
- Provide adequate disclosures in relation to the effectiveness of derivatives used to hedge risk exposures
- Improve disclosures in respect to measurement methodologies and inputs, including the impact of CVA and DVA
- Clearly disclose if the entity has applied macro-hedging or the EU carve-out to hedge accounting.

(4)(a) Credit risk – Credit risk management

Requirements of IFRS

The requirements for disclosures in respect of credit risk are included within IFRS 7 *Financial Instruments: Disclosure*.

Key disclosure requirements include:

- General requirements for both qualitative and quantitative disclosures regarding how credit risk arises, what the entity's objectives, policies and processes for managing the risk are, and how the entity measures the risk (IFRS 7.33):
 - IFRS 7.IG15(b) includes a narrative description of policies regarding impairment and processes for accepting, measuring, monitoring and controlling risk.
- Quantitative disclosures are based on the information that is provided internally to key management personnel regarding exposure to credit risk (IFRS 7.B10 provides a list of activities that give rise to credit risk)
- In respect of maximum exposure to credit risk (IFRS 7.36):
 - The amount that best represents this
 - A description of collateral held as security and other credit enhancements, and how they affect this amount
 - IFRS 7.IG22 provides an example of how this might be disclosed.
- Credit quality of financial assets that are neither past due nor impaired (IFRS 7.36)
- Concentration of credit risk, including how management determines concentrations and any shared characteristic(s) (e.g. counterparty, geographical area, currency or market etc.) (IFRS 7.34(c), B8)
- In respect of financial assets that are past due but not impaired and those that are individually determined to be impaired (IFRS 7.37(a)-(b)):
 - An ageing analysis by class of financial asset
 - A description of factors considered in determining that they are impaired.
- In respect of impaired financial assets:
 - Interest income, by class of financial asset (IFRS 7.20(d))
 - Impairment loss, by class of financial asset (IFRS 7.20(e))
 - An accounting policy detailing the criteria used to determine if there is any objective evidence that an impairment loss has occurred (IFRS 7.21, B5(f)).

ESMA's findings

Disclosure area	Details of ESMA's findings
Managing credit risk: credit risk exposure, concentration and mitigation of credit risk	<p>ESMA noted diversity in:</p> <ul style="list-style-type: none"> – Whether entities provided either/both internal and external credit rating systems – The level of detail in explaining internal credit rating systems – Whether exposure to credit risk was disaggregated further than by class of financial asset (i.e. by industry, geographical area, counterparty etc.) – Whether the maximum exposure to credit risk was reconcilable to amounts in the statement of financial position and other relevant disclosures – The level of detail in the explanations of credit risk concentration – Whether narrative disclosures regarding how credit risk concentration was managed were provided – The presentation of collateral held – Where credit derivatives were used to manage credit risk, the level of detail of the qualitative and quantitative disclosures.
Disclosure of financial assets that are past due or impaired	<p>ESMA noted diversity in:</p> <ul style="list-style-type: none"> – While most entities provided these disclosures, they were on the whole either brief or boilerplate – The accounting policies provided were general overall and rarely contained information on the specific criteria and factors incorporated in different methodologies for calculation of collective impairment – A wide variety of terminology was used when describing impairment – Where <i>Basel 2</i> was referred to in relation to formula-based or statistical methods used in calculating portfolio based loan loss provisions, there was insufficient disclosures around the adjustments made to the <i>Basel 2</i> parameters. <p>ESMA also noted diversity in:</p> <ul style="list-style-type: none"> – Whether an ageing analysis of financial assets that are past due but not impaired per class of financial assets was provided – Whether disclosures relating to individually impaired assets were separated from collectively impaired loans (as required by IFRS 7) – Whether interest on impaired loans was disclosed.

Conclusions and recommendations noted by ESMA

Overall, ESMA found that while the financial statements reviewed generally provided information regarding credit risks, the quality and presentation of the information could be improved.

ESMA recommends that in order to improve the quality and presentation of information related to credit risk entities should:

- Ensure disclosures regarding the maximum exposure to credit risk can be reconciled back to the statement of financial position and other relevant disclosures
- Ensure that specific information regarding how entities manage credit risk concentration is provided
- Ensure that adequate disclosures regarding the mitigation of credit risk are provided, including:
 - Comparable information on collateral
 - Allocation of collateral to financial assets
 - The use of credit derivatives in managing credit risk (i.e. whether they are used for trading purposes or for credit risk management).
- Ensure that there is clear and transparent disclosures regarding the credit quality of financial assets that are:
 - Neither past due nor impaired
 - Past due but not impaired
 - Individually determined to be impaired.
- Ensure that the accounting policy regarding the collective assessment of financial assets that were assessed individually for impairment but for which no objective evidence of impairment was identified is unambiguous
- Ensure that the entities internal rating system is adequately described
- Ensure that accounting policies regarding the impairment are specific rather than boiler plate
- Ensure that any adjustments made to *Basel 2* parameters are adequately disclosed and explained.

(4)(b) Credit risk – Forbearance

Requirements of IFRS

The disclosure requirements in respect of credit risk are included within IFRS 7 *Financial Instruments: Disclosure*.

Key disclosure requirements include:

- Disclosure of the accounting policy for financial assets that are the subject of renegotiated terms that would have otherwise be past due or impaired (had they not been renegotiated) (IFRS 7.B5(g)).

ESMA's findings

Disclosure area	Details of ESMA's findings
Forbearance	ESMA noted diversity in: <ul style="list-style-type: none"><li data-bbox="383 448 1511 515">– Whether forbearance practices were specifically referred to in either the accounting policies or credit risk management note<li data-bbox="383 515 1511 582">– Whether clear quantitative information regarding the extent of the application of forbearance measures were provided<li data-bbox="383 582 1511 627">– Whether the nature of the forbearance measures extended, and related risks thereof, were described<li data-bbox="383 627 1511 694">– The ability to distinguish between loans subject to forbearance related to financial difficulties and or to renegotiations for commercial reasons<li data-bbox="383 694 1511 761">– The ability to distinguish between specific and collective impairments attributable to loans subject to forbearance<li data-bbox="383 761 1511 790">– Whether a reconciliation of the movements in loans subject to forbearance was provided.

Conclusions and recommendations noted by ESMA

Overall, ESMA found that while it appeared that disclosures regarding forbearance had improved since the 2011 reviews there is room for further improvement.

ESMA recommends that in order to improve disclosures regarding forbearance, entities should:

- Ensure that they clearly distinguish between loans subject to forbearance and loans that have been renegotiated for commercial reasons
- Ensure that their accounting policy is clear in relation to the criteria that are applied in order to determine the point at which loans are no longer considered to be subject to forbearance.

(4)(c) Credit risk – Non-performing loans**Requirements of IFRS**

The disclosure requirements in respect of credit risk are included within IFRS 7 *Financial Instruments: Disclosure*.

Key disclosure requirements include:

- A general requirement for both qualitative and quantitative disclosures regarding how credit risk arises, what the entities objectives, policies and processes for managing the risk are, and how the entity measures the risk (IFRS 7.33 and 34). The policies and processes regarding the identification of indicators of non-performance is of particular relevance here (i.e. breach of contract – default or delinquency (IAS 39.59)).
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ESMA's findings

Disclosure area	Details of ESMA's findings
Non-performing loans	ESMA noted diversity in: <ul style="list-style-type: none"><li data-bbox="383 448 1509 515">– Whether non-performing loans were specifically referred to in either the accounting policies or credit risk management notes<li data-bbox="383 515 1509 582">– When other terms (such as defaulted loans) were used in addition to non-performing loans, the distinction between them was not always clear<li data-bbox="383 582 1509 627">– Whether the term 'non-performing loans' was defined (i.e. 90 days outstanding as per <i>Basel 2</i>)<li data-bbox="383 627 1509 658">– Whether an explanation of the relationship between non-performing loans and impaired loans was provided.

Conclusions and recommendations noted by ESMA

ESMA recommends that in order to improve disclosures regarding non-performing loans, entities should:

- Ensure that a clear definition of non-performing loans is provided
- Ensure that an explanation of the relationship between non-performing loans, defaulted loans (or similar), and impaired loans is provided
- Ensure that common terminology is used (i.e. the definition of non-performing loans set out in the EBA Implementing Technical Standards).

(4)(d) Credit risk – Country concentration risk including sovereign exposures**Requirements of IFRS**

The disclosure requirements in respect of credit risk are included within IFRS 7 *Financial Instruments: Disclosure*.

Key disclosure requirements include:

- Disclosure of concentration risk (IFRS 7.34(c))
 - Disclosure of (IFRS 7.B8, IG18):
 - How management determines concentrations
 - A description of the shared characteristics that identify each concentration (e.g. counterparty, geographical area, currency, or market etc.)
 - The amount of the risk exposure.
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ESMA's findings

Background (per the ESMA Report):

'By the 2012 year end, governments' and ECB's actions had led to a fall in yields on periphery Euro-zone sovereign debt, lessening the significance of many of the issues which had been of key importance to users of financial statements the previous year. At the same time, there was a heightened concern about the quality of non-sovereign exposures in certain 'at risk' countries. The countries generally considered to be at risk changed, with additional countries coming under economic pressure.'

Disclosure area	Details of ESMA's findings
Countries 'at risk'	<p>ESMA noted diversity in countries identified as being at risk by the sampled entities:</p> <ul style="list-style-type: none"> – Those commonly identified included Greece, Portugal, Ireland, Spain, and Italy – Other identified included Cyprus, Hungary, and some Baltic countries. <p>ESMA also noted diversity in that while all sampled entities provided enhanced disclosures for at risk countries, some sampled entities provided the same level of disclosure for all Eurozone countries.</p>
Sovereign exposures in countries 'at risk' (peripheral Eurozone)	<p>ESMA noted diversity in:</p> <ul style="list-style-type: none"> – Whether both the gross and net carrying values were disclosed for impaired balances – When balances were impaired, whether explanations of how/why impairment was recognised were provided – The level of detail provided in relation to credit protection on sovereign exposures – Whether a reconciliation between maximum exposure and the exposure after credit protection was provided – Whether specific disclosure regarding the classification of fair value measurement of sovereign exposures in the fair value hierarchy was provided. <p>ESMA noted that all impairment recognised by the sampled entities related only to the Greek Private Sector Involvement (PSI) and Greek Government Bonds buybacks.</p>
Non-sovereign exposures in countries 'at risk' (peripheral Eurozone)	<p>ESMA noted diversity in:</p> <ul style="list-style-type: none"> – The overall depth and quality of the disclosures – Whether information from the peripheral Eurozone area was provided – Disclosures regarding impairment, in particular whether amounts relating to non-sovereign exposures in countries at risk in the peripheral Eurozone were presented separately.

Conclusions and recommendations noted by ESMA

Overall, ESMA found that while it appeared that disclosures regarding country concentration risk including sovereign exposures had improved since the 2011 reviews there is room for further improvement.

ESMA recommends that in order to improve disclosures regarding country concentration risk, including sovereign exposures, entities should:

- Ensure that there is clarity in disclosures regarding credit default swaps
- Ensure that both gross amounts are presented for non-sovereign exposures in countries considered to be at risk
- Ensure that there is adequate disclosure relating to the impairment of non-sovereign exposures and impact of credit default swaps on these exposures
- Ensure that when the fair value measurement is not classified as Level 1, provide specific disclosure about fair value measurement and the basis for its determination
- Ensure that concentration risk and the level of disclosure required due to specific facts and circumstances is reassessed at each reporting date
- Ensure that information is disaggregated by material countries of exposure.

(5) Impairment of equity securities classified as available-for-sale

Requirements of IFRS

The disclosure requirements in respect of credit risk are included within IFRS 7 *Financial Instruments: Disclosure*, as well as being covered by the general disclosure requirements of IAS 1 *Presentation of Financial Statements*.

Key disclosure requirements include:

- Disclosure of the measurement basis of financial instruments (IFRS 7.21)
- Disclosure of the criteria an entity uses to determine that there is objective evidence that an impairment loss has occurred (IFRS 7B5(f)):
 - IAS 39.61 and 67 detail the specific recognition and measurement requirements related to the impairment of available for sale equity instruments (i.e. significant or prolonged decline below cost).
- Disclosure of significant judgments in determining what is significant or prolonged (IAS 1.122, 123 and IFRS 7.20)
- Disaggregation of the accumulated available-for-sale reserve within equity into positive and negative amounts when this is relevant to an understanding of the financial statements (IAS 1.55, 85).

ESMA's findings

Disclosure area	Details of ESMA's findings
Impairment of equity securities classified as available-for-sale	<p>In regard to the requirement to disclose an accounting policy for the impairment of available for sale equity instruments, ESMA noted that some entities:</p> <ul style="list-style-type: none"> – Did not provide such a policy – Provided a policy but omitted key references to a significant or prolonged decline below cost – Provided a policy, but the key references to a significant or prolonged decline below cost were used in an equivocal or ambiguous manner and did not disclose quantitative values or ranges. <p>ESMA noted that there was wide diversity in the quantitative values or ranges applied to a significant or prolonged decline below cost (for those entities that disclosed the information at all). For the significant criterion, a range of 20% to 50% was used and for the prolonged criterion between 6 and 36 months.</p> <p>ESMA noted that 33% of sampled entities applied a two-stage approach to impairment:</p> <ul style="list-style-type: none"> – <i>Stage 1</i>: low threshold, if breached move to stage 2 – <i>Stage 2</i>: higher threshold, if breached impairment required. <p>While ESMA noted that the two stage approach is useful in identifying instruments that may require impairment (i.e. <i>Stage 1</i>) it found that the thresholds in <i>Stage 2</i> in some cases were too high.</p> <p>ESMA noted that only around 20% of samples entities provided disaggregation of the accumulated available-for-sale reserve within equity into positive and negative amounts.</p>

Conclusions and recommendations noted by ESMA

ESMA recommends that in order to improve disclosures regarding Impairment of equity securities classified as available-for-sale, entities should:

- Ensure that accounting policy and significant judgements regarding the assessment of significant or prolonged are disclosed
- Ensure that the accumulated available-for-sale reserve within equity is disaggregated into positive and negative amounts
- Ensure that thresholds in relation to significant or prolonged are reasonable.



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