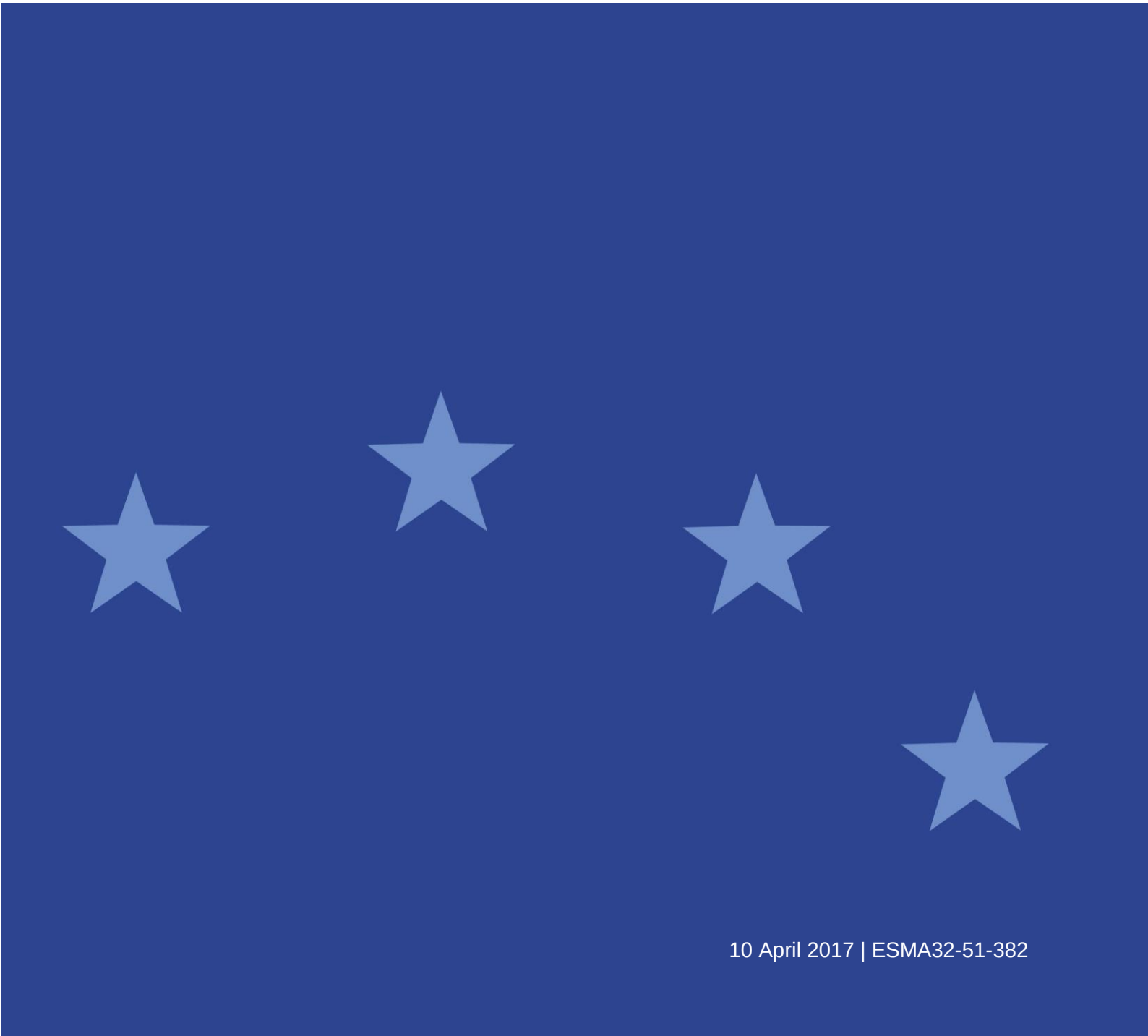
esma European Securities and Markets Authority

Report

Enforcement and Regulatory Activities of Accounting Enforcers in 2016



10 April 2017 | ESMA32-51-382

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Abbreviations and acronyms used in this report

APM	Alternative Performance Measures
ARC	Accounting Regulatory Committee
CWG	Consultative Working Group
DGS	Deposit Guarantee Schemes
EBA	European Banking Authority
EC	European Commission
ECEP	European Common Enforcement Priorities
EEA	European Economic Area
EEAP	European Electronic Access Point
EECS	European Enforcers Coordination Sessions
EFRAG	European Financial Reporting Advisory Group
EFRAG TEG	European Financial Reporting Advisory Group Technical Expert Group
ESEF	European Single Electronic Format
ESMA	European Securities and Markets Authority
EU	European Union
GAAP	Generally Accepted Accounting Principles
IAS	International Accounting Standards
IASB	International Accounting Standards Board
IFRS	International Financial Reporting Standard
IFRS IC	International Financial Reporting Standards Interpretation Committee
IOSCO	International Organization of Securities Commissions
iXBRL	Inline Extensible Business Reporting Language
MS	Member State
NCA	National Competent Authority
PDF	Portable Document Format
RTS	Regulatory Technical Standards
US SEC	United States Securities and Exchange Commission
XBRL	Extensible Business Reporting Language

Audit Regulation	Regulation (EU) No 537/2014 of the European Parliament and of the Council of 16 April 2014 on specific requirements regarding statutory audit of public-interest entities and repealing Commission Decision 2005/909/EC.
Market Abuse Regulation Regulation	(EU) No 596/2014 of the European Parliament and of the Council of 16 April 2014 on market abuse (market abuse regulation) and repealing Directive 2003/6/EC of the European Parliament and of the Council and Commission Directives 2003/124/EC, 2003/125/EC and 2004/72/EC
ESMA Regulation	Regulation (EU) No 1095/2010 of the European Parliament and of the Council of 24 November 2010 establishing a European Supervisory Authority (European Securities and Markets Authority), amending Decision No 716/2009/EC and repealing Commission Decision 2009/77/EC.
IAS Regulation	Regulation (EC) No 1606/2002 of 19 July 2002 of the European Parliament and of the Council on the application of International Accounting Standards.
Transparency Directive	Directive 2004/109/EC of the European Parliament and of the Council of 15 December 2004 on the harmonisation of transparency requirements in relation to information about issuers whose securities are admitted to trading on a regulated market.[1]
Prospectus Directive	Directive 2003/71/EC of the European Parliament and of the Council of 4 November 2003 on the prospectus to be published when securities are offered to the public or admitted to trading and amending Directive 2001/34/EC.

[1] As last amended by Directive 2013/50/EU of the European Parliament and of the Council of 22 October 2013.

1 Executive Summary

This report provides an overview of the activities of the European Securities and Markets Authority (ESMA) and the accounting enforcers in the European Economic Area (EEA), hereafter 'European enforcers', when examining compliance of financial information provided by issuers with IFRS in 2016. It also provides an overview of the main activities performed at European level, quantitative information on enforcement activities in Europe as well as ESMA's contribution to the development of the single rulebook in the area of financial reporting. In addition, it also outlines ESMA's activities for 2017 in the area of corporate reporting following its Supervisory Convergence Work Programme.

Supervisory Convergence

After the implementation of the ESMA Guidelines on Enforcement of Financial Information (hereafter the Guidelines on Enforcement) in 2015, ESMA and European enforcers continue to be committed to further strengthening supervisory convergence in the area of enforcement of financial information reporting. The Guidelines on Enforcement significantly contributed to the alignment of supervisory approaches/procedures. They provided for harmonised key concepts for examinations, a common set of enforcement priorities, a common understanding of enforcement actions and a single set of criteria for identifying accounting matters for which coordination at European level within ESMA is needed. To assess the level of compliance with the Guidelines on Enforcement and to share best practices, ESMA initiated a peer review in 2016, which will be concluded and reported on in 2017.

As in the past years, European enforcers submitted a high number of accounting issues to be discussed in EECS (50 emerging issues and 85 decisions in 2016 compared to 65 emerging issues and 67 decisions in 2015). This sharing of experience and exchange of views is crucial to ensure the convergence of supervisory outcomes in the area of accounting enforcement.

European enforcers examined the interim and/or annual financial statements of more than 1,200 issuers representing an average examination rate of 21% of all IFRS issuers with securities listed on regulated markets. This represents a slight increase in activity compared to last year, when about 20% of all issuers were examined. These examinations resulted in 311 actions taken to address material departures from IFRS. This represents in absolute numbers an increase of about 10%, compared to the 273 actions in 2015. The action rate (actions per ex-post examination) also increased slightly from 25% in 2015 to 27% in 2016. As in 2015, the main deficiencies were identified in the areas of financial statements presentation, impairment of non-financial assets and accounting for financial instruments.

In 2016, ESMA and European enforcers evaluated for a sample of 206 issuers the level of compliance with IFRS in the areas identified as common enforcement priorities for the 2015 annual financial statements. This assessment resulted in 45 enforcement actions being taken related to the two enforcement priorities assessed, namely (1) the impact of the financial market conditions on the financial statements and (2) the statement of cash flows and related disclosures.

As in previous years, ESMA together with European enforcers identified, and will include in

their supervisory practices, a set of common enforcement priorities significant for European issuers when preparing their 2016 IFRS financial statements. The 2016 priorities focus on (1) the presentation of financial performance, (2) the distinction between equity instruments and financial liabilities, and (3) disclosures of the impact of the new standards issued by the IASB, but not yet mandatorily applicable (IFRS 9 *Financial Instruments*, IFRS 15 *Revenue from Contracts with Customers* and IFRS 16 *Leases*). In the public statement, ESMA and European enforcers also urge issuers to provide disclosures on their exposure to risks arising from the UK's decision to leave the EU and its expected impacts and how management handles and plans to mitigate those risks.

ESMA's Guidelines on Alternative Performance Measures (hereafter the APMs Guidelines), which are aimed at contributing to the publication of transparent, unbiased and comparable information by European issuers on their financial performance, became effective in July 2016. The APMs Guidelines apply to APMs disclosed either by issuers when publishing regulated information or by persons responsible for prospectuses. European enforcers had to adapt their supervisory procedures and enforcers in 29 EEA countries already declared their compliance with the guidelines, while the NCA in one country intends to comply by July 2017. In 2016, ESMA actively contributed to raising awareness amongst stakeholders and to assisting them regarding the implementation of the APMs Guidelines. It also established a temporary task force in charge of monitoring the Guidelines' application and preparing guidance for both enforcers and the public. Some frequently asked questions and answers (Q&A) were published in December 2016 and January 2017.

Single Rule Book

ESMA actively participated in the accounting standards setting process by providing European enforcers' positions on all major new standards issued by the International Accounting Standards Board (IASB) as well as by contributing to the discussions in the EFRAG Board and the Technical Expert Group (EFRAG TEG) meetings. Notably, ESMA provided specific input to the due process and endorsement advices on IFRS 16 and IFRS 9, on aspects related to investor protection and financial stability as well as on the interaction of IFRS 9 with IFRS 4 *Insurance Contracts*. In addition, ESMA also contributed to the consistent application of IFRS by engaging with the IASB and the IFRS Interpretations Committee (IFRS IC) when enforcers identified relevant issues where a lack of clarity in IFRS could contribute to their divergent application.

Based on its mandate under the Transparency Directive, ESMA has published a Feedback Statement setting out the feedback received from the stakeholders on its consultation on the draft RTS on the European Single Electronic Format (ESEF) as well as the main technical decisions taken.

Work programme for 2017

ESMA published its Supervisory Convergence Work Programme, which covers, among other topics, the activities of accounting enforcers. In addition to the regular activities, especially related to the coordination of the European enforcers' work to ensure compliance of issuers' financial statements with IFRS, ESMA envisages to start updating internal guidance on methods to select issuers for examination. Moreover, ESMA will continue to work on a thematic study on IFRS 13 and initiate another thematic study on IFRS 10, 11 or

12 in order to contribute to the IASB's Post-Implementation Reviews on the respective standards. Finally, ESMA and European enforcers will continue to monitor the application of the APMs Guidelines and prepare further guidance if needed.

2 Introduction

1. This report provides an overview of the activities related to the supervision and enforcement of financial information carried out during 2016 at European and national levels in the EU and those countries from the EEA[2] who have agreed to comply with the Transparency Directive and the IAS Regulation. These activities also include ESMA's efforts to facilitate supervisory convergence and are referred to as 'European' activities in this report.

2. Furthermore, it also addresses developments related to ESMA's regulatory role regarding the contribution to the development of the single rulebook in financial reporting such as the process of the European system of endorsement of IFRS, interaction with the IASB and activities resulting from the mandate given to ESMA in the amended Transparency Directive.

3. The report is addressed to all stakeholders, including European issuers, investors, auditors, other regulators and the general public. It focuses primarily on enforcement and regulatory activities related to IFRS financial statements from issuers listed on regulated markets and consequently it does not take into account other (non-IFRS) enforcement and regulatory activities conducted by European enforcers.

3 Supervisory convergence activities

4. The promotion of harmonisation of enforcement activities related to IFRS has been an important area of development in the last years for the European regulators. The activities performed by ESMA and the European enforcers in the area of supervisory convergence in 2016 are described in detail in this chapter and are followed by an overview of the next steps that ESMA envisages in the area of corporate reporting in accordance with ESMA's Strategic Orientations 2016-2020. Appendix I provides a description of the main features of the European enforcement system on financial reporting with specific references and explanations to the Guidelines on Enforcement.

3.1. European Common Enforcement Priorities

5. An important activity in fostering supervisory convergence in Europe is establishing common enforcement priorities for financial reporting and communicating them to stakeholders in advance of the finalisation of the annual financial statements. ESMA has published European Common Enforcement Priorities (ECEP) every year since 2012 and is confident that announcing those priorities before the finalisation of annual financial statements helps to prevent misstatements and contributes to increasing the consistency and quality of financial reporting in Europe.

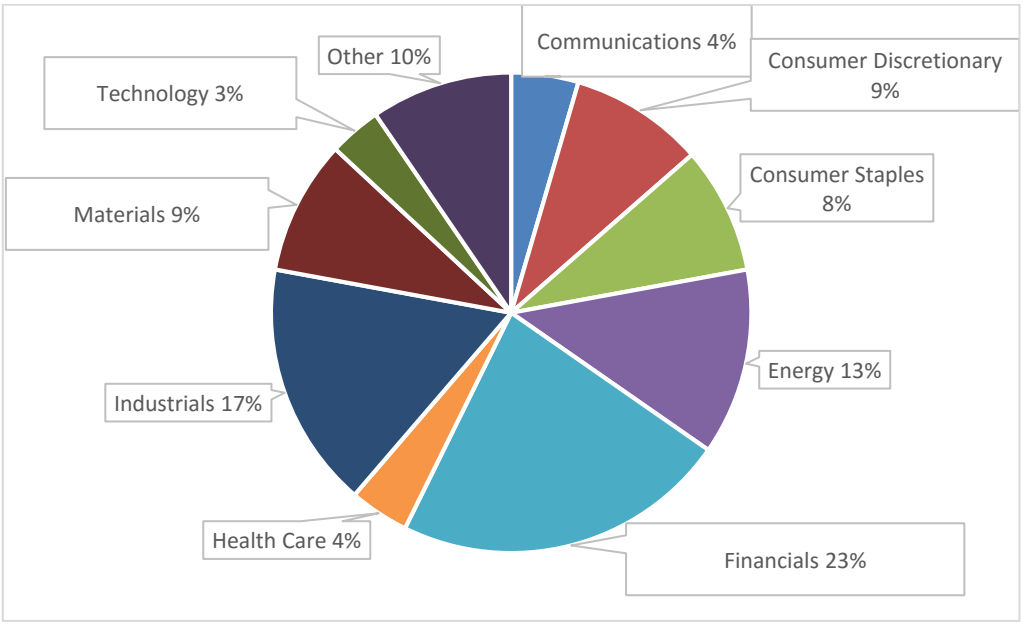
[2] Iceland and Norway

3.2. Assessment of compliance with 2015 Enforcement Priorities

6. European enforcers considered the Public Statement on the 2015 European Common Enforcement Priorities[3] (in the following: ECEP statement) during the examination process of 2015 annual IFRS financial statements. In order to assess how they had been addressed, ESMA analysed a sample of 206 issuers from 28 EEA countries selected for examination by European enforcers. When selecting the issuers, European enforcers did not use a randomised probability sampling method but selected issuers for which the enforcement priorities were of particular importance. Therefore, it is not possible to extrapolate the results from the assessment to the general population of issuers. The assessment related to: (a) the impacts of the financial market conditions on the financial statements and (b) the statement of cash flows and related disclosures. The compliance of issuers with the third common enforcement priority for 2015, fair value measurement and related disclosures, will be assessed in the course of a separate thematic review on IFRS 13.

7. As shown in the following graphics, the sample examined consisted of issuers from diverse sectors and with a range of market capitalisations.

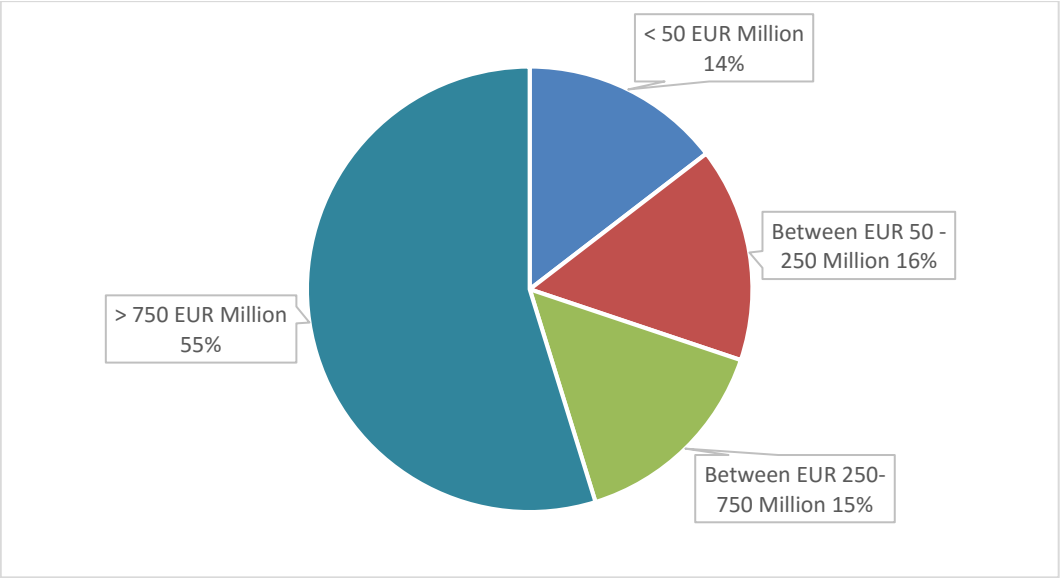
Figure 2: Issuers examined per sector of activity



8. The category “Other” includes multiple sectors not covered in the other categories, such as Conglomerates and Utilities.

[3] Public Statement, European common enforcement priorities for 2015 financial Statements, 27 October 2015, ESMA, Paris, ESMA/2015/1608

Figure 3: Market capitalisation of issuers examined



3.2.1 Impact of the financial markets conditions on financial statements

9. In 2015, reference interest rates and the market prices of a number of commodities decreased significantly and/or were highly volatile, while some exchange rates fluctuated significantly. Furthermore, macroeconomic conditions in some countries have deteriorated in such a way that these countries have enacted measures limiting the free movement of capital. Considering this, ESMA included in its 2015 ECEP and European enforcers assessed whether issuers have sufficiently considered these elements when applying accounting policies and when measuring assets and liabilities. Furthermore, European enforcers assessed whether issuers provided in their financial statements information on the risks to which they are significantly exposed and about the judgements and assumptions made by management. An assessment of compliance was performed on a sample of 151 issuers from 28 EEA countries.

Interest rate environment

Impairment of assets

10. Seventy-three percent of the issuers analysed were materially exposed to interest rate risk. Of these issuers, 65% either held (1) material goodwill or other intangible assets with indefinite useful life or (2) individual assets or cash generating units that may be impaired. These issuers therefore had to perform an impairment test and disclose the relevant information.

11. Eighty-nine percent of the issuers that had to perform an impairment test disclosed the discount rate applied to the cash flow projections which is required when the cash generating unit (CGU) tested for impairment includes goodwill or intangible assets with indefinite useful life. Eleven percent of the issuers either did not provide this information at all or not for each significant CGU or group of CGUs. European enforcers took three

actions related to this, requiring correction in future financial statements. For a further two issuers the inspections are not yet closed and may also result in an enforcement action.

12. For two thirds of the issuers that performed an impairment test, it was clear from the financial statements that the discount rate was lower than in the previous year. For the majority of the rest, the discount rate used did not decrease because either they were active in regions where the benchmark interest rates did not decrease or the decrease in the benchmark interest rates was offset by other components such as an increased market risk premium or a changed beta factor.

13. Of the issuers that disclosed the discount rate as a key assumption, 67% provided sufficient disclosures on the management approach to determine the value of the discount rate. The remaining part provided only boilerplate descriptions or no information at all on management's methodology. Of the issuers disclosing the discount rate as a key assumption, 80% provided a sensitivity analysis to a variation in the discount rate for each significant CGU or group of CGUs. For the others, it appeared that either no reasonably possible change in the interest rate would cause the aggregate of the CGUs' or group of CGUs' carrying amount to exceed the aggregate of their recoverable amounts or no information was provided. In 9% of the cases, European enforcers deemed the range of the disclosed sensitivities not to be reasonable. In some of these cases the change in the assumptions from last to the current year significantly exceeded the range disclosed in the sensitivity analysis. These unreasonable sensitivity analyses led to two enforcement actions (in one case correction in future financial statements was required and in the other case a corrective note was issued).

Defined benefit plans

14. Forty-two percent of the issuers in the sample that were materially exposed to interest rate risk disclosed material defined benefit plans in their financial statements. All of these issuers disclosed the discount rate used in their financial statements and European enforcers had no obvious indication that any of these issuers determined the discount rate in a biased way. Furthermore, the assumptions of all issuers in the sample regarding the determination of the defined benefit obligation seem to be mutually compatible. Finally, all issuers in the sample disclosed a sensitivity analysis and for all but one of them the range of the sensitivities disclosed was reasonable. Overall, in their sample, European enforcers could identify a high level of compliance by issuers regarding the requirements of IAS 19 *Employee Benefits* to determine the discount rate and regarding the associated disclosures.

Provisions

15. The sample of issuers materially exposed to interest rate risk includes 20% of issuers that have material long-term provisions. Even though not specifically required by IAS 37, the majority (55%) of these issuers disclosed the discount rate used as recommended by ESMA in its 2015 ECEP statement. Seventy-five percent of these issuers also disclosed the methodology used to calculate the rate.

Financial instruments exposed to interest rate risk

16. Of the issuers materially exposed to interest rate risk, 89% held material financial instruments exposed to interest rate risk. Overall, the level of compliance with the requirement to provide a sensitivity analysis for the interest rate exposure is relatively high, with only 5% of the issuers providing insufficient or no disclosure. Furthermore, 90% of the issuers having material financial instruments exposed to interest risk provide full disclosure of how they manage the risk to interest rate exposure and only 5% of these issuers provide insufficient or no disclosure.

Exposure to high volatility and low prices for commodities

17. Thirty-three percent of issuers in the sample were materially exposed to the risk of volatility of prices for commodities and low prices for commodities (referred to as commodities risk in the following section). The following section analyses how this risk was taken into account in the impairment tests and how it was disclosed in the financial statements.

Impairment of assets

18. Seventy percent of the issuers materially exposed to commodities risk had to carry out impairment tests either because they (1) have goodwill or other intangible assets with an indefinite useful life or (2) because there was an indication that a material individual asset or CGU was impaired. Of these issuers, 80% took the impact of the volatility of the commodities' prices into account in the calculation of the future cash flows and 34% in the discount rate applied in the impairment test.

19. Of the issuers preparing an impairment test because of the existence of intangible assets with indefinite useful life or goodwill, 74% disclosed that they consider commodity prices as a key assumption. According to paragraphs 134(d)(ii) and 134(e)(ii) of IAS 36 these issuers should disclose management's approach to determining the value of the prices of the commodities used in the test; however, only 50% of them did. Nevertheless, this was mitigated by the fact that a further 19% of those issuers that did not disclose the management's approach to determining the value of the prices, disclosed the commodity prices used in the impairment test. Enforcers took three enforcement actions addressing the lack of information on the determination of prices used in the impairment test.

20. Overall, 46% of the issuers preparing impairment tests disclosed the commodity prices used in the impairment test as recommended by ESMA in its 2015 ECEP statement.

21. Only 46% of the issuers provided a sensitivity analysis for each significant CGU due to a variation of the commodity prices and of these issuers that provided a sensitivity analysis, 33% provided ranges that seemed unreasonable. For instance, one issuer provided a sensitivity analysis in which the expected reasonable change of the respective commodity price was 5% whereas in 2015 the price of this commodity decreased by 47%. In one case, a European enforcer required a corrected sensitivity analysis in the future financial statements.

22. Of the issuers that had to prepare an impairment test, 49% recognised an impairment loss related to the impact of commodity prices. European enforcers did not determine that the recognised impairment amounts were inappropriate in any of these cases.

Foreign exchange rate and country risk

23. Fifty-seven percent of the issuers in the sample were materially exposed to a specific country at risk and/or exchange rate risk. Of these issuers, 35% were materially exposed to one or more countries facing significant uncertainties such as financial difficulties, political tensions, pressures on foreign exchange rates. This includes also countries with currencies that have more than one official exchange rate or capital restrictions. These countries in the following will be referred to as countries at risk.

Countries with multiple exchange rates, cash restrictions and other countries at risk

24. Based on paragraphs 125 to 129 of IAS 1 *Presentation of Financial Statements*, ESMA expressed in its 2015 ECEP statement its expectation that issuers with significant exposure to a country at risk, in which more than one foreign exchange rate exists, should provide information about the exposure. Furthermore, issuers should provide the foreign exchange rate and an analysis of the main judgements used (e.g. the judgements made and the reasons for selecting one specific foreign exchange rate rather than another), as well as a sensitivity analysis where relevant. Of the issuers with exposure to country or exchange rate risk, 10% were exposed to a country with more than one exchange rate, most of them to Venezuela. Sixty-six percent of them disclosed the exchange rate used and provided a sensitivity analysis. Only one third sufficiently described the judgements made while the rest provided either only boilerplate information or none at all.

25. Twenty-three percent of the issuers materially exposed to a specific country at risk and/or exchange rate risk were exposed to countries with restrictions. The countries most mentioned were Greece, Russia and Venezuela, where also certain capital controls apply. Also mentioned were, Algeria, Angola, Argentina, Iran and Nigeria. Forty percent of these issuers provided insufficient information on the extent of these restrictions and 65% of them provided only insufficient disclosure about the nature and extent of significant cash and cash equivalents held but not available to the group due to restrictions. E.g., one issuer exposed to Russia only referred to the existence of sanctions without specifying their extent and in which way the restrictions affect its business.

26. Overall, 42% of the issuers that were materially exposed to countries at risk recognised an impairment loss and, in none of these cases, European enforcers concluded that the impairment recognised was inappropriate.

Market risk - exchange rate risk

27. Of the issuers materially exposed to a specific country at risk and/or exchange rate risk, 78% held material financial instruments exposed to exchange rate risk. Eighty-two percent of these issuers provided a full sensitivity analysis for the exchange rate risk and 86% of them disclosed information how they would manage exchange rate risk.

Only 5% of these issuers had missing sensitivity analyses or provided insufficient information and only 3% provided insufficient information on how the exchange rate risk would be managed. The level of compliance with the requirements of IFRS 7 *Financial Instruments: Disclosures* in this respect can therefore be considered high.

Enforcement actions

28. As a summary of the analysis made above, following the examinations of 151 IFRS financial statements, which were assessed for this enforcement priority, European enforcers took enforcement actions against 18 issuers. From these:

    - in 4 cases the enforcer required public corrective notes and;
    - in 14 cases corrections in future financial statements were required.

29. Ten of the actions taken related to the interest rate environment. In this regard, most of the actions addressed deficiencies of the disclosures of key assumptions for the impairment test (most notably the discount rate used to discount the cash flows) and sensitivity analyses. Of the seven actions related to commodities risk, most addressed missing disclosures on the management approach to determine the value of the prices of the commodities used in the impairment test. The action regarding the exchange rate risk addressed insufficient sensitivity analysis.

3.2.2 Statement of cash flows and related disclosures

30. The statement of cash flows is a key element in understanding and analysing an issuer's performance and allows users to assess the ability of an issuer to generate and allocate cash and consider its reliance on new financing. Despite its importance, enforcers have often come across issues in the application of the IFRS requirements in relation to the statement of cash flows. Therefore, ESMA included the statement of cash flows in its common enforcement priorities for 2015.

31. The sample size for the assessment of this enforcement priority amounted to 136 issuers. The vast majority of them (88%) presents the cash flow statement using the indirect method, with only 12% presenting the cash flow statement using the direct method.

32. For 37% of the issuers in the sample, enforcers examined the interim financial statements and noted that in 14% of these cases the issuers only provided a three-line statement of cash flows. The IFRS IC determined in July 2014, that in order to meet the requirements in paragraphs 10, 15 and 25 of IAS 34 *Interim Financial Reporting* a condensed statement of cash flows should include all information that is relevant in understanding the entity's ability to generate cash flows and the entity's needs to utilise those cash flows. It also noted that it did not expect that a three-line presentation alone would meet the requirements in IAS 34. Based on this reasoning, one enforcer took an enforcement action after assessing that the provided information was insufficient and two further examinations are still ongoing and might lead to additional actions.

33. Where the classification of cash flows involves judgement, and the amounts are material, ESMA and European enforcers expected, based on paragraphs 125 to 129

of IAS 1, that issuers provide information on the classification together with the reasoning. The 2015 ECEP statement mentions examples of cash flows where classification requires judgement such as cash flows of an operator in a service concession agreement, cash payments for deferred or contingent considerations arising from a business combination or cash flows from interest and dividends. In 10% of the sample enforcers determined that the issuers did not sufficiently disclose in the accounting policies the judgements made when classifying cash flows. In several of these cases, the enforcers recommended issuers to provide more detailed information in the future, and enforcers also took a number of enforcement actions to address the missing disclosures immediately.

34. Paragraph 6 of IAS 7 *Statement of Cash Flows* defines operating activities as all the principal revenue-producing activities of an issuer and other activities that are not investing or financing activities. Therefore, also cash flows arising from activities or transactions not usually entered into in the normal course of business should be presented in cash flows from operating activities unless they meet the definition of cash flows from financing or investing activities. In 5% of the sample enforcers determined that the operating cash flows included cash flows that fulfil the definition of financing or investing cash flows. Examples were, for instance, cash inflows resulting from the sale of joint ventures, which should have been classified as investing activities, cash outflows resulting from the early repayment of debts or cash inflows from issuing long-term debt, which should have been classified as financing activities. European enforcers took three enforcement decisions related to this erroneous classification of cash flows that meet the definition of financing or investing cash flows.

35. In the 2015 ECEP statement ESMA encouraged issuers to present a breakdown of the changes in working capital if it is subject to significant variations from the comparative reporting period. Seventy-four percent of the issuers in the sample provided this breakdown.

36. Ninety-six percent of the issuers followed the requirement to separately report major classes of gross cash receipts and gross cash payments arising from investing and financing activities which is a high level of compliance. Of those issuers that presented cash flows arising from obtaining or losing control of subsidiaries or other businesses, 94% classified them as investing cash flows as required by paragraph 39 of IAS 7. Furthermore, 90% of these issuers reported the aggregated amount of cash paid or received as consideration for obtaining or losing control of subsidiaries or other businesses in the statement of cash flows net of cash acquired or disposed of as required by paragraph 39 of IAS 7.

37. The sample included 24% of issuers that reported cash flows arising from changes in ownership interests in a subsidiary that did not result in a loss of control. Out of these issuers, 88% reported the cash flow in financing activities as required by paragraph 42A of IAS 7. Of those that did not, most presented it as investing cash flow. One enforcement action was undertaken in this context.

38. Most issuers (77%) separately disclosed both dividends and interest, 10% disclosed only interest separately and 5% only dividends. In two cases, enforcers took an action requiring the separate disclosure of interest or dividends.

39. In its 2015 ECEP statement, ESMA raised awareness that it would be important for issuers to analyse the substance of supplier chain financing (also called 'reverse factoring') arrangements. ESMA noted that it would be important to assess whether the related trade payables should be reclassified as financial liabilities towards banks and whether the cash flows should be presented as operating or as financing cash flows. Only a few issuers in the sample (3%) entered into material reverse factoring agreements, but in two of these cases European enforcers took enforcement actions because the respective issuers did not sufficiently describe the relevant provisions of the arrangements, the quantitative impacts and the accounting policy applied.

40. A significant part of the issuers in the sample (26%) includes bank overdrafts as a component of cash and cash equivalents, which is permitted under IFRS if the bank overdrafts are repayable on demand and they form an integral part of the entity's cash management.

41. Almost all issuers in the sample excluded non-cash transactions from the statement of cash flows. Only 3% of the issuers incorrectly included transactions that do not generate cash flows during the period in their statement of cash flows. One issuer for instance included the unrealised fair value changes in the statement of cash flows.

42. European enforcers noted that only 51% of the issuers in the sample appropriately cross-referenced the figures in the cash flow statements with other primary financial statements or the notes. Another 21% provided only incomplete cross references, while 28% of the issuers did not cross-reference the information in the financial statements at all. This lack of compliance with the IFRS requirements, led to several enforcement actions.

Enforcement actions

43. The assessment of the financial statements of 136 issuers that constituted the sample for this enforcement priority led to enforcement actions against 25 issuers.

- In one case the enforcer required reissuance of the financial statements;
- in 4 cases the enforcer required public corrective notes and;
- in 20 cases corrections in future financial statements were required.

44. In seven cases, the enforcer required the issuers to improve the cross-referencing of items in the statement of cash flows to any related information in the notes or to the other primary financial statements. In six instances, the enforcers' actions addressed presentation in the cash flow statement that incorrectly netted cash receipts and cash payments or where the issuer did not disclose separately cash flows from interest and dividends. With six enforcement actions, enforcers also addressed erroneous classification of cash flows or insufficient disclosures related to the classification.

Conclusion

45. Overall, enforcement actions were taken against more than a fifth of the issuers included in the sample of 206 issuers. In many cases, enforcement actions cover several areas of the same set of IFRS financial statements. While the compliance with the requirements in IAS 7 is generally relatively high, the infringements were very often material which led to a relatively high number of enforcement actions of which 80%

were corrections in future financial statements. The common enforcement priority relating to the impacts of the financial market conditions on the financial statements led to fewer enforcement actions; however, this might also be because more judgement is required.

Table 1: Enforcement actions on the sample of issuers in the European Common Enforcement Priorities

Enforcement Action	Impact of the financial markets conditions	Statement of cash flows	Total number of enforcement actions
Reissuance of financial statements	0	1	1
Public corrective notes	4	4	8
Corrections in future financial statements	14	20	34
Total number of enforcement actions	**18**	**25**	**43**
Sample size	151	136	206[4]
Sample action rate	**12%**	**18%**	**21%**

3.3. European Common Enforcement Priorities for 2016 Financial Statements

45. As in previous years, ESMA and European enforcers agreed on European Common Enforcement Priorities in advance of the preparation, audit and publication of the 2016 annual IFRS financial statements. The 2016 ECEP statement (ESMA/2016/1528)[5] contains the financial reporting topics that were identified as particularly important for European issuers on the basis of, on the one hand, recurrent enforcement issues encountered by European enforcers and discussed in EECS and, on the other hand, the expected significant changes that the new IFRS standards will bring. When selecting the topics, ESMA took into account the result of the examinations of financial statements performed in 2016 and consulted with the Consultative Working Group (CWG) of the Corporate Reporting Standing Committee.

46. The 2016 priorities focus on: (1) the presentation of financial performance, (2) the distinction between equity instruments and financial liabilities and (3) disclosures of the impact of the new standards issued by the IASB, but not yet mandatorily applicable (IFRS 9, IFRS 15 and IFRS 16). In the 2016 ECEP statement, ESMA and the European enforcers also urge issuers to provide disclosures on their exposure to risks arising from the UK's referendum decision to leave the EU and its expected impact. Furthermore, issuers should describe how management manages and plans to mitigate

[4] As enforcement examinations might cover several areas of the same set of IFRS financial statements, the total number of issuers is lower than the total of the sample sizes in the respective areas.
[5] Public Statement, European common enforcement priorities for 2016 financial statements, 28 October 2016, ESMA, Paris, 2015/ESMA1608

those risks.

47. Monitoring the way issuers address these priorities is part of the work programme of ESMA and European enforcers, who will consider these topics in their examinations of the 2016 year-end IFRS financial statements. In its Report on Enforcement and Regulatory Activities of Accounting Enforcers (Activity Report) for 2017, ESMA will report on how European issuers applied the IFRS requirements on these topics.

3.4. Coordination of enforcement decisions

48. In accordance with the Guidelines on Enforcement, ESMA has a coordination role to facilitate analysis and discussion of enforcement issues regarding IFRS financial statements in the European Enforcers' Coordination Sessions (EECS). Most discussions in the EECS refer to issues that fulfil the submission criteria set out in the Guidelines on Enforcement such as issues that might be of significant importance to European markets or of widespread effect in Europe. Discussions can take place on an ex-ante (emerging issues) or an ex-post (decisions) basis. EECS discussions offer an opportunity to benefit from the experience of other enforcers who already encountered similar issues, and to gather useful input for the analysis of technical issues. When time constraints do not allow waiting until the next EECS physical meeting (nine meetings took place in 2016) to discuss an emerging issue, they can be discussed in ad-hoc conference calls or through written procedure. When taking an enforcement decision, European enforcers should take into account the outcome of previous discussions in EECS.

49. From the discussions of emerging issues and decisions, ESMA gains a sense of the application of IFRS in Europe and of the main topics which pose challenges to issuers. In 2016, 50 emerging issues were discussed at the EECS. In addition to that, European enforcers submitted 85 decisions to the EECS database, 44 of which were discussed. The discussions and the conclusions reached by European enforcers at EECS are intended to improve the level of consistent application and enforcement of IFRS, subject to the specific facts and circumstances of the situations or transactions discussed. The examples presented below are neither intended to represent all types of issues discussed nor all areas where the application of IFRS was challenged by European enforcers. They are merely illustrative of some of the issues most frequently found.

Classifications of financial instruments (IAS 32 Financial Instruments: Presentation)

50. As in previous years, a number of issues debated in the EECS meetings related to the classification of financial instruments. EECS discussed, amongst other issues, the application of paragraph 22 of IAS 32 which states that a contract that will be settled by the entity receiving or delivering a fixed number of its own equity instruments in exchange for a fixed amount of cash or another financial asset is an equity instrument (the so called 'fixed-for-fixed' condition). Cases discussed related for instance to convertible instruments that contain anti-dilution clauses or to contracts where the transaction price is in a different currency than the entity's functional currency, both situations leading to a potential adjustment of the transaction price.

51. Furthermore, EECS discussed on several occasions new structures where the entity's shareholders, potentially acting as a corporate decision making body, had the possibility to avoid payments of the entity to shareholders or to third parties. It was discussed whether in such cases the entity has an unconditional right to avoid delivering cash and, consequently, if a financial liability exists. EECS noted that the decision whether in these circumstances the entity can avoid payments or not requires judgement and is not always straightforward. Therefore, in those exceptional cases where the applicable standards do not provide clear guidance, issuers are reminded of the need for disclosures of the accounting policy applied when accounting for these types of instruments in accordance with paragraphs 117 and 122 of IAS 1.

52. In this respect, ESMA notes that the IASB is currently undertaking a project to improve and simplify the financial reporting requirements for financial instruments with characteristics of equity. A key objective of this project is to develop a better distinction between equity and non-equity instruments. Due to the recurrence of issues related to the classification of financial instruments this topic was furthermore included in the European Common Enforcement Priorities for the 2016 annual financial statements.

Unused tax losses

53. In light of the economic environment and the recurrence of the issue, ESMA had included in its 2014 European Common Enforcement Priorities the recognition and measurement of deferred tax assets arising from unused tax losses and uncertain tax positions. As indicated in the Activity Report in 2015[6], the analysis of the outcome of the European enforcers' examinations showed that from a sample of 65 completed examinations, 10 led to enforcement actions on this particular topic. This revealed that there was still room for improvement in the application of the IAS 12 requirements.

54. Therefore, in 2016 European enforcers continued to monitor issuers' compliance with the requirements of IAS 12 and EECS discussed on several occasions accounting issues related to the recognition of deferred tax assets arising from unused tax losses. In addition to that, ESMA and European enforcers set up a group of experts that assesses how to further increase convergence in the application and enforcement of the relevant IAS requirements. Moreover, ESMA will deliberate whether it would be helpful to report to IASB and/or IFRS IC difficulties encountered by European enforcers due to a lack of clarity in the standard.

Presentation of financial performance

55. ESMA and European enforcers discussed several issues linked to the presentation of financial performance. Some of the issues discussed were related to issuers including in the financial statements alternative performance measures and other information not specifically required by IFRS Standards. European enforcers required issuers to ensure that this information is compliant with IFRS Standards for instance by safeguarding that the information presented is unbiased and that not only negative aspects of the entity's performance are eliminated when calculating an alternative performance measure. Likewise, European enforcers discussed issues related to the

6 ESMA Report on Enforcement and Regulatory Activities of Accounting Enforcers in 2015, 29 March, ESMA, Paris, ESMA/2016/410

application of paragraph 85A of IAS 1 regarding the labelling of subtotals in the statement of profit or loss and other comprehensive income.

56. ESMA and European enforcers attach high importance to high quality disclosures related to financial performance. The ESMA Guidelines on Alternative Performance Measures (APMs Guidelines)[7] are applicable to items presented in regulated information other than the financial statements such as management reports or ad-hoc disclosures, and became effective in July 2016. The presentation of financial performance was also included in the European Common Enforcement Priorities for the 2016 annual financial statements. In this context, ESMA and the European enforcers welcome that also the IASB underlined that one of its priorities for the following years is to increase the effectiveness of communication in the financial statements[8].

3.5. ESMA enforcement database

57. In order to facilitate the sharing of enforcement decisions and experiences, in 2005 ESMA established an internal database to which European enforcers submit the decisions that they have taken as part of their national enforcement processes. In accordance with the Guidelines on Enforcement, European enforcers should submit their emerging issues and enforcement decisions if these meet any of the submission criteria therein defined. European enforcers should consult the database before taking significant enforcement decisions and take into account the outcome of the discussions in EECS on similar issues.

58. Including the 50 emerging issues and the 85 decisions submitted in 2016, as of 31 December 2016, the EECS database includes now 965 decisions and 431 emerging issues and thus constitutes a rich source of knowledge. ESMA regularly publishes enforcement decisions to inform market participants which accounting treatments European enforcers may or may not consider as complying with IFRS. In 2016 ESMA prepared two extracts from the EECS database for publication, the 19th Extract[9] and the 20th Extract[10] containing in total 25 enforcement decisions. The 20 extracts from the EECS database of enforcement ESMA has published contain already 223 enforcement decisions. As these decisions are based on the IFRS requirements valid at the time of preparation of the respective IFRS financial statements, some of them may by now be superseded but most of the decisions are still relevant. ESMA is confident that these extracts are helpful and contribute to the consistent application of IFRS. ESMA plans to continue publishing enforcement decisions on a semi-annual basis. Published decisions are also included in the database of the International Organization of Securities Commissions (IOSCO).

7 Final Report, ESMA Guidelines on Alternative Performance Measures, 30 June 2015, ESMA, Paris, ESMA//2015/1057
8 Speech by IASB Chairman Hans Hogervoorst: Better Communication, Zurich, 30 June 2016
9 Report, 19th Extract from the EECS's Database of Enforcement, 28 July 2016, ESMA, Paris, ESMA/2016/1208
10 Report, 20th Extract from the EECS's Database of Enforcement, 5 January 2017, ESMA, Paris, ESMA32-63-200

3.6. Guidelines on Alternative Performance Measures (APMs)

59. The APMs Guidelines became mandatorily applicable in July 2016. The guidelines define what is an APM and set out the principles to be followed by issuers and persons responsible for the prospectus when they include these measures in prospectuses or in regulated information documents (such as management reports or ad-hoc disclosures published in accordance with the provisions of the Market Abuse Regulation). These principles relate amongst others to the labelling, calculation, presentation and comparability of APMs. National Competent Authorities should monitor whether issuers comply with the APM Guidelines. NCAs in 29 EEA countries confirmed their compliance and one NCA intends to comply by July 2017 with the guidelines.

60. During the course of 2016, ESMA and NCAs actively promoted awareness among issuers and the persons responsible for the prospectus to ensure a high quality application of the principles included in the guidelines. As such, ESMA staff has participated in conferences and workshops with the aim to gather issuers' views on the application of the APMs Guidelines and, where necessary, to provide further explanations on the rationale for the principles included therein.

61. At the same time, in order to ensure supervisory convergence of enforcers practices, ESMA established an internal temporary task force with the objective of monitoring the application of the guidelines and gathering the most frequent issues raised from the application and supervision and reaching common understanding where more guidance is needed.

62. In this respect, ESMA published in December 2016[11] and January 2017[12], seven frequently asked questions and answers (Q&A) on the APMs Guidelines. These Q&As do not set additional requirements for issuers but rather further explain the principles included in the APMs Guidelines and how they interact with each other. In 2017, ESMA will continue to monitor closely the application of the guidelines and, where necessary, will issue more guidance in areas where significant divergence in application of the guidelines is identified.

3.7. Study on the implementation of IFRS 13

63. In order to contribute to the IASB's Post Implementation Review on IFRS 13 *Fair Value Measurements*, ESMA's Supervisory Convergence Work Programme for 2016 in the area of corporate reporting included a thematic study on IFRS 13.

64. For this purpose, at the end of 2016 ESMA has established a temporary task force with the objective of assessing, based on a sample of issuers, the level of compliance, consistency and comparability of financial statements of European issuers with respect to the application of IFRS 13.

65. ESMA plans to issue the thematic study by the end of the first half of 2017. Based on

11 Q&A on Prospectus Related Topics, ESMA, Paris, 2016/1674

12 Questions and answers: ESMA Guidelines on Alternative Performance Measures (APMs), ESMA32-51-370

the evidence gathered in the course of the study, ESMA will respond to the IASB's request for information.

3.8. ESMA Statement on implementation of IFRS 9 and IFRS 15

66. In 2016 ESMA published two Statements on the implementation of new standards issued by the IASB (but not yet mandatorily applicable), one related to IFRS 15[13] and one related to IFRS 9[14]. In the light of the expected impact and importance of these two standards and given that some aspects of the new standards represent a significant change compared to the current standards, ESMA highlighted in these statements the need for timely preparation and implementation. Furthermore, ESMA calls upon issuers to provide users of financial statements with sufficient information to understand the impact that the future application of the new standards will have on the financial position and performance of the entity.

67. The statement related to the implementation of IFRS 15 was published on 20 July 2016. IFRS 15 establishes a new, comprehensive framework for measuring and recognising revenue and, while in some circumstances the impact of the implementation will be limited, for other transactions, the impact on the amount and/or timing of revenue may significantly differ from current practices. Following the endorsement in the EU, IFRS 15 will apply from 1 January 2018 to all issuers.

68. The statement related to IFRS 9 was published on 10 November 2016 in parallel with a report of the European Banking Authority (EBA) on the impact assessment of IFRS 9. IFRS 9 replaces major parts of IAS 39 *Financial Instruments: Recognition and Measurement* and contains a new impairment model based on expected credit losses (ECL). It also includes new requirements and guidance on the classification and measurement of financial assets and introduces new requirements to address the so-called 'own credit' risk issue. The new standard is expected to have significant impact on financial institutions as well as on non-financial entities that will potentially benefit from the changes made to the accounting requirements for transactions that qualify as hedging.

69. In the two statements, ESMA calls on issuers to ensure that they will be ready when the new requirements become mandatorily applicable and that they provide relevant disclosures on the expected impact in accordance with paragraph 30 of IAS 8 as soon as they are known or reasonably estimable. ESMA expects that as the implementation of the two standards progresses, information about their impact should become more reasonable estimable and issuers will be able to provide progressively more entity-specific qualitative and quantitative information about the application of these two standards. To assist issuers in their implementation efforts, the two statements also provide an illustrative timeline and good practices of disclosures.

70. ESMA expects that these two statements will be taken into account by issuers and

[13] Public Statement, Issues for consideration in implementing IFRS 15: Revenue from Contracts with Customers, ESMA, Paris, ESMA/2016/1148, published on 20 July 2016
[14] Public Statement, Issues for consideration in implementing IFRS 9: Financial Instruments, ESMA, Paris, ESMA/2016/1563, published on 10 November 2016

reflected in the 2016 and 2017 annual and interim financial statements. ESMA, together with NCAs, will monitor the level of transparency that issuers provide in their financial statements regarding the implementation of the two standards, the changes in accounting policies resulting from its implementation and the relevant information to assess the possible impact on the issuers' financial statements in the initial period of application.

3.9. Main indicators of the IFRS enforcement activity at national level

71. In order to monitor the level of enforcement activity, ESMA collects statistics in relation to the number of examinations performed and the number of actions taken by European enforcers. At the European level, around 6,000 issuers of securities admitted to trading on regulated markets[15] prepare IFRS financial statements, among which 5,141 prepare consolidated IFRS financial statements and 820 prepare only non-consolidated IFRS financial statements. Furthermore, 103 issuers prepare consolidated financial statements under third country GAAP deemed equivalent to IFRS (mainly US-GAAP).

72. In 2016, European enforcers performed 812 unlimited scope examinations[16] of the financial statements of IFRS issuers[17], covering financial statements of around 14% of listed IFRS issuers in Europe (13% in 2015). In addition, the financial statements of 446 IFRS issuers were subject to focused examination, representing a coverage of around 7% of the listed IFRS issuers (6% in 2015). Altogether, in 2016, the financial statements of 21% (20% in 2015) of the entities listed on European regulated markets preparing financial statements according to IFRS were subject to examination by European enforcers.

Table 2: Number of issuers examined

	Number of issuers examined			
	Unlimited scope	Focused	Total 2016	Total 2015
Ex-post examinations	**767**	**380**	**1,147**	**1,089**
- thereof: Annual IFRS financial statements	697	242	939	925
- thereof: Interim IFRS financial statements only	70	138	208	164
Ex-ante examinations	**45**	**66**	**111**	**139**
Total number of issuers preparing IFRS financial statements examined	**812**	**446**	**1,258**	**1,228**
Ex-post examinations of financial statements prepared using third country GAAP deemed equivalent to IFRS	5	0	5	9

73. In 2016, 1,147 of issuers were subject to ex-post examinations, which represents a

[15] This number and subsequent analysis do not include the IFRS financial statements of entities not issuing securities admitted to trading on regulated markets that are required to prepare IFRS financial statements on the basis of options in the IAS Regulation.
[16] Definitions of unlimited scope examination and focused examinations are included in Appendix I to this report.
[17] Each issuer is only counted once; in the case where both annual and interim financial statements were examined, only annual financial statements count.

slight increase in relation to the previous year (1,089 in 2015). On the other hand, the number of ex-ante examinations, which require more resources from European enforcers in the control of compliance of all relevant documents (e.g. financial information included in prospectuses), has slightly decreased to 111 (139 in 2015). Overall, both the examination rate (21% in 2016 compared to 20% in 2015) and the unlimited scope examination rate (14% in 2016 compared to 13% in 2015) are broadly stable.

74. ESMA also provides information by clusters of countries reflecting the size of the respective capital markets. The clusters have been determined based on the number of issuers listed on regulated markets in each jurisdiction preparing financial statements in accordance with IFRS.

Table 3: Number of IFRS issuers per country

Number of IFRS issuers	Countries
1-99 issuers	Cyprus, Czech Republic, Estonia, Hungary, Iceland, Latvia, Lithuania, Malta, Portugal, Romania, Slovakia, Slovenia
100-249 issuers	Austria, Belgium, Croatia, Denmark, Finland, Greece, Ireland, Luxembourg, Netherlands, Norway, Spain
250-450 issuers	Bulgaria, Italy, Poland, Sweden
>450 issuers	France, Germany, United Kingdom

75. The following table summarises the actions and examinations undertaken by enforcers in relation with IFRS issuers during 2016 and divides countries in clusters by the number of issuers.

Table 4: Number of examinations and actions for IFRS issuers in 2016

	Number of issuers per cluster	Number of issuers subject to unlimited scope examinations	Unlimited scope examination rate	Total number of issuers subject to examinations	Examination rate[18]	Total number of issuers subject to ex-post examinations	Total number of issuers for which actions were taken	Sample action rate[19]
Countries with 1-99 issuers	556	126	23%	173	31%	157	40	25%
Countries with 100-249 issuers	1,728	240	14%	419	24%	351	120	34%
Countries with 250-450 issuers	1,370	188	14%	299	22%	286	42	15%
Countries with >450 issuers	2,307	258	11%	367	16%	353	109	31%
Total 2016	**5,961**	**812**	**14%**	**1,258**	**21%**	**1,147**	**311**	**27%**
Total 2015	**6,283**	**844**	**13%**	**1,228**	**20%**	**1,098**	**273**	**25%**

[18] Number of issuers examined divided by total number of issuers.
[19] Number of issuers for which actions were taken divided by number of issuers subject to ex-post examination.

76. In around 27% of the ex-post examinations performed during 2016, European enforcers have taken enforcement actions. In view of this sample action rate which is somewhat higher than in the previous year (2015: 25%), ESMA considers that there is still room for improvement in the quality of IFRS financial reporting in Europe.

77. The coverage of unlimited scope and focused examinations varies significantly from one country to another because of the diversity in the number of issuers per jurisdiction, the level of complexity of their financial statements, the availability of enforcer's human resources and the importance of the financial market. Furthermore, the number of enforcement actions taken in individual jurisdictions varies because of the complexity, number and type of issuers that have securities admitted to trading on a regulated market and the legal framework in which the national enforcer operates in these specific jurisdictions.

78. ESMA performed an analysis of the type of actions taken by European enforcers during 2016. An enforcement action related to a single issuer might have identified multiple areas of concern. In around 30% of the actions taken, European enforcers requested immediate information of the market by the issuance of corrective notes or by reissuance of financial statements whereas in around 70% of the cases European enforcers considered corrections in future financial statements to be sufficient.

Table 5: Number of issuers for which actions were taken

	Annual IFRS Financial statements	Interim IFRS Financial state-ments	Total	Thereof: actions relating to disclosures only
Require a reissuance of the financial statements	5	3	8	2
Require a public corrective note	62	30	92	24
Require a correction in fu-ture financial statements	189	22	211	132
Total 2016	**256**	**55**	**311**[20]	**158**
Total 2015	**236**	**37**	**273**	**not available**

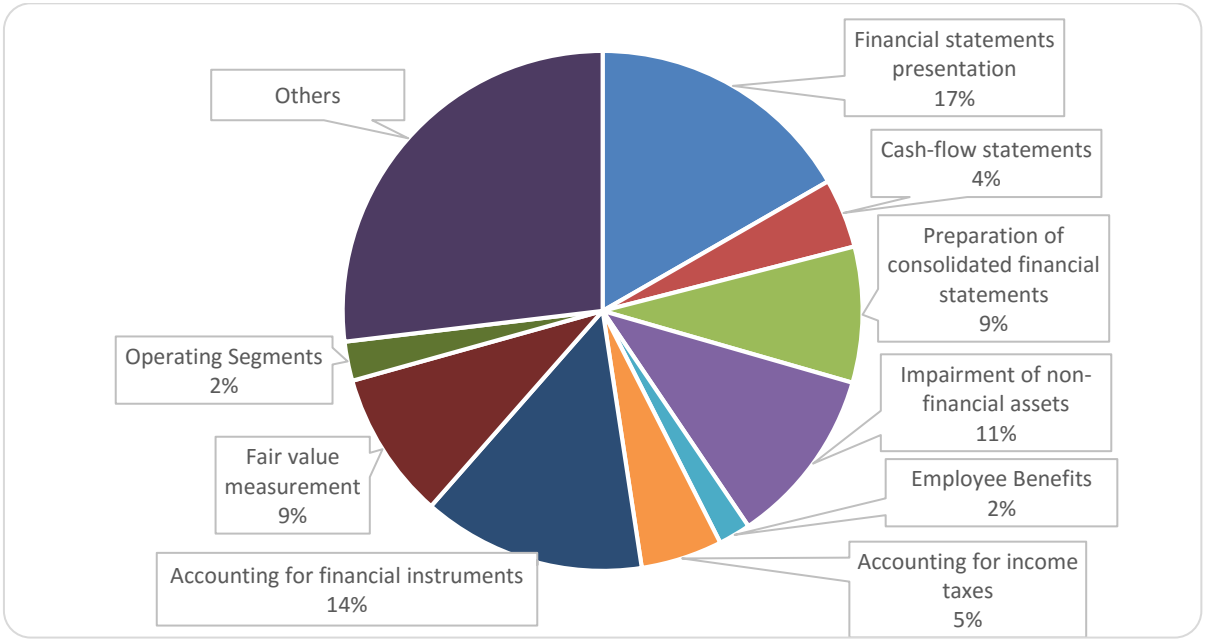
79. When deciding to require a correction in future financial statements (rather than an action leading to information provided immediately to the market), enforcers consider the timing of the decision (e.g. the next financial statements' publication time), its nature and the surrounding circumstances, such as the assessment whether the market is sufficiently informed at the moment the decision is taken. In almost two thirds of the cases in which the enforcer required to correct an infringement in a future financial statement, the action related to disclosures only. This is a significantly higher percentage than for reissuances of the financial statements or corrective notes, where only 26% of the actions relate to disclosure issues only.

80. Figure 7 presents an overview of the accounting topics in which enforcers have taken

20 In addition to the actions taken by enforcers, there were 26 instances in which issuers spontaneously issued a corrective note in response to an initial communication with the enforcer.

actions in 2016:

Figure 4: Areas addressed by enforcement actions taken in 2016



81. ESMA notes that the areas where most infringements were identified by European enforcers remained consistent when compared with 2015. Actions of significant importance related to: (1) financial statements presentation, (2) accounting for financial instruments and (3) impairment of non-financial assets. These three areas represent more than 40% of all the issues addressed by enforcement actions taken by European enforcers in 2016.

82. It is also interesting to notice that the share of actions European enforcers took in these three areas, compared to all actions taken by them in 2016, remained broadly stable compared to last year. Fourteen percent of the actions taken related to the accounting for financial instruments (13% in 2015); 17% to the financial statements presentation (21% in 2015); 11% to impairments of non-financial assets and (12% in 2015).

3.10. Peer Review on the Guidelines on Enforcement

83. In line with the 2016 ESMA supervisory convergence work programme, ESMA started its work on the peer review on some of the Guidelines on Enforcement. The peer review has as main objectives: (i) to assess the level of compliance by European enforcers with the guidelines, (ii) to identify good practices and (iii) to identify potential areas for improvement. The peer review will focus on Guideline 2 (effectiveness of the enforcement and financial and human resources), Guideline 5 (selection methods) and Guideline 6 (examination procedures).

84. The first stage of the peer review involved a targeted self-assessment questionnaire prepared by the peer review team and completed by all European enforcers. Subsequently, the enforcers in UK, Norway, Portugal, Italy, Malta, Germany and

Romania were selected to be visited on-site.

85. ESMA will finalise the peer review in 2017 and it is expected that the final report will be published in the second half of the year.

3.11. Other supervisory convergence activities

86. To assist competent authorities in their supervisory activities and to ensure convergence in supervisory outcomes, ESMA prepared two methodological frameworks and one supervisory briefing. As they are only addressed to competent authorities they were not made public.

87. To ensure that there is no duplication or absence of supervision, ESMA prepared a methodological framework including guidance on how and when NCAs may cooperate with each other and contact issuers for the identification and disclosure of their home Member State. Identification of the home MS is a key element to ensure that every issuer whose securities are admitted to trading on an EU regulated market falls under the supervision of a NCA. For this purpose, ESMA has created a consolidated list of issuers starting from Q1 2016.

88. Guideline 12 of the Guidelines on Enforcement requires that enforcers, under certain conditions, bring to the attention of ESMA and present for discussion in EECS meetings, emerging accounting issues before they take a final decision. ESMA prepared a methodological framework on the submission of emerging issues to provide further guidance and to help enforcers to decide on when and how to submit emerging issues to the EECS.

89. Finally, ESMA prepared a supervisory briefing to promote a common approach and provide guidance on how enforcers can contribute to the improvement of disclosures as part of their examinations of the financial statements. It includes questions to be considered by enforcers as part of their examination procedures. This work is a follow-up on an ESMA public statement on improving the quality of disclosures in the financial statements (2015/ESMA/1609)[21] published 2015.

3.12. Work Programme for 2017

90. In accordance with ESMA's Supervisory Convergence Work Programme for 2017, ESMA will pursue its regular activities in the area of corporate reporting in order to ensure that financial information published by issuers complies with IFRS and contributes to the transparency of information relevant to the decision making process of investors. These activities include preparing the 2017 European Common Enforcement Priorities as well as the coordination of emerging issues and decisions.

91. In addition to that, to further enhance the effectiveness of the supervisory process and

[21] https://www.esma.europa.eu/sites/default/files/library/2015/11/2015-esma-1609_esma_public_statement_-_improving_disclosures.pdf

convergence of supervisory outcomes, the following activities will be conducted:

a. The thematic study on IFRS 13 shall be finalised and another thematic study on the implementation of IFRS 10, IFRS 11 or IFRS 12 which should contribute to the post implementation review conducted by the IASB will be initiated;

b. The peer review on the Guidelines on Enforcement will be pursued and finalised. Moreover, ESMA will start to prepare a supervisory briefing on methods to select issuers for examination taking into account the findings from the peer review.

c. ESMA will continue to monitor the application of the APMs Guidelines and prepare further guidance, if needed.

4 Single rule book

4.1. Contribution to accounting standard setting

4.1.1. Contribution to the European endorsement process

92. ESMA continued to be actively involved in EFRAG's work by participating as official observer in the activities of EFRAG's Board, EFRAG's technical expert group and the EFRAG working groups, where ESMA presented its views on enforceability of standards and shared the experience of European enforcers on the application of IFRS in Europe. Furthermore, ESMA continued to actively contribute to the European endorsement process by participating as an official observer in the Accounting Regulatory Committee.

93. In 2016, ESMA provided 10 comment letters to EFRAG, focusing on the draft EFRAG comment letters, the draft endorsement advices and other pieces of work open for consultation. Through this participation, ESMA presented the European accounting enforcers' view to the IASB and in relation to the endorsement process. Amongst others, ESMA provided input to the endorsement process for IFRS 16[22] and the amendments to IFRS 4 due to the interaction between IFRS 9 and the accounting for issued insurance contracts.[23]

4.1.2. Cooperation with the IASB

94. ESMA and the IFRS Foundation signed in 2014 a Statement of Protocols to serve as the basis for future co-operation in areas of mutual interest considering the two organisations' overall goal of having in place high quality financial reporting standards. This Statement was updated in September 2016 to further deepen the cooperation of the two organisations on the development of IFRS Standards and to further support their consistent application across the EU. ESMA participates as a member in the IFRS Advisory Council[24], which meets regularly to give its opinion on the technical agenda, project priorities and strategic direction as well as to serve as a sounding board.

95. In addition to that, the IFRS Project Group, an ESMA permanent working group composed of IFRS experts from 13 different European enforcers together with ESMA staff, meets regularly to discuss major projects issued by the IFRS Foundation, the IASB and topics discussed by the IFRS IC.

96. In 2016, ESMA provided four comment letters to the IASB on Exposure Drafts regarding amendments to the existing standards and commented on two Draft Interpretations of the IFRS IC, on the Exposure Draft of the IFRS Practice Statement

[22] Letter, ESMA's Response to EFRAG's Draft Endorsement Advice on IFRS 16, ESMA, Paris, ESMA/2016/1617
[23] Letter, ESMA's Response to EFRAG Draft Letter to the European Commission regarding the endorsement of *Applying IFRS 9 Financial Instruments with IFRS 4 Insurance Contracts: Amendments to IFRS 4*, ESMA, Paris, ESMA/2016/1660
[24] The IFRS Advisory Council is the formal advisory body to the Board and Trustees of the IFRS Foundation.

on the application of materiality to financial statements[25] and on the IFRS Foundation's Invitation to Comment on the IFRS Taxonomy due process[26].

97. In 2016, EECS met with representatives of IASB and IFRS IC in order to discuss complex issues identified by European enforcers for which there was no specific IFRS guidance or where widely diverging interpretations appeared to exist. Among others, the following accounting subjects were discussed:

    a) Measurement of cash collaterals related to contributions to the single resolution mechanism;

    b) Presentation in the primary financial statements;

    c) Classification of issued financial instruments;

    d) Application issues related to deferred tax assets arising from unused tax losses.

98. In those meetings, ESMA provided an overview of the relevant practices applied by issuers in the EU and the European enforcers had the opportunity to provide the IASB and IFRS IC representatives with feedback on the application of the standards and on the degree of uncertainty in their interpretation.

99. Finally, while not an official observer to the IFRS IC, ESMA contributed to the IFRS IC due process by submitting three comment letters on tentative agenda decisions and providing input to the European Commission which is an observer of the IFRS IC.

100. Two additional bilateral meetings were organised with the IASB in which ESMA provided IASB Board members and staff with an overview of recent enforcement activities and discussed matters in relation to enforceability of the standards. Furthermore, other important topics were also deliberated, such as the implementation issues identified as part of the reviews of accounting practices undertaken by ESMA, the IFRS Taxonomy and the interaction between the disclosure initiative project and ESMA's regulatory work. Moreover, the interactions of the APMs Guidelines with the IASB's work were considered.

4.2. Activities related to the amended Transparency Directive

101. The amended Transparency Directive requires ESMA to develop and submit to the European Commission Regulatory Technical Standards (RTS) setting technical requirements regarding the access to regulated information. In 2015, ESMA published the Final Report on the Draft RTSs on European Electronic Access Point (EEAP) (ESMA/2015/1460)[27] and submitted these to the EC. The EC endorsed them on 19 May 2016 as Commission Delegated Regulation (EU) 2016/1437, which was published

25 Letter, ESMA's response to the IFRS Practice Statement: Application of Materiality to Financial Statements, ESMA, Paris, ESMA/2016/302

26 Letter, ESMA's response to IFRS Foundation's Invitation to Comment – IFRS Taxonomy Due Process, ESMA, Paris, ESMA/2016/235

27 Final Report, Draft Regulatory Technical Standards on European Electronic Access Point (EEAP), 25 September 2015, ESMA, Paris, ESMA/2015/1460

in the Official Journal of the European Union on 31 August 2016[28]. The RTSs include the technical requirements for the EEAP, the search criteria, the infrastructure, as well as the rationale for its introduction.

102. ESMA pursued its work for the development of a draft RTS to specify the European Single Electronic Reporting Format (ESEF) for the preparation of annual financial reports with effect from 1 January 2020. In September 2015, ESMA published a Consultation Paper on the Draft RTS on ESEF (ESMA/2015/1463)[29]. The consultation period ended on 18 January 2016. ESMA received 161 responses, which it duly analysed.

103. ESMA published on 21 December 2016 a Feedback Statement[30] summarising the responses received as well as the broad technical decisions ESMA made based on the analysis. ESMA concluded that all annual financial reports should be prepared in the Extensible Hyper Text Markup Language (XHTML) format. A document in XHTML format can, if properly formatted, be consumed by standard browsers without the need of specialised tools and be prepared and displayed by the issuer as intended. Where annual financial reports contain consolidated financial statements drawn up in accordance with IFRS, the issuer should label the information contained therein using the Extensible Business Reporting Language (XBRL)[31]. By marking-up the information with XBRL, it can be processed by software for analysis and thus becomes machine readable and 'structured'. The IFRS Taxonomy, issued by the IFRS Foundation has been specifically developed to mark-up financial statements in a structured electronic format and therefore ESMA will propose to use it as a basis for ESEF. The issuers shall embed the XBRL data directly into the XHTML documents through a format known as Inline XBRL.

104. ESMA will focus on developing the detailed technical rules, field test its proposed solution and afterwards submit the RTS to the European Commission for endorsement around year-end 2017.

4.3. Activities related to the Audit Regulation

105. In 2016, ESMA has actively participated in the establishment of the Committee of the European Audit Oversight Bodies (CEAOB) which held its inaugural meeting on 12 July 2016. ESMA participates as a member, without voting rights, contributing by providing the securities regulator perspective. ESMA has contributed in the establishment and running (drafting its terms of reference and work programme) of the CEAOB sub-groups and in particular, the one chaired by ESMA on equivalence assessments of public oversight systems of third countries and facilitating the international cooperation between Member States and third countries in this area. In

28 Commission Delegated Regulation (EU) 2016/1437 supplementing Directive 2004/109/EC of the European Parliament and of the Council with regard to regulatory technical standards on access to regulated information at Union level

29 Consultation Paper, Consultation Paper on the Regulatory Technical Standards on the European Single Electronic Format (ESEF), 25 September 2015, ESMA, Paris, 2015/ESMA/1463

30 Feedback Statement on the Consultation Paper on the Regulatory Technical Standard on the European Single Electronic Format (ESEF), ESMA, Paris, ESMA/2016/1668

31 In the first two years, only the primary financial statements would be required to be tagged

2017, this sub-group will focus on the analysis of the impact of the new audit regulatory framework on the equivalence and adequacy assessment methodology and clarify the assessment criteria. Furthermore, it will identify and set up dialogue with potential third-country audit oversight authorities for equivalence and adequacy assessments.

106. ESMA, through its Audit Working Group, has been also monitoring developments in financial reporting and auditing. In particular, ESMA has contributed with a comment letter to the International Auditing and Assurance Standard Board's (IAASB) project on enhancing audit quality in the public interest. Maintaining high quality international standards on auditing (ISAs) is an important element in promoting high quality audits and therewith, high quality financial information. ESMA has also monitored the discussions and contributed to the EBA guidelines on communication between competent authorities and auditors.

4.4. International cooperation

107. With a growing number of jurisdictions adopting IFRS, ESMA maintains regular contact with other IFRS enforcers across the world with the aim of exchanging practical experience on IFRS enforcement.

108. As part of the common objectives of promoting high quality and consistent application of financial reporting standards and avoiding conflicting regulatory decisions on the application of both IFRS and US GAAP, ESMA and the United States Securities and Exchange Commission (US SEC) cooperate and have regular dialogue since 2006. Areas of common interest or concern are the application of converged accounting standards, enforcement related issues, accounting areas of concern in relation to foreign private issuers and other matters related to issuers or market behaviour.

Appendix I – Description of the enforcement process

110. ESMA is responsible for the promotion of an effective and consistent application of the securities and markets legislation with respect to financial reporting, it aims to foster supervisory convergence in Europe and thereby reduce regulatory arbitrage. Converged enforcement practices contribute not only to the integrity, efficiency and orderly functioning of the EU Single Market but can also have positive impact on financial stability.

1 Guidelines on enforcement of financial information

111. On the basis of Article 16 of ESMA Regulation, in 2014, ESMA published the Guidelines on enforcement of financial information (ESMA/2014/1293). These became effective from 29 December 2014 and aim at strengthening the supervisory convergence in the enforcement practices amongst the competent authorities designated in each Member State and/or in some cases by other entities which have received a delegation for this purpose.[32]

112. Compliance with the Guidelines on enforcement implies that all competent authorities confirm in writing to ESMA whether they (a) comply; (b) intend to comply; or (c) do not comply or do not intend to comply with the Guidelines on enforcement. ESMA published a compliance table on its website (ESMA/2015/203)[33] which identifies 21 countries, which comply, 3 countries that intend to comply by a particular date and 6 countries which do not comply and do not intend to comply with part of the Guidelines on enforcement because of conflicts with existing national legislation or lack of resources.

113. The Guidelines on enforcement define the objectives of enforcement, the characteristics of European enforcers and set out the principles to be followed throughout the enforcement process, such as selection methods, examination procedures and enforcement actions. They also strengthen the convergence of enforcement activities at European level by codifying European common enforcement priorities and including requirements for coordination of views on accounting matters prior to taking significant enforcement decisions at national level.

114. The scope of enforcement of financial information of companies that issued securities admitted to trading on the regulated markets, as defined under the Transparency Directive, covers all reporting frameworks applicable to listed issuers. This includes IFRS as endorsed by the EU for consolidated financial statements, IFRS as endorsed by the EU or national GAAPs when applied to non-consolidated financial statements and third country accounting standards for non-European issuers, if deemed equivalent to IFRS as endorsed in the EU. However, the main areas of focus for ESMA are in relation to issues derived from the requirements of the Transparency

[32] List of European enforcers is included in Appendix II.
[33] Guidelines compliance table – Guidelines on the enforcement of financial information, 19 January, ESMA, Paris, ESMA/2015/203 REV

Directive in relation to the application of the IAS Regulation.

115. ESMA activities on supervisory convergence of enforcement are carried out mainly through the EECS, a forum of 41 European enforcers from 30 EEA Member States who have responsibilities in the area of supervision and enforcement of financial information. With responsibility for co-ordination of supervision of approximately 6,000 issuers listed on European regulated markets preparing IFRS financial statements, EECS currently constitutes the largest regional enforcers' network with supervision responsibilities for IFRS.

116. According to Guideline 10, through EECS, European enforcers discuss and share their experience on the application and enforcement of IFRS. In particular, they discuss enforcement cases, which fulfil the submission criterion, set out in the Guidelines on enforcement before or after decisions are taken in order to promote a consistent approach in the application of IFRS. When taking an enforcement decision, European enforcers should take in account the outcome of the discussion of ex-ante cases in EECS. In addition, EECS produces technical advice on the issuance of ESMA Statements and/or opinions on accounting matters, which deserve specific focus. It also reviews accounting practices applied by European issuers to enable ESMA to monitor market developments and changes in those practices.

117. Because of the enforcement coordination, ESMA and European enforcers identify areas where a lack of guidance from the standards or divergent interpretations of the IFRS are observed. Such matters are subsequently referred to the IASB or the IFRS IC, as appropriate.

2 Key definitions and Concepts

118. Enforcement activity refers to examining compliance of financial information with the applicable financial reporting framework as well as taking appropriate measures when infringements are identified.

119. European enforcers identify the most effective way for enforcement of financial information. The enforcer's selection of issuers for examination is based on a mixed model whereby a risk-based approach is combined with a sampling and/or a rotation. A risk-based approach considers the risk of a misstatement as well as the impact of a misstatement on the financial markets. Enforcers can use either unlimited scope examination or a combination of unlimited scope and focused examinations of financial information of issuers selected for enforcement.

120. Unlimited scope examination entails the evaluation of the entire content of the financial information, while focused examination refer to the evaluation of pre-defined issues in the financial information and the assessment of whether this information is compliant with the relevant financial reporting framework. However, the depth and scope of an examination procedure cannot be equated with those of an audit of financial statements.

121. Whenever a material misstatement is detected, European enforcers should, in a timely manner, take at least one of the following actions:

- Require a reissuance of the financial statements - issuance of revised financial statements which are subject to a new audit opinion;
- Require a corrective note - making public either by the issuer or the enforcer a material misstatement with respect to particular item(s) included in already published financial information and the corrected information; or
- Require correction in future financial statements with restatement of comparatives, where relevant - the issuer adopts an acceptable treatment in the next accounts and corrects the prior year by restating the comparative amounts or otherwise includes additional disclosures not requiring the restatement of comparatives.

122. When deciding between the type of action to be applied, European enforcers should consider that the final objective is that investors are provided with the best possible information and an assessment should be made whether the original financial statements and a corrective note provide users with sufficient clarity for taking decisions or whether a reissuance of the financial statements is more appropriate. Other factors should also be considered, namely timing, nature of the decision and the surrounding circumstances.

123. Furthermore, European enforcers seek to improve the quality of future financial statements, by engaging in activities designed to provide helpful guidance to issuers, such as defining enforcement priorities and/or pre-clearance[34] procedure.

[34] In some jurisdictions, issuers may approach a local enforcer before finalising their financial statements and seek a formal advice on whether a proposed accounting treatment is compliant with IFRS.

Appendix II – List of European enforcers

Member State	European enforcer	Abbreviation
Austria	Financial Market Authority Austrian Financial Reporting Enforcement Panel	FMA AFREP
Belgium	Financial Services and Markets Authority	FSMA
Bulgaria	Financial Supervision Commission	FSC
Croatia	Croatian Financial Services Supervisory Agency Croatian National Bank Ministry of Finance -Tax Administration	HANFA HNB RHMF
Cyprus	Cyprus Securities and Exchange Commission	CySEC
Czech Republic	Czech National Bank	CNB
Denmark	Danish Financial Services Authority Danish Business Authority	Danish FSA DBA
Estonia	Estonian Financial Supervision Authority	EFSA
Finland	Finnish 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	The Central Bank of Hungary	MNB
Ireland	Central Bank of Ireland[35] 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	Bank of Lithuania	LB
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 and Pension Funds Supervisory Authority	CMVM BP IPFSA
Romania	Financial Supervisory Authority	ASF
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 AB	Swedish FSA NGM AB Nasdaq Stockholm
United Kingdom	Financial Conduct Authority Financial Reporting Council	FCA FRC

[35] While CBI is the national administrative competent authority represented in ESMA Board of Supervisors, IAASA was designated as the sole competent authority for carrying out the obligations in the Transparency Directive.