

Preparing for IAASA financial reporting reviews

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Background

The Irish Accounting and Auditing Supervisory Authority (IAASA) has responsibility for monitoring and enforcing compliance with certain aspects of the Transparency (Directive 2004/109/EC) Regulations, 2007 ('the Regulations'). In pursuance of its remit, IAASA selects and reviews half-yearly and annual financial reports of companies covered by the Regulations to assess whether those reports have been prepared in full compliance with the 'relevant reporting framework' which includes:

- In the case of *half-yearly financial reports*: the requirements of IAS 34/ASB Statement *Half Yearly Financial Reports*, the Regulations and the Financial Regulator's Interim Transparency Rule;
- In the case of *annual financial reports*: the accounting and disclosure requirements of International Financial Reporting Standards/Irish GAAP, the Regulations, Company Law, and Financial Regulator's Interim Transparency Rule ('Regulatory Requirements').

IAASA's remit also allows it to review other information required by the Directive as part of annual and interim reports, in particular the 'fair review' of the company's development and performance and description of principal risks and uncertainties.

The Regulations apply to companies and investment vehicles with listings on a regulated market which includes debt issuers and closed ended funds, as well as equity issuers.





The process

Where, following a review of half-yearly or annual financial reports, IAASA forms the view that it is not clear that the financial statements are in full compliance with the relevant reporting framework, IAASA will issue a letter to the directors of the company identifying the issue(s) in question and seeking relevant information, clarification and/or explanations (including the directors' rationale for certain accounting treatments).

The letter from IAASA in this respect will commonly be referred to as an 'information request'.

Normally the company will respond in writing. Depending on the circumstances there may be a number of communications between the parties until each of the matters raised has been resolved. Following the information gathering process IAASA will generally:

- (i) confirm that the matters raised have been satisfactorily resolved; or
- (ii) receive undertakings from the company that any identified deficiencies will be satisfactorily dealt with in future financial statements; or
- (iii) seek a restatement, re-issue and refiling of amended financial statements.

On occasion, companies seek to meet with IAASA to clarify various matters.

Where IAASA ultimately forms the view that the previously published financial report should be withdrawn and restated and the company is in disagreement with that determination, IAASA is empowered to initiate legal proceedings with a view to compelling the publication of amended financial information.



Consideration of the impact of IAASA reviews

Audit Committees of companies that come within the remit of the Transparency Directive will already have processes in place related to their review of both half-yearly and final annual financial reports to ensure full compliance with the relevant Regulatory Requirements

These processes may have identified issues in past years where management has sought to take a narrow interpretation of accounting and/or disclosure requirements where there was a perception of a threat to the commercial interests of the company leading to challenging discussions with the Audit Committee and the external auditors. The commencement of IAASA's monitoring and compliance function under the Transparency Directive increases the likelihood that any performance failure in terms of appropriate accounting and/or adequate disclosures arising from the Regulatory Requirements will be challenged and may ultimately lead to the requirement to restate financial statements with the risk of consequent material reputational damage.

Accordingly, Audit Committees are recommended to:

- (i) review the existing processes adopted by the company to ensure that half-yearly and annual financial reports are in full compliance with the accounting and disclosure requirements of the Regulatory Requirements; and
- (ii) establish processes to be followed where the company is in receipt of an information request from IAASA arising from a review of published financial statements.

Set out on page 5 are suggested steps the Audit Committee might consider to fulfil the above recommendations.

On 16 January 2009, IAASA published a communication outlining details of certain areas of focus for their reviews of annual financial reports that ended in 2008. The key areas are summarised on page 6 and the full text of the communication may be accessed at:

http://www.iaasa.ie/publications/FRSUobs_Jan09.pdf.





Process to ensure compliance with Transparency Directive

Audit Committees need to:

- become familiar with the requirements of the Transparency Directive (see further reading material on page 7 for relevant guidance);
- consider and understand the risk of non-compliance with the Transparency Directive in the context of reputational damage and the cost of any consequent financial reporting restatements;
- review existing processes that are in place to ensure full compliance with the relevant Regulatory Requirements and determine whether the processes need to be changed and/or augmented and whether management has adequate resources to fulfil its remit in this respect;
- at the planning stage related to the preparation of either half-yearly or annual financial reports, meet with management and the external auditors to identify accounting and/or disclosure issues requiring special focus and seek to determine preliminary evaluations for the benefit of management;
- at the meetings to approve either half-yearly or annual financial reports, seek reports from management and, where relevant, the external auditors on the key issues that need to be addressed by the Audit Committee in their review process related to compliance with the Regulatory Requirements;
- ensure the process, its oversight and the adequacy of resources are documented as evidence of the directors having acted with due skill and care.

Process to deal with IAASA information request letters

Audit Committees should:

- establish a process for the steps to be taken and the parties to be notified when an information request letter is received from IAASA;
- if considered necessary, meet as soon as possible following receipt of the information request letter with management and external auditors to gain a preliminary overview and agree a plan to ensure the letter is dealt with as expeditiously as possible. Consideration to be given to requesting a meeting with IAASA if necessary and in particular if a large number of significant issues have been raised;
- receive and review the proposed response drafted by management to ascertain that the issues discussed are clearly explained and supported with sufficient background information, including the substance and economics of any transaction and that reference is made to the appropriate sources of guidance in the professional literature relevant to the issues;
- receive and review a communication from the external auditors in relation to the proposed draft response from management;
- discuss and ultimately approve the response for submission to IAASA;
- ensure the above process is replicated for subsequent communications/meetings with IAASA;
- conduct a debrief with management and the external auditors once the matter is concluded to understand lessons learned and note and plan for any necessary performance improvements.



Areas of indicated likely focus for IAASA's 2008 financial reporting reviews

- **Valuation and impairment of assets** - in particular, disclosure of the rationale underlying significant assumptions made and methodologies used;
- **Retirement benefits** - sufficient explanations of the rationale underlying significant valuation assumptions;
- **Going concern/principal risks and uncertainties** - quality of risk and uncertainty disclosures including whether they are meaningful and issuer specific as opposed to boiler plate;
- **Financial instruments: IFRS 7/FRS 29 disclosures** - the standard, quality and appropriateness of disclosures and, in particular, whether they are meaningful, issuer specific and balanced as opposed to boiler plate;
- **Hedge effectiveness** - disclosure of the nature and extent of risks arising, including counterparty risk;
- **Judgements** - clear and comprehensive disclosure of judgements made in preparing financial statements;
- **Related party disclosures** - full compliance with all IFRS/Irish GAAP and statutory requirements, including those relating to transactions with directors;
- **Deferred tax assets** - treatment will continue to be examined for recoverability;
- **Operating profit** - consideration should be given to including an accounting policy to explain the directors' judgement and rationale in relation to the classifications of items within and outside of operating profit;
- **Alternative performance measures** - narrative explanations relating to alternative performance measures should be comprehensive, and terminology defined;
- **Business combinations** - focus on IFRS 3 requirements, allocation of acquisition costs and use of provisional fair values;
- **Earnings per share** - required for all issuers, including funds;
- **Prior period errors** - restatement of comparatives is required, with full explanation of the nature and effect;
- **Recently promulgated accounting pronouncements** - full disclosure, including information relevant to assessing the possible impact.

IAASA's principal observations following review of half-yearly reports

- minimum content requirements of the Transparency Directive or the applicable accounting pronouncement had not been met;
- issuers not stating whether financial statements complied with IAS 34 or the ASB Statement;
- explanations provided by issuers insufficient to explain material changes vis-à-vis comparative figures with information provided regarded as insufficient to explain the nature of the amount and/or the change in that amount from the comparative period;
- necessary disclosures regarding business combinations not being made such as, for example, the fair values of assets and liabilities acquired, the resultant goodwill recognised and details of the combined entity's revenue and profit or loss from the beginning of the period tended to be omitted;
- lack of clarity regarding specific accounting treatments adopted in respect of certain matters and how the adopted treatments complied with relevant accounting standards;
- requirements regarding the format of presentation used, with reference, in particular, to the requirements of IAS 1, not being fully satisfied;
- incomplete or lack of disclosure regarding changes in accounting policies, even though new accounting pronouncements had become effective in the period; and
- omission of required comparative information.



Further reading:

IAASA publications

Commentary on half-yearly financial statements available on line at:
http://www.iaasa.ie/publications/TD_Commentary2008.pdf

Observations on year end financial reporting issues available on line at:
http://www.iaasa.ie/publications/FRSJobs_Jan09.pdf

Guide to Financial Reporting Requirements of the EU Transparency Directive and to IAASA's role under the Directive available on line at:
http://www.iaasa.ie/publications/IAASA_TD_Guide.pdf

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