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The Market Newsletter addresses topical matters concerning interpretations and regulation as well as supervisory findings relating to listed companies' disclosure obligation, financial reporting enforcement, securities trading and insider issues. The newsletter is published by the Financial Supervisory Authority's Capital Markets Supervision.

Erkki Liikanen. Photo: Paula Ojansuu.

IFRS stakeholder event with Erkki Liikanen and Hans Hoogervorst

In September, the Chairs of the IFRS Foundation Trustees and the IASB presented current issues in IFRS regulation to Finnish IFRS reporting stakeholders. Participants received information on strategic policies and the key content of standard-setting projects.

On 13 September 2019, the Financial Supervisory Authority's IFRS Enforcement organised a stakeholder event at which Erkki Liikanen, Chair of the IFRS Foundation Trustees, and Hans Hoogervorst, Chair of the International Accounting Standards Board (IASB), presented current issues in IFRSs. The event participants represented various IFRS stakeholders: preparers, auditors, ministries and representatives of academia. The event was the second at which Finnish IFRS reporting stakeholders had the opportunity to hear from Erkki Liikanen, Chair of the IFRS Foundation Trustees. The previous event was held in October 2018.

Given the global significance of IFRS standards – they are very widely applied – it was a privilege for the Financial Supervisory Authority's IFRS Enforcement to have the opportunity to organise the event, at which its own stakeholders could hear directly from the IFRS regulatory framework's senior figures. IFRS standards were given a face at the event by Erkki Liikanen and Hans Hoogervorst. The standards are not just two books full of financial reporting requirements; they are backed by a large group of experts.

Strategic policies of the IFRS Foundation

Erkki Liikanen assumed the position of Chair of the IFRS Foundation Trustees in autumn 2018, in succession to Michael Prada of France. The chair's term of office is usually three years, after which he or she can be re-elected twice. IFRS Foundation has a total of 22 trustees.

The objective of the IFRS Foundation is to develop, in the public interest, a single set of high quality, understandable, enforceable and globally accepted financial reporting standards based upon clearly articulated principles. A further goal of the IFRS Foundation is to promote the use and rigorous application of these standards. A third task is to promote and facilitate adoption of IFRS Standards, also taking into account their convergence with national accounting standards.

The duties of the IFRS Foundation Trustees include appointing the members of the IASB and the IFRS Interpretation Committee, preparing the codes of conduct of both bodies, annually reviewing strategy and ensuring financing.

In his presentation, Liikanen reviewed the objectives and tasks of the IFRS Foundation, which often remain in the background of IFRS experts' daily work. IFRS Standards (IFRSs) are truly the foundation of the global community of accounting professionals. The IASB has reviewed the financial reporting regulatory requirements of a total of 166 countries, and currently IFRSs are applied in 144 countries in all or nearly all publicly listed companies.

Liikanen outlined the Foundation's key strategic policies. These are globalisation, relevance and technology. Globalisation in itself promotes the global capital market. Implementing as well as possible the allocation of capital globally requires the further promotion of the transparency of financial information.

The requirement for relevant information is of particular importance in assessing long-term financial performance. For example, the European Commission has launched a debate on whether financial reporting itself encourages banks and companies to behave in such a way as to pursue financial performance only in the short term. Non-financial information might also be relevant to investors.

Information on environmental and social responsibility as well as good governance is increasingly relevant.

The technology that provides information is undergoing a major transformation. Companies are moving to electronic reporting, and investors are increasingly accessing information provided digitally. The impacts of this trend must also be taken into account in regulation. The IFRS Foundation publishes annually the XBRL-compliant IFRS taxonomy, which is based on IFRSs presentation and disclosure requirements[1].

From major IFRS projects and income statement information to goodwill testing

IASB Chair Hans Hoogervorst spoke about current issues relating to the IFRSs. The IASB consists of 14 members, most of whom are full-time members. The criteria for the election of members are diversity of professional competence and geographical balance. IASB members are appointed for an initial term of five years, which may be renewed once for a further term of at least three years, but for at most five years. The IASB's task is to develop and publish the IFRS regulatory framework: IFRSs and changes to them as well as IFRIC interpretations.

Hans Hoogervorst became the Chair of the IASB in 2011. Before joining the IASB, he served as Chair of the Executive Board of the Dutch Authority for the Financial Markets (AFM) from 2007 to 2011, and prior to that he held a number of government positions in the Netherlands, including as a minister in various fields between 2002 and 2007.

In his presentation, Hoogervorst covered all the current issues of IFRSs concisely and comprehensively. He reviewed new standards – IFRS 9 *Financial Instruments*, IFRS 15 *Revenue from Contracts with Customers*, IFRS 16 *Leases* and IFRS 17 *Insurance Contracts*. Listed companies applied IFRS 9 and IFRS 15 for the first time in financial statements for 2018 and will apply IFRS 16 in the financial statements for 2019. IFRS 17 is likely to be adopted on 1 January 2022. Hoogervorst briefly outlined the key changes to IFRS 9, IFRS 15 and IFRS 16 and their impacts on reporting.

He addressed the insurance contracts standard in particular depth. The primary objective of this standard is to improve comparability by harmonising the measurement and accounting of insurance liabilities. Hoogervorst stated that the insurance contract project has taken a long time and that there has been a constant stream of proposals from the industry for amendments to the requirements of the standard. The latest changes, which aim to facilitate further the adoption of the standard, were made to the completed standard and published for comment in autumn 2018. At the same time, it was proposed that the effective date of the IFRS 17 standard be deferred by one year to 1 January 2022.

The IASB's regulatory initiatives for 2017–2021 included a project for better financial reporting. This included improving the financial information of the primary financial statements – particularly the income statement and notes. The intention is for the content of guidance on the management commentary to be reassessed, particularly from the perspective of responsibility reporting.

Users of financial statement information have highlighted, in particular, the inadequate comparability of information on the financial performance of entities. In addition, alternative performance measures presented by management that contain useful information require greater transparency and disciplined approach to presentation. To improve the comparability of the income statement's subtotals, the IASB is clarifying requirements for the structure of the income statement. The IASB is expected to propose as

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[1] The IFRS taxonomy is the basis for the ESEF taxonomy, which European listed companies will use when they start reporting their financial statements in a structured format starting with the annual financial statements for 2020 (ESEF= European Single Electronic Format).

subtotals of the income statement operating profit, operating profit and share of profit or loss from integrated associates and joint ventures, and profit before financing and tax.

Finally, Hoogervorst presented a reassessment of the requirements for goodwill impairment testing. The assessment is part of the IASB's ex-post review of requirements contained in IFRS 3 *Business Combinations*. There are problems associated with goodwill impairment testing, including recognising impairment losses too late, the high cost to companies of annual – possibly wholly unnecessary – testing, and the need for users of financial statement information to obtain information about post-acquisition financial performance of operations. IASB members have also discussed whether goodwill should be amortised – as was previously the case. In the discussions, however, the majority took the position that the requirements for impairment testing should be clarified and that the quality of information provided on impairment testing should be increased and improved.

Erkki Liikanen (left) and Hans Hoogervorst.
Photo: Paula Ojansuu.

Discussion – on the IASB's strategy development, the impact of new standards, and management performance measures

Finally, the event participants had the opportunity to discuss the topics presented. The IFRS Foundation's strategy process – how the strategy is formed – was addressed. An important element in strategy development is interaction, in which the IFRS Foundation is supported by, among others, the Accounting Standards Advisory Forum.

With regard to IFRS 15, the question was raised as to whether there had been an assessment of the progress made on a global level of the advocated harmonisation of the definition of revenue and the extent to which management judgments in applying the requirements of IFRS 15 contribute to potential unconventional revenue recognition solutions. The response to the question emphasised the principle-based nature of IASB regulation, so standards cannot answer all the questions that arise in practice. Similarly, in respect of IFRS 9, the question was asked whether the banks have applied consistently the requirements on the impairment model for financial assets. The IASB, as the standard-setter, has no systematic information on the topic; it is more a matter for enforcement.

In addition, there was discussion on the management performance measures included in the new regulation and their location in the financial statements. Concerns were raised that the IASB is proposing bringing alternative performance measures into the financial statements, as companies have now learned to disclose them outside the financial statements.

The event presentations have been published on the FIN-FSA website.

Virpi Haaramo (left), Tiina Visakorpi and Sirkku Palmuaro.
Photo: Paula Ojansuu.

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Accounting treatment of leases still seeking its form – IFRS Enforcement's observations on the year of adoption

Listed companies adopted the new IFRS 16 *Leases* on 1 January 2019. The adoption of IFRS 16 brought significant changes to the financial statements of many companies. The first-quarter financial reports had a new item called right-of-use asset, either as a separate line item or as part of other assets in the balance sheet, as well as increased lease liabilities.

This article

- outlines the observations that IFRS Enforcement made on the information disclosed in companies' financial statements for 2018 about the impact of IFRS 16 and on the information disclosed in interim reports for 2019 about the accounting treatment of leases
- describes entity-specific enforcement focusing on leases in 2019
- addresses the IFRS 16 enforcement in 2020, based on ESMA's[2] priorities[3]
- outlines the issues regarding leases addressed by the IFRS Interpretation Committee, one of the most important of which is the definition of the lease term of evergreen leases.

Review of transition disclosures in companies' financial statements and interim reports

ESMA's priorities, among other things, were discussed at a FIN-FSA event[4] for listed companies in 2018. ESMA emphasised the following transition disclosures[5]: transition approach, use of exemptions, nature and characteristics of types of contracts, management judgments made, and the most important assumptions in determining lease liabilities. The FIN-FSA also outlined its expectations for information to be disclosed in interim reports.

IFRS Enforcement reviewed lessees' financial statements for 2018 and interim reports for the first and second quarters of 2019 in industries whose financial statements were significantly impacted by IFRS 16. In more than half of the financial statements reviewed by IFRS Enforcement, the balance sheet impact of IFRS 16 exceeded 30%.

Typically, companies disclosed the applied transition approach in their financial statements for 2018, but at the latest in interim reports for 2019. For the majority it was the so-called modified retrospective approach according to IFRS 16.C5(b). Companies also reported the quantitative impact of IFRS 16 in their financial statements for 2018.

Descriptions of management judgment were general

One conclusion of the review was that descriptions of applicable exemptions were often general in nature, both in the financial statements for 2018 and the interim reports for 2019. Description of management judgement focused primarily on listing the components of the determination of the lease liability, but the descriptions did not reveal what factors management had assessed in the assumptions and how.

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[2] *European Securities and Markets Authority.*
[3] *European Common Enforcement Priorities, ECEP*
https://www.esma.europa.eu/sites/default/files/library/esma32-63-791_esma_european_common_enforcement_priorities_2019.pdf
[4] *https://www.finanssivalvonta.fi/globalassets/fi/paaomamarkkinat/liikkeeseenlaskijat-ja-sijoittajat/ifrs/esitykset/ifrs_16_listayhtiotilaisuus_2018.pdf. (in Finnish)*
[5] *IAS 8.30-31.*

The financial statements for 2018 did not reveal much about how the company's management had assessed whether a contract contains a lease and how the lease components are separated from the non-lease components, such as the service component of a contract (IFRS 16.9, IFRS 16.12-15). Based on the financial statements, it was not clear whether the leases were so straightforward that such judgments did not have to be made. Similarly, the accounting policies of companies' interim reports gave little explanation as to how the company's management had assessed whether a contract is a lease, contains a lease and whether it has non-lease components and how the different components were treated in the financial statements.

Other observations on the interim reports

Generally, the companies disclosed revised accounting policies in their first-quarter reports in 2019. Half-yearly financial statements prepared in accordance with IAS 34 *Interim Financial Reporting* did not provide more extensive or more detailed information about IFRS 16 compared to information disclosed in the first interim report, despite the fact that in some of the companies the first interim report was not fully compliant with IAS 34.

Some companies[6] disclosed a reconciliation according to IFRS 16.C12(b) in their interim reports in 2019. These transition reconciliations provided clear information on the impacts of adopting the new standard and on the changes arising to the figures of the interim reports for 2019. The FIN-FSA considered the disclosure of a reconciliation to be particularly useful. The reconciliation helped the reader to better understand many decisions related to the adoption of IFRS 16 during the financial year, and meant that they did not have to wait until the financial statements for 2019.

In summary, there were significant differences between the companies in how detailed and how clearly information was disclosed about leases in various financial reports. Many of the companies whose financial statements were materially affected by IFRS 16 provided company- and asset-specific accounts of the types of assets that the company has leased, the terms and conditions of the leases and how the asset/assets are classified. In addition, companies provided quantitative information by asset class. There were companies, however, with whose information on the IFRS 16 transition IFRS Enforcement was not satisfied.

Observations on the entity-specific application of the standard

Significant differences in the level of documentation

For companies selected for full review[7], IFRS Enforcement asked more detailed questions and requested internal analyses and documentation. There were significant differences between the companies in the level of detail and documentation of their analysis of IFRS 16. At best, the companies had in-depth analyses based on IFRS 16 paragraphs, which reflected in detail the judgments made by management. With some companies, the documentation consisted mainly of copying the standard text for internal guidance and there was little company-specific guidance on the application of the standard.

IFRS Enforcement draw companies' attention to the fact that the analyses and guidance underlying the financial statements should be sufficiently thorough and comprehensive to show how the company applies the standard. In particular, the factors determining lease liability, such as the lease term, the discount rate and the payments to be included in the rent, as well as the management judgment applied to them, should be described in detail.

[6] *If the lessee has opted to apply the transition approach according to IFRS 16.C5(b), i.e. the so-called modified retrospective approach.*

[7] Full review of financial statements, further information: https://www.finanssivalvonta.fi/en/capital-markets/issuers-and-investors/ifrs/.

Other comments on the application of the standard

Low value assets
According to the FIN-FSA's findings, companies appear to have a mutually consistent and systematic way of determining which assets or asset classes are of low value and therefore fall outside the scope of IFRS 16. Some companies stated in their financial statements that they comply with the materiality concept of IAS 1 and do not apply the threshold (USD 5,000) mentioned by IFRS 16.BC100, which the preparer of standard considered to be low value. In practice, IFRS Enforcement's findings show that, irrespective of a company's industry or size, similar assets of the same type and value have remained unrecognised in lease liability. These assets include, for example, various items of IT equipment.

Separating components of a contract
In practice, separating the service component of the lease might be onerous in practice, particularly if the lessor does not provide information or the contract itself does not contain sufficient information. In accordance with IFRS 16.15, the entire rental cost of the lease may accordingly be taken into account in determining the lease liability. Based on the findings made by the FIN-FSA in full review enforcement, the said paragraph has been interpreted in this way.

Construction company land leases
The FIN-FSA had nothing to comment on the treatment of construction company land leases. A lease of land in a construction project is recognised as a lease liability and as a right-of-use asset in inventories as determined in accordance with IFRS 16 principles.

In 2019, IFRS Enforcement did not take actions on the lease term, as the issue has been under discussion by the IFRS Interpretation Committee.

Leases will continue to be a priority of ESMA's financial reporting enforcement in 2020

ESMA and European Enforcers will pay due attention to the requirements of IFRS 16.51 and particularly IFRS 16.59. IFRS 16.51 requires lessees to provide information that gives a basis for users of financial statements to assess the effect that leases have on the financial position, financial performance and cash flows of the lessee. IFRS 16.59 emphasises the disclosure of additional quantitative and qualitative information to meet this objective. The purpose of ESMA is also to draw attention to cash flows that are not taken into account in determining lease liabilities but to which the lessee is potentially exposed.

In its review, ESMA emphasises the disclosures to be made on low-value or short-term leases[8] as well as the information that should be disclosed on right-of-use assets at the end of the reporting period by class of underlying asset[9]. In addition, ESMA draws attention to the disclosures to be made on transition that relate particularly to lessees applying the so-called modified retrospective approach under IFRS 16C5(b).

In IFRS Enforcement's view, little information has been disclosed on the definition of leases. Companies are therefore urged to supplement their descriptions of leases insofar as the company has had to analyse whether the contract in question is a lease (IFRS 16.9, IFRS 16.B9-31).

Impact of new standard on e.g. goodwill impairment tests

Goodwill impairment tests are regularly the subject of IFRS enforcement. Although IFRS 16 has not resulted in changes to the requirements of IAS 36 *Impairment of Assets*, leases affect the technical

[8] *IFRS 16.53 (c) and (d).*
[9] *IFRS 16.53 (j).*

implementation of impairment testing calculations, such as the definition of various input data and components. IFRS 16 right-of-use assets are included as part of the carrying amount of the cash generating unit being tested.

If a company defines the discount rate in the impairment testing so that components of the interest rate are based on information derived from a peer group, the company should specify how that information was collected in the financial statements for 2019: whether the company has used peer group information taking into account IFRS 16 or whether the balance sheets and capital structure are based on IAS 17 *Leases*. Investment cost affecting cash flow may also change with the adoption of IFRS 16. Companies are urged to describe how investment assumptions have changed.

IFRS Enforcement draws companies' attention to the fact that they should document the decisions they make with justifications and standard references on a sufficiently detailed level. Moreover, ESMA[10] emphasises that these changes should be disclosed in notes to IAS 36 so that the reader can obtain information on how inputs and assumptions as well as calculation methods have changed.

IFRS Enforcement reminds companies also to disclose in the notes to the financial statements any possible impact on deferred taxes insofar as IFRS 16 affects their recognition.

ESMA draws attention to interpretation issues addressed by IFRS Interpretation Committee

The IFRS Interpretations Committee has issued five decisions on the application of IFRS 16. The IFRS Interpretations Committee has stated in all of its decisions that the standard is clear and that all of the accounting issues that have been addressed by it are resolvable by the standard. Thus there is no need to amend the standard. An agenda paper analysing the accounting treatment of each issue addressed is available on the www.ifrs.org website.

ESMA encourages companies to follow the decisions of the IFRS Interpretations Committee and to take them into account insofar as they are applicable to the company's leases. Of the IFRS Interpretation Committee's decisions, ESMA emphasises those made regarding the determination of lease term and discount rate. The decision on lease term is addressed below.

The IFRS Interpretation Committee's decision on Lease term and useful life of leasehold improvements (IFRS 16 and IAS 16) concerned the determination of the lease term as well as the depreciation period for leasehold improvement costs[11]. IFRS Enforcement participated actively in ESMA's handling of the issue. The ESMA interpretation request asked for clarity on how the lease term is determined in leases which are valid indefinitely or which are renewed unless expressly terminated. The request highlighted, in particular, the ambiguity of the definition of insignificant penalty (IFRS 16.B34). In addition, the IFRS Interpretation Committee was asked whether the useful life of leasehold changes and improvements can exceed the lease term of the underlying asset.

The decision of the IFRS Interpretation Committee stated that in determining the lease term and the enforceable period of the lease, the entity should take into account the broader economics of the contract. The entity should also consider whether each of the parties has the right to terminate the lease without permission from the other party with no more than an insignificant penalty.

[10] *ESMA: European Common Enforcement Priorities 2019 (ECEP).*

[11] *https://www.ifrs.org/projects/work-plan/lease-term-and-useful-life-of-leasehold-improvements-ifrs-16-and-ias-16/.*
https://www.ifrs.org/-/media/feature/meetings/2019/june/ifric/ap3-lease-term-and-useful-life.pdf
https://cdn.ifrs.org/-/media/feature/meetings/2019/november/ifric/ap4-ifrs-16-lease-term-and-useful-life-of-leasehold-improvements.pdf.

The Staff Paper prepared to support the IFRS Interpretation Committee's decision-making provides guidance on how the application guidance on determining the lease term is intended to be read. The penalty that the lessee might suffer is, according to the description, a broader term than merely the contractual termination penalty. Instead of penalty, IFRS 16 uses the expression "payments for penalties for terminating the lease" when merely the more limited concept of contractual payments for terminating the contract is referred to.

With regard to assessing the lessor's intentions, an analysis prepared by IASB staff states that IFRS 16.B34 does not require the lessee to assess the lessor's intentions. The analysis states that, for example, the factors listed in IFRS 16.B37 represent the lessee's economic incentives to extend the lease. The analysis clarifies that, despite the existence of these economic incentives, the lessee may also be able to identify factors that would result in the lessor not terminating the lease.

IFRS Enforcement considers that, in determining the lease term of evergreen leases or automatically continuing leases, all relevant facts and circumstances that affect the exercise or non-exercise of the option to terminate should be taken into account.

In determining the lease term and the existence of a penalty that is more than insignificant, the company should consider, among other things, the following factors:

- the significance of the underlying asset of the lease for the company's business
- the direct and indirect costs that the company will incur as a result of the termination of the lease; for example, finding new premises, customer communications, or moving inventory to a new warehouse
- the real nature of the terms of termination, and the commercial considerations in contractual conditions relating to the duration of the lease.

With regard to lease terms, companies are expected to disclose in their financial statements the judgment exercised in determining them, in accordance with IFRS 16 as well as IAS 1.122 and IAS 1.125.

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What did financial institutions disclose about credit risks and expected credit losses?

The FIN-FSA's IFRS Enforcement reviewed the 2018 IFRS financial statements of 10 Finnish banking groups, and analysed what the financial institutions disclosed about credit risks and expected credit losses based on the requirements of IFRS 7 *Financial Instruments: Disclosures*. In its review, IFRS Enforcement focused on studying the subareas of the application of the new IFRS 9 *Financial Instruments* which ESMA[12] had selected as enforcement priorities[13] for 2018 financial statements with regard to financial institutions. ESMA will later publish the results of the enforcement done on the basis of the enforcement priorities, in a European-wide accounting enforcement activity report.

IFRS Enforcement found that most Finnish financial institutions disclosed information on credit risks and expected credit losses on a fairly general level. On the basis of general descriptions it is difficult for the

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[12] European Securities and Markets Authority.
[13] European Common Enforcement Priorities, ECEP.
https://www.esma.europa.eu/sites/default/files/library/esma32-63-503_esma_european_common_enforcement_priorities_2018.pdf.

readers of the financial statements to form an overall picture and to assess the nature and extent of credit risks. This article includes IFRS Enforcement's findings on the disclosure of accounting policies, forward-looking information, significant increase in credit risk, and expected credit losses. The hope is that the findings will help financial institutions develop their disclosures.

Accounting policies for financial instruments presented on a general level

Disclosure of accounting policies

Entities shall disclose significant accounting policies, including the measurement bases used in preparing the financial statements and the other accounting policies used that are relevant to an understanding of the financial statements (IFRS 7.21). The adoption of IFRS 9 resulted in significant changes in the accounting policies for financial instruments, which must be described in accordance with the requirements of the standard.

All of the financial institutions described the adoption of IFRS 9 and the new requirements and main principles included in the standard in their accounting policies. IFRS Enforcement observed, however, significant differences between the financial institutions in how clearly and entity-specifically they disclosed the judgment they exercised, the choices they made and their use of exemptions permitted by the standard. Not all of the financial institutions, moreover, disclosed accounting policies for the comparative year.

Disclosures about the transition to IFRS 9

IFRS 7 requires a number of disclosures to be made on the transition to IFRS 9 at the date of initial application (IFRS 7.42I-42S).

The financial institutions in the review often provided transitional notes within the accounting policies. These included measurement categories and carrying amounts in accordance with IAS 39 and IFRS 9 as well as a reconciliation between the closing balance of impairments according to IAS 39 and the opening balance of expected credit losses according to IFRS 9. As a rule, the financial institutions clearly disclosed carrying amounts, reconciliations and the impact of the adoption of IFRS 9 on equity, balance sheet or profit or loss, but the verbal description of the changes and impacts caused by the adoption of the new standard was sometimes on a general level or unclear.

Classification of financial assets

For the classification of financial assets, IFRS 9.4.1.1 requires entities to determine
(a) the entity's business model for managing the financial assets and
(b) the contractual cash flow characteristics of the financial asset.

The business model and contractual cash flow characteristics determine the classification of financial assets at amortised cost, fair value through other comprehensive income or fair value through profit or loss. A financial asset is classified as amortised cost when it is held by an entity with the objective of collecting contractual cash flows, and the contractual cash flows are solely payments of principal and interest (SPPI). The term "SPPI test" has emerged in the industry with the purpose of describing the assessment of cash flows generated by financial assets. (IFRS 9.4)

Most financial institutions in the review reported that they had determined and performed a SPPI test, but only a few financial institutions reported the impact of the SPPI test on the classification of financial assets. The financial asset measurement categories according to IFRS 9 differ from the measurement categories according to the previous standard and are therefore not directly comparable. As a result, IFRS Enforcement assessed the changes in the classification of financial assets at the transition, based on the extent to which financial assets previously measured at amortised cost had been reclassified at the transition date to measured at fair value through profit or loss. In most cases, financial institutions explained the reasons for these changes rather briefly. In some financial institutions, the changes in classification were so significant that it would have been useful for the reader to know, for example, to what extent the classification changes were due to the fact that financial assets did not pass the SPPI test.

Taking into account forward-looking information

In determining expected credit losses, an entity shall take into account all reasonable and supportable information about past events, current conditions and forecasts of future economic conditions (IFRS 9.5.5.11, IFRS 9.5.5.17). In connection with this requirement, IFRS 7.35G requires entities to disclose how forward-looking information has been included in the measurement of expected credit losses.

Of the Finnish financial institutions in the review, six of the ten stated that they use scenarios in taking forward-looking information into account. Of these, only three financial institutions reported the weighting of the scenarios used in the assessment of possible outcomes, and two stated how far into the future the scenarios used in the impairment models extended. The financial institutions rarely stated how, in addition to scenarios, they took forward-looking information into account, for example when assessing customer-specific or sector-specific risks.

Room for improvement in disclosing indicators of significant increase in credit risk

IFRS 9 requires the classification of financial assets in a three-stage impairment model. In connection with initial recognition, the financial asset is usually classified in stage 1 of the impairment model. A financial asset is later transferred to stage 2 when the entity assesses that the credit risk of the financial asset has increased significantly since initial recognition (IFRS 9.5.5.9-11). For this, entities shall determine indicators of significant increases in credit risk (SICRs). A financial asset is transferred to stage 3 when it is credit-impaired. In stage 1 of the model, expected credit losses are assessed by assuming that the default event occurs within the 12 months following the reporting date, affecting all future cash flows of the financial asset. The expected credit loss for financial assets classified in stage 2 and stage 3 are assessed by determining the probability of the default event and the resulting impact on the cash flows over the lifetime of the financial asset. (IFRS 9.5.5)

In their financial statements, entities shall disclose various qualitative and quantitative information on credit risks and risk concentrations. In addition, entities shall explain the inputs and assumptions, and the estimation techniques used by it as indicators of a significant increase in credit risk. (IFRS 7.33-35H) IFRS Enforcement considers that entities are also required to disclose quantitative information on SICR indicators.

Based on the review, Finnish financial institutions have room for improvement, particularly in the disclosure of bank-specific indicators of a significant increase in credit risk. IFRS Enforcement found that financial institutions disclose on a fairly general level the indicators used for transfer to stage 2 and how they were determined. Only a few financial institutions in the review clearly disclosed which were the changes in SICR indicators that require transferring a financial asset to stage 2. Some financial institutions stated that they use either the relative or the absolute change in the probability of default, or both as SICR indicators, but did not, however, disclose quantitative values for the indicators. Several of the financial institutions in the review mentioned a deterioration of internal credit rating as an indicator of significant increase in credit risk.

According to an enforcement decision[14] published by ESMA, expected forbearance measures are an indication of significant increase in credit risk and that requires a transfer of the financial asset from stage 1 to stage 2. In addition, entities should always carefully assess whether a financial asset is credit-impaired, and possibly classify it to stage 3. The purpose of the published enforcement decisions is to promote uniform application of IFRSs in Europe.

Over half of the financial institutions in the review stated that they use granted forbearance measures[15] as an indicator of significant increase in risk. IFRS Enforcement drew attention to the fact that none of the financial institutions disclosed expected forbearance measures as SICR indicators.

In the IFRS 9 impairment model, a financial asset can be transferred back from stage 3 to stage 2 and from stage 2 to stage 1. This requires an improvement in the credit risk of the financial asset so that the criteria for transfer to stage 2 or stage 3 are no longer met, which may be reflected in, for example, the making of overdue payments. The standard states in connection with modified financial contracts that typically a customer would need to demonstrate consistently good payment behaviour over a period of time before the credit risk is considered to have decreased. (IFRS 9.5.5.7, IFRS 9.B5.5.27)

In their impairment models, the financial institutions in the review used time periods of very different lengths when they assessed the transfer of financial assets back to stage 2 or stage 1. The financial statements usually did not contain justifications for the lengths of the periods used. More than half of the financial institutions did not disclose in their financial statements information on the periods used.

Room for improvement in describing expected credit loss models

Various entity-specific models for measuring expected credit losses are permitted under the standard when the requirements of IFRS 9 are met. In accordance with IFRS 7.35A-38, entities shall disclose in the financial statements the inputs, assumptions and estimation techniques used in determining expected credit losses. In addition, the financial statements should contain qualitative and quantitative information on credit risks and their management, in a way that provides the user of the financial statements an opportunity to understand and assess the credit risks to which the entity is exposed. A further objective is to combine qualitative and quantitative information so that it is possible for the reader to form an overall picture. (IFRS 7.31-38)

All of the financial institutions in the review used, for at least some categories of financial assets, the PD*LGD*EAD model[16] to determine the amount of expected credit losses. In addition, several banks used, for some categories of financial assets, the historical credit loss model, adjusted for the impacts of future forecasts. All of the financial institutions in the review described the impairment models they used, but there were clear differences in the level of detail of the descriptions. In some cases, the financial statements contained very good bank-specific descriptions of the models or credit risks. Only a few financial statements, however, provided sufficient detail on how the parameters of the PD*LGD*EAD model had been determined and what the most important inputs and values were in determining them. In some cases, it was, for example, unclear to the reader whether the bank determined the PD in the impairment model at the exposure level, the customer level, the rating level or the portfolio level, and whether the PD in question was for the next 12 months or for the lifetime of the financial asset.

When reviewing the financial statements, IFRS Enforcement also found that banks might disclose a good qualitative description of the areas of credit risk outside the financial statements, but did not

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[14] https://www.esma.europa.eu/press-news/esma-news/esma-publishes-23rd-extract-eecs-database.
[15] Debt-servicing relief for debtors in financial difficulty.
[16] Probability of Default PD, Loss Given Default LGD, Exposure at Default EAD.

necessarily use cross-references that would have given the reader the opportunity to combine various information into a clear overall picture (IFRS 7.35C).

As a rule, the financial institutions in the review provided a reconciliation from the opening balance to the closing balance of the loss allowance in accordance with IFRS 7.35H.

Criteria for recording write-offs must be assessed with care

IFRS 9.5.4.4 requires: "An entity shall directly reduce the gross carrying amount of a financial asset when the entity has no reasonable expectations of recovering a financial asset in its entirety or a portion thereof. A write-off constitutes a derecognition event (see paragraph B3.2.16(r))." The application guidance provides, with the aid of an example, guidance on the timing of a write-off, in which forward-looking information should be taken into account. IFRS 7.35F(e) requires entities to disclose their write-off policy in the financial statements.

The review revealed that, typically, Finnish financial institutions considered, for example, termination of debt collection, realisation of collateral or bankruptcy of the debtor as criteria for recording a write-off. Based on the information obtained from financial institutions' financial statements, it appears that financial institutions need to carefully assess the criteria they apply for recording write-offs.

For further information, please contact:

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ESMA's accounting enforcement priorities for 2020 – broader statement covering non-financial information and alternative performance measures

On 22 October 2019, the European Securities and Markets Authority (ESMA) published European Common Enforcement Priorities (ECEP) for the 2019 IFRS financial statements of listed companies.

The public statement on priorities is divided into two sections, of which the first presents priorities related to IFRS standards and the second presents topics related to non-IFRS reporting to which ESMA wishes to draw companies' attention. The IFRSs-related priorities presented in section 1 are

– specific issues related to the application of IFRS 16 *Leases*
– follow-up of specific issues (ECEP 2018) related to the application of IFRS 15 *Revenue from Contracts with Customers* and IFRS 9 *Financial Instruments*; and
– specific issues related to the application of IAS 12 *Income Taxes* (including application of IFRIC 23 *Uncertainty over Income Tax Treatments*).

Section 2 addresses the reporting of alternative performance measures and non-financial information, more on which below. In the reporting of alternative performance measures, ESMA wishes to draw companies' attention to

– the clear disclosure in alternative performance measures of impacts related to IFRS 16 *Leases*
– disclosures on the use of alternative performance measures.

Reporting of non-financial information

The significance of environmental, social and governance (ESG) factors has grown in companies' operations. Investors and various stakeholders increasingly expect from companies information on how they promote ESG. In its statement, ESMA also sets out general principles and content recommendations that, if followed, would improve the reporting of non-financial information. In line with the common European objectives, environmental responsibility is currently focused on combating climate change. In June 2019, the European Commission published guidelines on companies' reporting of climate-related information, which ESMA also refers to in its statement. The Commission emphasises the necessity and urgency of further improvements in reporting.

Key principles and content of reporting

Listed companies have complied with the EU Directive on the disclosure of non-financial and diversity information, implemented in the Accounting Act, by reporting for two years now the information in either the management report or a separate report. Based on the findings made to date, ESMA urges companies to pay particular attention in their reporting of information to materiality assessment, completeness, balance and accessibility.

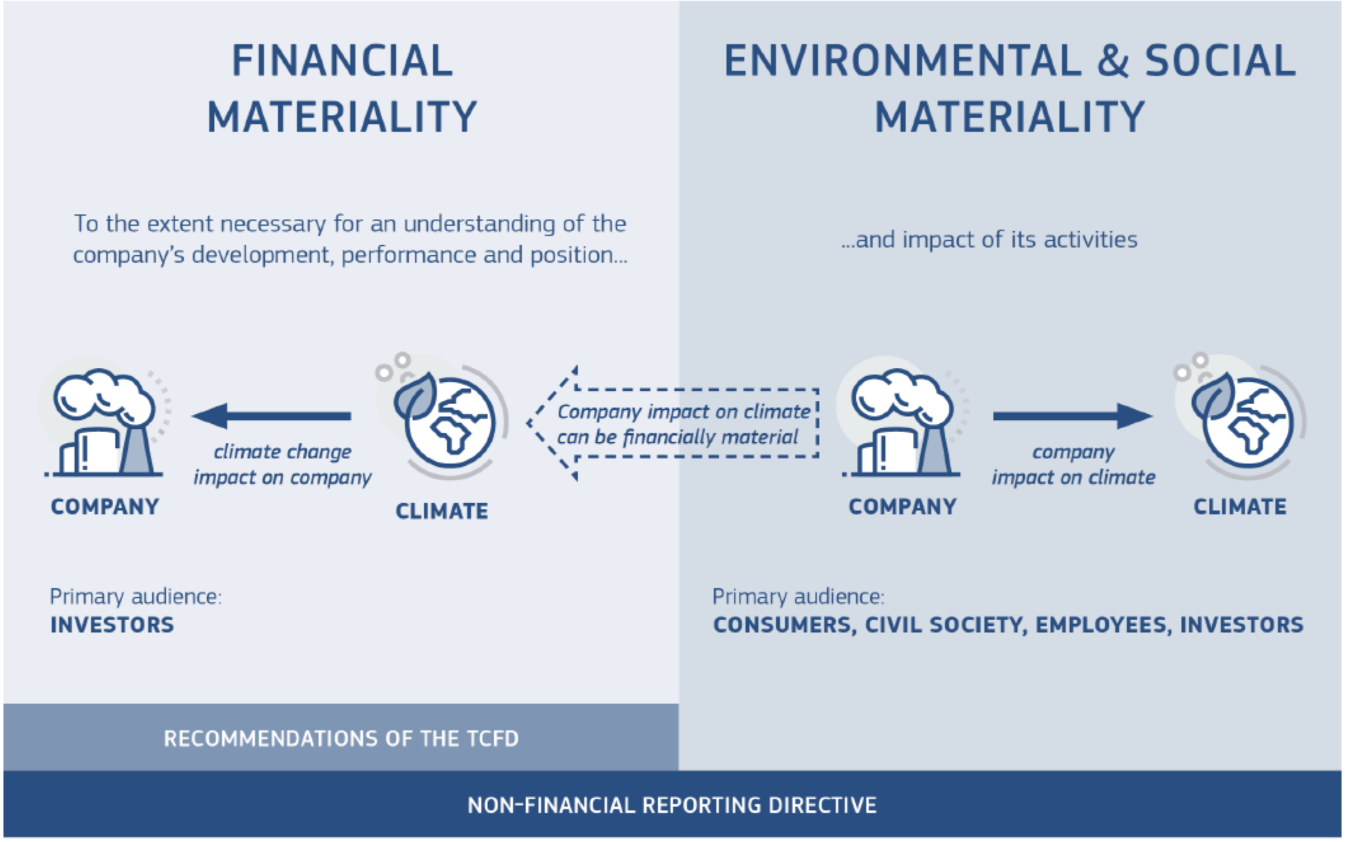
With regard to the content of reporting, ESMA highlights as key issues

- environmental and, in particular, climate reporting
- selection and presentation of relevant performance indicators
- use and reference to reporting frameworks or standards and
- reporting related to the whole value chain.

The underlying idea of the Directive is to assess materiality from two different perspectives: how the company's operations affect the environment, social stakeholders, and society; and how changes or expectations in the environment, stakeholders, and society affect the company's operations in terms of risks or opportunities.

The Commission's guidelines clarify the materiality assessment referred to in the Directive. In the latest guidelines, issued in June 2019, the Commission makes practical recommendations to companies, particularly on how they could improve reporting on the climate impacts of their own operations and the effects of climate change on their own operations. The figure below illustrates well materiality assessment from two different perspectives.

Figure 1: Materiality assessment from two different perspectives in reporting climate-related information



*Financial materiality is used here in the broad sense of affecting the value of the company, not just in the sense of affecting financial measures recognised in the financial statements.

** TCFD = Task Force on Climate-related Financial Disclosures
In June 2017, the Task Force on Climate-related Financial Disclosures (TCFD), established by the G20's Financial Stability Board, published recommendations to encourage financial institutions and non-financial companies to disclose information on climate-related risks and opportunities.

Source: Communication from the Commission, Guidelines on non-financial reporting: Supplement on reporting climate-related information, Official Journal of the European Union 20 June 2019.

For further information, please contact

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Guidelines on Risk Factors under the Prospectus Regulation will apply from 4 December 2019

The FIN-FSA will implement nationally the ESMA Guidelines "Risk Factors under the Prospectus Regulation" (ESMA31-62-1293) by issuing Regulations and guidelines 9/2019 "Presentation of information in prospectuses coming under the Prospectus Regulation".

The FIN-FSA recommends that the persons responsible for prospectuses should read and follow the guidelines in order to expedite the prospectus inspection process, even though the guidelines are directed at the competent authorities.

Regulations and guidelines 9/2019 were issued on 25 November 2019 and they will apply from 4 December 2019.

For further information, please contact

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Errors in managers' transaction notifications and future changes

It has been a requirement that managers' transactions (MAR Article 19) should be published and reported to the FIN-FSA since MAR entered into force on 3 July 2016. Transactions have been reported to the FIN-FSA by email using a pdf-format form. Reported notifications largely meet the reporting requirements of EU regulation, but occasionally notifications need to be corrected. The most common errors are listed below

– The nature of the notification is incorrect. Either *Initial notification* or *Change* is selected as the type of notification on the form. Of these, *Initial notification* should always be selected when reporting a new transaction. *Change* is used only when a notification that has already been submitted is corrected. Particular care should be taken to include the reference number of the original notification being corrected in the change notification. If the reference number is left blank, the correction will not be executed properly.
– The price unit must also be filled in, even in cases where the unit price is 0. Most commonly, an error is caused by a transaction where no price is involved. Even in such cases, however, the price unit cannot be left blank; depending on the case, either the currency or *Not applicable* should be filled in. More detailed instructions on the selection can be found on the FIN-FSA website notification examples (in Finnish).
– Empty rows should not be left in transaction details. As transactions are reported based on actual trading items, it is often necessary to list transaction details on multiple rows, from which the form automatically calculates aggregate information. In some cases, however, more rows have been added to the form than actual trading items. This causes a technical error in the form, so extra lines should always be deleted before submission.

Reporting of managers' transactions to the FIN-FSA will change in the near future through the launch of the FIN-FSA's electronic services. Then an electronic form corresponding to the present pdf form will be completed and sent to the FIN-FSA direct via a browser. The form sent by e-mail will be discontinued after a transition period. Use of the electronic service will require the sender to be authenticated in the Population Register Centre's Suomi.fi service, but it will also be possible in the future to make a notification on behalf of another person. The change will also affect the processing of incorrect or incomplete notifications. If a notification is incorrect or incomplete, the electronic service form will show the fields that are incorrect or incomplete. These fields will have to be corrected before it is possible to move forward in the service. In the case of a change notification, the notification to be corrected will be selected via a pull-down menu, which will also leave less scope for interpreting how the original notification should be referenced. The electronic service will therefore facilitate the submission of notifications in the future, but it is worth paying attention to the errors listed above before the service is launched, so that use of the service is as smooth as possible in the future.

The FIN-FSA will provide further information on this topic closer to the introduction of the electronic service.

For further information, please contact

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Information on listed companies' electronic XBRL reporting at RTE seminar in Otaniemi

On 14 November 2019, the FIN-FSA, the Real-Time Economy (RTE) programme of Aalto University School of Business and the XBRL Finland consortium organised a seminar on electronic reporting of annual financial reports at Aalto University in Otaniemi. Over 200 representatives of listed companies and other stakeholders attended the seminar.

The morning theme of the seminar was listed companies' European Single Electronic Format (ESEF) for annual financial reporting, which will be applied for annual financial reports published from 1 January 2020. The seminar heard, among other things, Nokia Corporation's experiences of XBRL reporting in the United States. The afternoon theme was XBRL reporting for small and medium-sized enterprises and municipalities. The seminar was attended by a large number of software suppliers and service providers, whose products and services the seminar attendees had the opportunity to view.

See the seminar presentation material and the contact information of participating service providers here. See also the XBRL Finland and FIN-FSA websites.

For further information, please contact

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European Securities and Markets Authority's new address

The European Securities and Markets Authority (ESMA) has moved. ESMA's new address is 201-203 Rue De Bercy 75012 Paris. The office is right next to Gare de Lyon.

For further information on the Market newsletter, please contact

Capital Markets Supervision, telephone +358 9 183 5577