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Turbulent times
Financial reporting considerations arising from the Eurozone crisis

The purpose of this communication is to highlight some of the key issues emerging from the ongoing Eurozone crisis that need to be considered by entities preparing their financial statements for periods ending on or after 30 June 2012.

Continued uncertainty about the situation in Greece and other economies in the Eurozone, such as Ireland, Italy, Portugal and Spain, along with weaker economic conditions in Europe and elsewhere, raises a number of challenging financial reporting issues.

The financial reporting considerations discussed below are based on the assumption that the membership of the Eurozone is unchanged at the reporting date and date of the signing of the financial statements. The financial reporting impact of a country exit from the Eurozone is discussed in greater detail in a related publication: "Exiting the Euro: Financial reporting implications of a country's exit from the Eurozone".

This accounting update includes material relating to:

July 2012
IFRS Global Office

Economic conditions in the Eurozone

Economic conditions, particularly within Europe, continue to be difficult. Continued doubts about Greece's ability to meet its debt obligations and the political instability associated with recent elections and a new Government, have highlighted the risk of a country's exit from the Euro. Whilst the recent Greek election and formation of a new Government may have reduced that risk for the time being, the situation remains uncertain – as does the general economic outlook for Europe and other regions. The *IMF World Economic Outlook* in April 2012 noted that "the Eurozone is still projected to go into mild recession in 2012 as a result of the sovereign debt crisis, and a general loss of confidence, the effects of bank deleveraging on the real economy, and the impact of fiscal consolidation in response to market pressures". The implications of events in the Eurozone are far-reaching.

Within the Eurozone:

- Fears remain that the sovereign debt crisis, particularly in Greece, could lead to a change in the membership of the Eurozone and impede economic growth in the region.
- Economies such as Greece, Ireland, Italy, Portugal and Spain (known collectively by some as the GIIPS) have high levels of public debt and are pursuing policies to manage their debt and their deficits.
- Concerns over instability in the Eurozone are resulting in the 'flight of capital' away from some jurisdictions and widening credit spreads are putting considerable pressure on the ability of some countries to raise debt in the capital markets.
- Greece, Ireland and Portugal continue to rely on official sector support and doubts remain about their ability to return to capital markets as a source of long-term funding. Both Spain and Italy continue to issue medium- to long-term debt in the capital markets at interest rates that are at historically high levels since the date of introduction of the Euro. Recently, Spain requested assistance from the European Financial Stability Facility to recapitalise some of their banks[1]. Other members of the Eurozone, such as Cyprus[2], are also facing financial difficulties.

Outside the Eurozone:

- Continued fears about contagion to the rest of the Eurozone area and elsewhere are contributing to weak prospects for growth in the global economy.
- The implications of falling demand for output from trading partners outside the Eurozone are further dampening the prospects for recovery within.

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1 EFSF, "FAQ – Financial Assistance for Spain", available at http://www.efsf.europa.eu/attachments/faq_spain_en.pdf

1 Standard and Poors, "Cyprus Ratings Lowered to 'BB+/B'; Outlook Negative", available at http://www.standardandpoors.com/ratings/articles/en/eu/?articleType=HTML&assetID=1245327297152

Implications of difficult trading conditions

General considerations

The current economic turmoil in the Eurozone raises a range of financial reporting issues. Whilst some of the key issues are set out below, the unique circumstances and risk exposures for each reporting entity must be assessed comprehensively; as there may be other issues not considered below that apply to the entity. The overriding consideration is to ensure that the financial statements and management commentary convey all material uncertainties potentially calling for enhanced disclosures not strictly required by any particular IFRS.

Going concern

An entity's current facts and circumstances may challenge the going concern basis of preparation. Assessing whether an entity is a 'going concern' typically requires the following factors to be considered:

- whether the forecast performance would result in an adequate level of headroom over the entity's available borrowing facilities and compliance with relevant loan covenants; and
- the availability of sufficient committed borrowing facilities for the foreseeable future and whether there are indicators that the lending counterparty will be unable to provide this funding.

IAS 1 *Presentation of Financial Statements* requires this assessment to take into account all available information about the future (covering a period of at least 12 months from the reporting date).

Consistency of assumptions and estimates

A number of assumptions or estimates may be required for more than one purpose (for example, forecast revenues may be relevant to impairment, recognition of deferred tax assets and going concern assessments). Consistent assumptions should be used for all relevant assessments.

In addition, external events and circumstances should be considered in assessing whether changes made in assumptions and estimates from the previous period are appropriate or not.

Recognition and measurement

Impairment of non-financial assets (including goodwill) and investments in subsidiaries, associates and joint ventures

Various aspects of the current economic environment may indicate that an entity's non-financial assets are impaired. For example:

- deteriorating economic conditions resulting from reductions in public spending in countries implementing austerity measures and experiencing falling tax revenues;
- reductions in spending by the entity's customer base (for example, reduced capital expenditure rates for a business to business supplier or reduced consumer spending for a retailer);
- extended credit terms for customers experiencing financial difficulty, reducing the present value of sales;
- a change in the entity's business model as a result of the economic environment;
- a high concentration of customers in countries with weak growth forecasts;
- a fall in asset prices as a consequence of poor demand; or
- increased costs of capital including borrowing with widening credit spreads resulting in higher discount rates.

Assets affected may include:

- goodwill and intangible assets;
- land, buildings, machinery and equipment;
- investment property carried at cost;
- biological assets carried at cost; and
- investments in subsidiaries, associates and joint ventures carried at cost.

The overriding consideration is to ensure that the financial statements and management commentary convey all material uncertainty requiring enhanced disclosures not strictly required by any particular IFRS.

Goodwill, intangible assets with an indefinite useful life and intangible assets not yet available for use are tested for impairment annually and at interim dates if there are indicators of impairment.

IAS 36 *Impairment of Assets* sets out a number of internal and external indicators (some of which are set out above) that an entity needs to consider to assess whether an asset may be impaired. Those indicators are not exhaustive and the general principle in the Standard is that at the end of each reporting period, an entity needs to assess whether there is any indication that an asset may be impaired such that its carrying amount is no longer recoverable.

An impairment loss will need to be recognised whenever an asset's carrying amount exceeds its recoverable amount (being the higher of its value-in-use and its fair value less costs of disposal). If any indication of impairment exists, the entity will be required to estimate the recoverable amount of the asset to determine whether an impairment loss has arisen and, if so, its amount.

Goodwill, intangible assets with an indefinite useful life and intangible assets not yet available for use are tested for impairment annually and at interim dates if there are indicators of impairment.

Value-in-use calculations

Careful consideration of the cash flow projections, growth rate(s) and discount rate(s) as well as 'current' sales prices used in value-in-use calculations will be critical in terms of the supportability and reasonableness of the calculations given the market conditions.

Key principles to bear in mind include:

- estimated cash flows and discount rates should be free from both bias and factors unrelated to the asset in question;
- estimated cash flows or discount rates should reflect a range of possible outcomes, rather than a single, most likely, minimum or maximum possible amount;
- cash flow projections should be based on the most recent financial budgets/forecasts, approved by management at the appropriate level of authority, covering a maximum period of five years, unless a longer period can be justified;
- projections of cash flows beyond the period covered by the most recent budgets/forecasts should be estimated by extrapolating the projections based on the budgets/forecasts using a steady or declining growth rate for subsequent years, unless an increasing rate can be justified based on objective information about patterns over a product or industry lifecycle. The growth rate should not be overly optimistic and should not exceed the long-term average growth rate for the products, industries or countries in which the entity operates, or for the market in which the asset is used, unless a higher rate can be justified. In some cases, it may be appropriate for the growth rate to be zero or negative;
- future cash flows shall be estimated for the asset in its current condition and should not include estimated future cash inflows or outflows expected to arise from improving or enhancing the asset's performance or future restructurings to which the entity is not yet committed;
- the entity's weighted average cost of capital (WACC) may be used as a starting-point for estimating a market discount rate, but this should then be adjusted to reflect the way that the market would assess the specific risks associated with the asset or cash-generating unit's estimated cash flows (unless that risk (or some elements of that risk) is already included in the estimated cash flows). IAS 36.A18 specifically mentions country risk in this context and this may be particularly relevant for entities operating in countries currently experiencing financial difficulties; and
- care should be taken as to the consistency of the data being prepared and compared so avoid double-counting or omission of some data. For instance, attention should be paid to how inflation has been included in the estimated cash flows and growth rate(s), as well as the discount rate. Similarly, care should be taken when comparing the carrying amount of a cash-generating unit with its value-in-use, so that the latter is derived only from the same assets and liabilities included in the cash-generating unit.

Inventory

IAS 2 Inventories requires inventory to be measured at the lower of its cost and net realisable value (NRV). In a difficult economic environment, NRV calculations may warrant additional challenge and scrutiny at the end of the reporting period.

Deferred tax assets

Deferred tax assets need to be assessed for recoverability at the end of each reporting period.

IAS 12 Income Taxes requires the recognition of a deferred tax asset only to the extent that it is probable that future taxable profit will be available against which a deductible temporary difference can be utilised. A reduction in forecast performance stemming from the current economic environment should lead to a reassessment of the extent to which this is the case.

The effect of restructurings

In a difficult economic environment, entities may be considering or implementing restructuring plans such as the sale or closure of parts of their businesses or the downsizing of continuing operations.

Plans such as these may require consideration of a number of issues, including whether:

- the entity has a detailed formal plan for the restructuring and has raised a valid expectation in those affected that it will carry out the restructuring by starting to implement that plan or announcing its main features to those affected by it. If and only if both of these criteria (as detailed in IAS 37.72 *Provisions, Contingent Liabilities and Contingent Assets*) are met, should a restructuring provision be recognised; and

- any part of the business is available for immediate sale in its present condition and completion of such a sale within one year is highly probable. If so, the assets and liabilities to be disposed of are classified as held for sale and written down to their fair value less costs to sell if this is lower than their carrying amount (as required by IFRS 5 *Non-current Assets Held for Sale and Discontinued Operations*).

Defined benefit plans

The current economic climate may impact the measurement of both plan assets and defined benefit obligations.

Plan assets

The considerations of fair value of both financial assets and non-financial assets (for example, investment property) are also relevant to the measurement of plan assets under IAS 19 Employee Benefits. In particular, significant amounts of sovereign debt may be held by pension schemes.

Plans also may have holdings in hedge funds, structured products and other illiquid assets and it is important that such arrangements are valued appropriately.

Some pension schemes have participated in stock lending or have purchased derivative financial instruments to mitigate their funds' exposure to interest rate risk, inflation and equity market volatility. Where this is the case, directors need to consider counterparty risk (and actual default) when valuing their investments.

Estimated returns on plan assets may also need to be reassessed to take into account changes in market expectations (IAS 19.106).

Defined benefit obligations

The discount rate used to value defined benefit obligations under IAS 19 should be set by reference to the yield available on high quality corporate bonds of an appropriate term (or, where there is not a deep market in such bonds, the market yields on government bonds). Typically, AA rated bonds or similar bond yields have been used for this purpose. A lack of liquidity in capital markets may lead to reconsideration of whether a deep national or regional market in high quality corporate bonds denominated in the same currency as the underlying defined benefit obligation continues to exist.

In recent years, it has been common to refer to the average yield on an index of corporate bonds. In a volatile economic environment, there may be challenges in the use of such an index.

- A spread of yields for constituents of published indices may indicate that some corporate bonds within the index are no longer considered by the market to be of high quality even though their credit rating has yet to be adjusted. In these circumstances, the index should be adjusted to exclude yields on such bonds.

- A lack of a sufficient number of bonds within the index which have a term consistent with the term of the retirement benefit obligation. In these circumstances, extrapolation of current market rates for bonds with a shorter term along a yield curve is required.

Both the requirement and methodology for any adjustment to the constituents of an index or extrapolation of yields should be carefully considered to ensure that the discount rate selected:

- reflects the time value of money, but not actuarial risk, investment risk or credit risk specific to an entity;
- is unbiased (i.e., neither imprudent not excessively conservative); and
- is compatible with other actuarial assumptions used in measuring the defined benefit obligation.

Once entities have chosen an approach for determining the discount rate, the approach shall be applied consistently from one period to the next. It is also appropriate to consider the outcome of this approach compared to other approaches for setting up the discount rate, in order to assess the reasonableness of the outcome. Finally, depending on the size of the obligation and the sensitivity to changes in the discount rate, consider whether disclosure of the factors affecting the choice of rate used is required as a critical judgement or key source of estimation uncertainty under IAS 1.

Disclosures

Impairment

Information about asset impairments will be critical in helping investors and others understand the impact of the current Eurozone crisis on an entity's financial performance and position.

At a time of falling markets, it is critical for preparers of financial statements to reassess the recoverability of any goodwill balances. Disclosure of the basis on which the recoverable amount has been measured, i.e. value-in-use or fair value less costs of disposal, and the key assumptions used to determine that value must be provided in sufficient detail. For example, providing the specific assumptions for material cash-generating units, rather than a range of assumptions across cash-generating units, makes it easier for a reader to assess the recoverability of goodwill.

If a reasonably possible change in a key assumption used in an impairment review (whether a change in discount rate or any other assumption) would result in the recognition of an impairment loss, additional disclosures are required of:

- the amount by which recoverable amount exceeds carrying amount;
- the value assigned to the key assumption; and
- the amount by which the value assigned to the key assumption must change, after incorporating any consequential effects of that change on the other variables used to measure recoverable amount, in order for recoverable amount to be equal to carrying amount.

Other disclosures

Other disclosure requirements of IFRSs may become more sensitive in a volatile economic environment. For example:

- the requirements of IAS 1 to disclose information on the entity's objectives, policies and processes for managing capital. The requirement to disclose compliance with externally imposed capital requirements may make these disclosures particularly significant for financial institutions;
- the requirements of IAS 1 to disclose information about the assumptions made about significant sources of estimation uncertainty and judgements made in the process of applying the entity's accounting policies. These assumptions and judgements may become more significant in a volatile environment or may change if the entity's business model changes in response to that environment; and
- the requirements of IAS 10 Events after the Reporting Date to disclose material events occurring after the reporting period. In a volatile environment, non-adjusting events such as commencement of a major restructuring, disposal of assets or large changes in asset prices may occur more frequently.

In addition to the requirements of IFRSs, many local laws or regulations (for example, SEC Regulation S-K and the EU Transparency Directive as implemented in each Member State) require disclosure of the risks facing an entity. In the current economic environment, entities subject to such requirements should consider whether new risks have emerged or previously identified risks have become more significant.

Financial instruments issues

Recognition and measurement

Exposures to Greek sovereign debt

As part of the terms of the Private Sector Involvement (PSI), Greek Government Bonds (GGBs) under Greek law were exchanged in March 2012 (and foreign law bonds in April 2012) for new GGBs, notes issued by the European Financial Stability Fund (EFSF) and a GDP-linked security.

The European Securities Markets Authority (ESMA) has requested that the IASB's Interpretations Committee provide guidance on how to determine the effective interest rate at initial recognition of the new GGBs. Specifically, should the effective interest rate be based on the assumption that all contractual cash flows of the new bonds will be recoverable or reflect doubts about recoverability in the same way as for an acquisition of distressed debt (under IAS 39 *Financial Instruments: Recognition and Measurement,* AG5)? The IASB's Interpretations Committee is currently deliberating on this issue and is expected to issue an agenda decision on this matter following its July meeting. Further advice will be issued once the Interpretations Committee reaches a decision.

The new bonds issued by Greece in the PSI exchange need to be assessed for potential impairment.

Exposures to other Eurozone sovereign debt

At the time of writing, we do not consider the sovereign debt of other Eurozone countries including Portugal, Italy, Ireland and Spain to be impaired under IAS 39 or IFRS 9.

Fair valuation of financial assets and financial liabilities

The continued economic turbulence in Greece and other economies has led to a decrease in market activity for certain financial instruments. This may bring into focus again questions of how to establish the fair value of financial instruments in markets that are no longer active. There is extensive discussion of this topic in IAS 39, IFRS 13 *Fair Value Measurement and the IASB Staff Educational Guidance: Using judgement to measure the fair value of financial instruments when markets are no longer active*[3].

The literature:

- provides guidance on identifying what is a 'forced' transaction (and which transactions are not at fair value);
- addresses the inputs in a valuation technique and, in particular, the need to include the current market assessment of credit risk (both 'counterparty' and 'own credit risk') and liquidity risk, both for derivative and non-derivative instruments; and
- addresses the reliance that can be placed on the use of data from brokers and independent pricing services in determining fair value. This is particularly the case where markets become inactive and trading data is thin.

This guidance will also be relevant for fair value disclosures of financial instruments required by IFRS 7 Financial Instruments: Disclosures, e.g., levels 1, 2 and 3 of the fair value hierarchy. Preparers will also need to consider whether derivative valuations adequately reflect counterparty credit risk given the possible impact of the Eurozone crisis.

Impairment of other financial assets

In addition to GGBs, other financial assets should be assessed for impairment given the economic situation in Greece and other Eurozone economies affected by the crisis. Financial assets measured at amortised cost under either IAS 39 or IFRS 9 and available-for-sale financial (AFS) assets under IAS 39 must be considered for impairment under those Standards. In particular, entities should consider the following:

- **AFS equity investments** may be impaired as a result of declines in equity markets. An available-for-sale equity security is impaired if it has suffered a significant or prolonged decline in its fair value below its cost. For example, the Greek ASE stock market index has fallen by 61% between the start of June 2011 and the end of May 2012, and Madrid's IBEX 35 index fell to a nine-year low at the end of May 2012. Although impairment is assessed individually for each equity investment, the extent of decline in these equity markets is indicative of potential impairment of the underlying securities. Entities should have a defined accounting policy on what they regard as 'significant' and 'prolonged' and should apply that policy consistently from period to period. In determining an accounting policy for AFS equity investments, the IASB's Interpretations Committee has noted (i) the fact that a decline in the value of an investment is in line with the overall level of decline in the relevant market is not sufficient for determining that there is no impairment; (ii) the existence of a significant or prolonged decline cannot be overcome by forecasts of an expected recovery of market values, regardless of their expected timing; and (iii) 'significant or prolonged' should be determined in the entity's functional currency in the case of foreign currency denominated equity securities (this may be particularly important for holdings of Euro-denominated equity securities by investors outside Europe given the relative weakness in the Euro relative to other currencies).

3 The IASB staff educational guidance issued in 2008 now forms part of IFRS 13, the new Standard on fair value measurement.

- If the fair value of an AFS equity instrument continues to fall after an impairment loss has been recognised in profit or loss, then these further declines should be recognised immediately in profit or loss. Reversals of impairments of AFS equity securities through profit or loss are not permitted. As a result, any future increases in fair value would be recognised in other comprehensive income (OCI).

- **Debt securities** issued by, or loans to, companies affected by the Eurozone crisis may be subject to a greater risk of impairment. For instance, financial institutions may have extended loans or written credit facilities to Greek entities. Financial and non-financial institutions may have invested in debt securities issued by entities in the affected countries. In either case, the instruments may be classified in amortised cost categories (loans and receivables or held-to-maturity) or as available-for-sale (with fair value changes recognised in OCI).
  In both cases, careful judgement will be required to establish whether events have occurred (such as a change in credit rating, negative news about the issuer of a debt instrument, or delinquencies in payments) that are indicative of an impairment loss.

- **Trade receivables** from entities in affected Eurozone countries or entities with significant exposure to those countries may be subject to a greater risk of impairment. Particular attention should be given to recoverability where receivables are overdue even if the entity has the right to charge interest for late payment. Impairment should be recognised if the full contractual amount is no longer expected to be received or if the contractual cash flows are expected to be received but later than when contractually due without receipt of compensating interest. The current level of 90 days past due status of uncollectable invoices in Greece is more than twice that of the average for Western Europe . One industry which is widely reported to have a large and growing balance of outstanding overdue receivables in the affected Eurozone countries is the pharmaceuticals sector with some receivables reported to be now over three years old. Whilst it is understood that has been the situation in Greece for over a decade, in the past, these amounts were considered 'recoverable' because they were backed by the Greek government. The current situation makes that presumption less tenable. These circumstances are likely to be affecting other industries also. In some jurisdictions, governments have taken steps to protect creditors for past due amounts due from public sector entities. Where this is the case, such measures should be taken into account in impairment assessments.

4 "Atradius survey reveals 30% of the total value of B2B receivables paid late", available at: http://global.atradius.com/corporate/pressreleases/atradius-survey-reveals-30-of-the-total-value-of-b2b-receivables.html

Impact on hedge accounting

The current economic situation in Greece and other Eurozone economies could have a very significant effect on both (a) the ability of entities to apply hedge accounting and (b) the profit and loss impact of hedge accounting:

- Consideration should be given to whether forecast transactions remain 'highly probable'. In the case of a Greek entity (or one with significant exposure to Greece) there could be changes in the entity's intention to undertake purchases, make sales or in its intention and ability to rollover debt financing. Also, the ability of counterparties and customers to buy from or lend to the reporting entity may be affected. For instance, if an entity was relying on purchases from Greek customers or lending from Greek banks as the basis for highly probable sales or highly probable interest payments respectively, these hedging relationships should be reviewed carefully.

- Consideration should be given to the effect of any impairment loss on hedge effectiveness. For example, cash flows on a receivable or debt security hedged for interest rate or foreign currency risk should not be included in the hedge effectiveness assessment if not expected to be recovered.

- Careful consideration should be given to the impact of credit and liquidity risks on the assessment of hedge effectiveness as both can be a source of hedge ineffectiveness. This could be particularly acute for entities that have uncollateralised hedging instruments with Greek financial institutions (since the fair value of such instruments could be significantly affected by concerns over their credit risk) but it may also be an issue for uncollateralised hedging instruments where the counterparties are banks in other Eurozone countries.

Current and non-current financial liabilities

Liabilities are classified as current if the entity does not have an unconditional right to defer settlement for at least 12 months after the reporting period.

Given the difficult trading conditions in Greece and other some other countries in the Eurozone there is an increasing risk of breaches of financial covenants (e.g., failure to achieve a specified level of profits or interest cover). If such a breach occurs on or before the end of the reporting period with the effect that the lender has the right to demand repayment within 12 months of the end of the reporting period, the liability is classified as current. A waiver of such a right or renegotiation of the terms of the liability after the end of the reporting period does not affect the classification of the liability as current but is disclosed as a non-adjusting event after the reporting period.

Renegotiation of financial liabilities

The increasing number of entities experiencing financial difficulty has led to a greater number of borrowings being renegotiated (for example, to extend maturity, reduce the coupon or relax the covenant terms). An assessment is required of whether the renegotiation results in a substantially different instrument, in which case it is accounted for as an extinguishment of the original liability with recognition of a new liability, resulting in a profit or loss impact. In the case of troubled debt restructurings, where debt may be exchanged for equity of the borrower, the guidance in IFRIC 19 Extinguishing Financial Liabilities with Equity Instruments would apply.

Disclosures

IFRS 7 includes detailed requirements for disclosure of:

- credit risk;
- liquidity risk; and
- market risk.

In the current economic environment in Greece and the other affected Eurozone economies, some or all of these risks may become more evident, in which case more extensive disclosures than before may be required.

Greater uncertainty of creditworthiness has led to increasing demands for entities to pledge or receive collateral. IFRS 7 and IAS 39 have specific disclosures where assets continue to be recognised but are pledged as collateral. Showing the extent to which assets are pledged, or collateral is received and is returnable, is of increasing focus as regulators and other users assess the strength of an entity's balance sheet.

In respect of liquidity risk, IFRS 7 requires a description of how liquidity risk is managed.

In respect of market risk, IFRS 7 requires a sensitivity analysis based on the effect of 'reasonably possible changes in the relevant risk variable'. Entities should reassess what is 'reasonably possible' given the current market conditions. For example, given the effect of the crisis on Greek, Spanish and Italian equity markets, entities may need to assess whether the sensitivity analysis in relation to prices of AFS equity investments adequately reflects what is 'reasonably possible'. Price volatility in other markets such as currency and commodities markets may also lead to a reconsideration of whether the sensitivity analyses presented adequately reflect what is reasonably possible.

IFRS 7 also requires disclosure of any defaults on loans payable or other breaches of loan agreement terms (e.g., loan covenants) including whether the default or breach was remedied or the terms of the loan renegotiated before the date that the financial statements were authorised for issue.

In addition, the disclosures required by IAS 1 in respect of significant sources of estimation uncertainty and key judgements made in the process of applying the entity's accounting policies may include, for example, judgements about the identification and measurement of impairments of financial assets.

Greater uncertainty of creditworthiness has led to increasing demands for entities to pledge or receive collateral. IFRS 7 and IAS 39 have specific disclosures where assets continue to be recognised but are pledged as collateral. Showing the extent to which assets are pledged, or collateral is received and is returnable, is of increasing focus as regulators and other users assess the strength of an entity's balance sheet.

Interim reporting

The current uncertainty in the Eurozone warrants careful consideration when preparing interim financial statements.

IAS 34 Interim Financial Reporting requires that the measurement of estimates should be reliable and reflect all relevant information at the reporting date.

Specifically for financial instruments:

- Depending on the carrying amount of the old GGBs at 31 December 2011, an additional impairment loss may need to be recognised in the first half of 2012 as a result of the derecognition in full of old GGBs in March and April 2012 with initial recognition of the new financial instruments at fair value.

- Entities will need to classify the new GGB financial assets received on the date of exchange. In our view, the detachable GDP-linked security meets the definition of a derivative hence will be classified as fair value through profit and loss (FVTPL). In our view, the new GGBs are quoted in an active market and therefore classification at initial recognition as 'Loans and Receivables' is not permissible under IAS 39. The 'held-to-maturity' (HTM) classification will only be available where the entity has the positive intention and ability to hold the instruments to maturity. In the absence of classification as HTM or held for trading, the new GGBs will be classified as AFS.

- Where the old GGBs are classified as HTM investments, we do not consider the exchange would 'taint' an entity's intention to hold other investments to maturity.

For defined benefit plans, IAS 34.B9 requires the basis of calculating pension costs (such the fair value of plan assets and discount rates) to be challenged at the interim date where there are significant market fluctuations or other relevant events.

There are also a number of specific disclosure requirements in IAS 34 that may warrant particular attention in preparing the interim report:

- 'significant events and transactions' relevant to understanding the changes that have occurred since the last annual financial statements;

- changes in the business or economic circumstances that affect the fair value of the entity's financial assets and financial liabilities, whether those assets or liabilities are recognised at fair value or amortised cost;

- changes to assumptions and methods that underpin the estimates in the financial statements;

- the impact of risks at a segment level (where segmental reporting is required in the annual financial statements);

- the accounting policies that have changed since the most recent annual financial statements; and

- events after the interim period that have not been reflected in financial statements.

In determining which information to report in the interim financial statements, it is important that the qualitative aspects of materiality judgments are carefully assessed.

Regulatory activity

Some or all of the issues noted above have been announced as areas of focus for regulatory bodies in various jurisdictions including, but not limited to:

- the Securities Exchange Commission, "European Sovereign Debt Exposures"[5];
- the European Securities Markets Authority "Sovereign Debt in IFRS Financial Statements"[6];
- the Ontario Securities Commission "Staff Notice 52-720 Office of the Chief Accountant Financial Reporting Bulletin"[7];
- the United Kingdom Financial Reporting Review Panel (FRRP) "Annual Report"[8];
- the United Kingdom Financial Reporting Council "An Update for Directors of Listed Companies: responding to heightened country and currency risk in interim financial reports"[9];
- the French Autorité des Marchés Financiers (AMF)[10]; and
- the German Financial Reporting Enforcement Panel (FREP)[11].

5 http://www.sec.gov/divisions/corpfin/guidance/cfguidance-topic4.htm

6 http://www.esma.europa.eu/system/files/2011_397.pdf

7 http://www.osc.gov.on.ca/documents/en/Securities-Category5/sn_20120223_52-720_oca-fin-rpt.pdf

8 http://www.frc.org.uk/frrp/press/pub2637.html

9 http://www.frc.org.uk/publications/pub2805.html

10 http://www.amf-france.org/documents/general/10260_1.pdf

11 http://www.frep.info/docs/press_releases/2011/20111020_pruefungsschwerpunkte_2012_en.pdf

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