



# Some accounting-related issues based on financial reporting supervision in 2008

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# 1. Introduction

Kredittilsynet, pursuant to the Securities Trading Act § 15-1, third paragraph, supervises the periodic financial reporting of issuers of tradable securities who are listed, or have applied for a listing, on a regulated market in the EEA and whose home state is Norway pursuant to the Securities Trading Act § 5-4. Detailed rules concerning this supervision are stipulated in the Regulations to the Securities Trading Act of 29 June 2007 no. 876, chapter 13, part II.

Section 2 discusses some observations Kredittilsynet has made during its supervision of financial reporting in 2008.

New regulations in the Securities Trading Act came into force partly on the 1<sup>st</sup> November 2007 and partly on the 1<sup>st</sup> January 2008. Section 3 discusses some issues Kredittilsynet believes it is necessary to highlight.

## 2. Accounting issues

### 2.1 General issues concerning information in notes and directors' reports

During its supervision Kredittilsynet has observed that for many issuers the descriptions in the notes to the annual financial statements are too general. According to IAS 1 *Presentation of Financial Statements*, notes to financial statements should present information about the basis on which the financial statements were prepared, disclose the information required by IFRS and provide additional information not presented in the balance sheet, income statement, statement of changes in equity, or cash flow statement, but which is relevant to understanding them, cf. IAS 1.103<sup>1</sup> (revised IAS 1.112). Kredittilsynet would like to stress that it is important that the information presented in notes is specific to the reporting issuer and that the notes highlight information necessary to know to understand the issuer's financial position, income and cash flows. Detailed notes about immaterial issues may overshadow necessary information in the financial statements. According to IAS 1.31, a particular disclosure requirement does not have to be fulfilled if the information is immaterial.

For many issuers the turbulent market situation in 2008 will be of vital importance when assessing the issuer's profit (loss) and financial performance. According to the Accounting Act § 3-3a, the Board of Directors' report must include descriptions of the most material risks and uncertainty factors faced by an entity. Kredittilsynet stresses that issuers must be open and forthright about these risks. Information about financial risk that is material to an assessment of the issuer's assets, liabilities, financial position and profit (loss) must be presented. An account of the entity's exposure to market risk, credit risk and liquidity risk

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<sup>1</sup> Reference to IAS 1 relates to the standard before amendments in 2007. Revised IAS 1 is effective for annual periods beginning on or after 1<sup>st</sup> January 2009. In cases where the revised IAS 1 has resulted in changed numbering, the new numbering is presented in brackets.

must also be presented. Please refer to the requirements in IFRS 7 *Financial Instruments: Disclosures* described in section 2.2 of this circular.

Given the current market conditions, Kredittilsynet would specifically like to highlight the requirement to present additional information about the uncertainty associated with estimates. Entity shall disclose information about the key assumptions concerning the future, and other key sources of estimation uncertainty on the balance sheet date, that have a significant risk of causing a material adjustment to the carrying amounts of assets and liabilities in the next financial year, cf. IAS 1.116 (revised IAS 1.125). The disclosures must be presented in a manner that helps users of financial statements understand the assessments management has made about the future and about other key sources of estimation uncertainty. IAS 1.120 (revised IAS 1.129) mentions, among other factors, sensitivity analyses as an example of the type of disclosures it may be relevant to present.

According to IAS 1.113 (revised IAS 1.122), an entity shall disclose, in the summary of significant accounting policies or other notes, the judgements apart from those involving estimations, management has made in the process of applying the issuer's accounting policies and that have the most significant effect on the amounts recognised in the financial statements. Kredittilsynet observed that a number of issuers disclosed insufficient information concerning these assessments when applying accounting policies in their annual financial statements for 2007.

## 2.2 Financial Instruments: Disclosures – IFRS 7

### 2.2.1 Introduction

A substantial proportion of the reviewed annual financial statements for 2007 contained insufficient notes about financial instruments.

IFRS 7 *Financial Instruments: Disclosures* became mandatory for annual financial statements from and including 1<sup>st</sup> January 2007. This standard also requires non-financial entities to make extensive disclosures, and Kredittilsynet is aware that implementation of this standard has been demanding for many entities. However, a review of a sample of annual financial statements for 2007 revealed that disclosures concerning financial instruments vary in quality, and only a minority of the reviewed financial statements contain sufficient disclosures. Given this, and the fact that information concerning financial instruments is particularly relevant in times of turbulence in financial markets, Kredittilsynet expects issuers to improve the information provided in the annual financial statements for 2008.

IFRS 7 requires entities to disclose information that enables users of their financial statements to evaluate the significance of financial instruments with respect to the issuer's financial position and performance. IFRS 7 also requires entities to disclose information that enables users of their financial statements to evaluate the nature and extent of risks arising from financial instruments to which the issuer is exposed on the reporting date. Kredittilsynet has observed deficiencies in the information associated with both these objectives, especially with respect to fair values and risks.

## 2.2.2 Significance of financial instruments for financial position and performance

IFRS 7.21 requires disclosure of accounting policies that are relevant to an understanding of the financial statements. In Kredittilsynet's view, many issuers' descriptions of their accounting policies concerning financial instruments are still too general. Issuers must to a greater extent identify factors that are relevant to their own entity and describe these in their accounting policies. This can be done, for example, by referring to B5 in appendix B of the standard, which provides more information about what it may be relevant to describe with respect to financial instruments.

Entities shall disclose the fair value of financial instruments and the methods applied in determining these fair values cf. IFRS 7.25-30. Entities shall disclose whether fair values are determined, in whole or in part, by direct reference to published price quotations in an active market or are estimated using a valuation technique. When valuation techniques are applied, entities shall disclose the techniques, in which instances they have been applied and the assumptions applied in determining fair values. Examples of relevant assumptions may include rates for estimated credit loss and interest and discount rates. Entities shall also disclose the impact of changes in one or more of these assumptions. Entities shall disclose the accounting policies applied when recognising the difference between fair value upon initial recognition and current fair value using the valuation technique ("day 1" gains). Few of the issuers reviewed by Kredittilsynet had disclosed such information. Given the current situation of less liquid markets, a growing number of issuers will presumably have to estimate fair value using valuation techniques. In light of this, Kredittilsynet would refer readers to the IASB Expert Advisory Panel's guidance concerning "Measuring and disclosing the fair value of financial instruments in markets that are no longer active" available from the IASB's website, [www.iasb.org](http://www.iasb.org) (the International Accounting Standards Board).

If an entity has designated financial assets or financial liabilities at fair value through profit and loss, the entity shall, pursuant to IFRS 7. 9 to 11, cf. B4 and B5 a) in appendix B, disclose the methods used to fulfil the conditions for using this option. It must also disclose information about credit risk and the effect a change in credit risk would have on the assets and the liabilities. Entities must disclose the methods applied to calculate this effect. A number of issuers did not disclose sufficient information about this in their annual financial statements for 2007.

An entity that uses hedge accounting shall disclose information pursuant to IFRS 7.22 to 24. In Kredittilsynet's experience the information disclosed varies greatly. Some financial statements do not contain explicit information about whether an entity uses hedge accounting or whether an entity uses hedge accounting that does not qualify as hedge accounting pursuant to IAS 39. A number of issuers that use hedge accounting did not disclose sufficient information about the hedging and the specific information required by IFRS 7.23 and 24 with respect to cash flow hedging, fair value hedging and the hedging of net investments in foreign operations.

Amendments to IAS 39 and IFRS 7 were issued in October 2008 that provide entities with greater latitude to reclassify between different categories in IAS 39 than before. Kredittilsynet would like to remind issuers that have used this ability to reclassify of the new disclosure requirements in IFRS 7.12A.

## 2.2.3 Nature and extent of risks arising from financial instruments

IFRS 7 requires both qualitative and quantitative disclosures for credit risk, liquidity risk and market risk. Kredittilsynet has observed insufficient disclosures for all three types of risk.

### *Credit risk*

A number of issuers have not provided a description of credit risk, cf. IFRS 7.36, including the risk concentration different financial assets are exposed to, cf. IFRS 7.34. A number of issuers have not provided an analysis of the age of financial assets that are past due or impaired on the reporting date pursuant to IFRS 7.37. Entities shall disclose information about any collateral or other credit enhancements for such financial assets.

### *Liquidity risk*

In today's financial situation when it is more difficult to get access to capital, a good description of how liquidity risk is managed will be necessary information for users of financial statements. As far as quantitative information about liquidity risk is concerned, IFRS 7.39 requires entities to provide maturity analyses that cover all financial liabilities. B11 to B16 contain detailed guidelines on how such an analysis should be prepared and which amounts must be disclosed. These guidelines emphasise that the information that must be disclosed includes the contractual undiscounted cash flows of financial liabilities. This means, for example, that interest payments related to interest-bearing liabilities are a part of the cash flow and thus must be included in the analysis. A number of issuers did not provide an aggregate maturity analysis in their notes, while other issuers did not provide a maturity analysis covering all of their financial liabilities, disclosed discounted liabilities, or did not include interest payments.

Entities shall also describe how liquidity risk is managed within the various maturity periods presented in a maturity analysis, cf. IFRS 7.39 b).

### *Market risk*

Kredittilsynet observed that a number of issuers did not provide sensitivity analyses for each type of market risk, to which they are exposed, cf. IFRS 7.40-42 and points B17-21 in the standard's appendix. With respect to interest risk, Kredittilsynet would like to remind all entities that information must be provided about both the risk of the fair value of an instrument with a fixed interest rate fluctuating as a consequence of changes in market interest rates and the risk of cash flows from instruments with a floating interest rate fluctuating due to changes in market interest rates.

## 2.3 Impairment

### 2.3.1 Goodwill

IAS 36 *Impairment of Assets* requires a number of disclosures concerning the entity's measuring of the recoverable amount for the cash-generating units that include goodwill. Kredittilsynet observed in its review of annual financial statements for 2007 that a number of issuers provided insufficient information.

IAS 36.134 a) requires entities to disclose the carrying amount allocated to various cash-generating units. The basis on which the recoverable amount for a unit has been determined, i.e. value in use or fair value less costs to sell shall be disclosed, cf. IAS 36.134 c). In annual financial statements reviewed by Kredittilsynet the recoverable amounts were determined mainly on the basis of value in use. If a recoverable amount is based on value in use, an entity shall disclose information concerning assumptions pursuant to IAS 36.134 d) for each cash-generating unit. The information entities shall provide include descriptions of each key assumption on which management has based its cash flow projections for the period covered by the most recent budgets or forecasts and the length of this period, cf. IAS 36.134 d) i) and iii). The information shall include a description of management's approach to determining the values assigned to each key assumption, cf. IAS 36.134 d) ii). In Kredittilsynet's opinion the descriptions are often too general and do not provide the users of financial statements with sufficient information to understand the assessments management has made concerning the future.

Entities shall also disclose the period over which management has projected cash flows and the growth rate used to extrapolate cash flow projections beyond the period covered by the most recent budgets, cf. IAS 36.134 d) iv). Entities shall also disclose the discount rate, cf. IAS 36.134 d) v).

A number of the annual financial statements reviewed by Kredittilsynet did not include sufficient information about one or more of the requirements listed above. A majority of the reviewed annual financial statements did not present assumptions for each cash-generating unit, even in cases where a significant proportion of goodwill is allocated to more than one unit and where there is or there appears to be reason to assume that there is significant variation in profitability, growth rate and risk between the units. When the notes to the financial statements only provide one set with assumptions for several cash-generating units, they do not state whether these assumptions are an average of the assumptions used or the same assumptions are used for all the units. Kredittilsynet expects issuers to provide the information required by the standard for each cash-generating unit in their annual financial statements for 2008.

Pursuant to IAS 36.134 f) entities shall provide a sensitivity analysis if a reasonably possible change in a key assumption would cause the unit's carrying amount to exceed its recoverable amount. A large number of issuers reviewed by Kredittilsynet did not provide this information in their annual financial statements for 2007. There is a reason to assume that several issuers will experience situations when a reasonably possible change in a key assumption would cause the unit's carrying amount to exceed its recoverable amount at the end of 2008. Kredittilsynet assumes that issuers will provide sufficient information concerning this fact.

### **2.3.2 Other groups of assets**

In light of today's market situation, Kredittilsynet would like to remind issuers that IAS 36.130 requires complementary information for each material impairment loss recognised during the period. This requirement relates to any individual asset, including goodwill or a cash-generating unit. The information entities must disclose includes information about the events and circumstances that led to the recognition of the impairment loss, the amount of the impairment loss recognised and the nature of the asset. If the recoverable amount is fair value less costs to sell, the basis used to determine fair value less costs to sell shall be disclosed,

including whether fair value was determined by reference to an active market, cf. IAS 36.130 f). If the recoverable amount is value in use, the discount rate used and previous estimate of value in use shall be disclosed, cf. IAS 36.130 g).

IAS 36.134 requires a description of each key assumption on which management has based its determination of the cash-generating unit's recoverable amount when goodwill or intangible assets with indefinite useful lives are included in this unit's carrying amount. As far as assumptions used to determine the recoverable amount for other individual assets are concerned, entities are encouraged to disclose such information, cf. IAS 36.132. In Kredittilsynet's view, this information is useful for users of financial statements, especially in today's market. Kredittilsynet encourages issuers to disclose this information regardless of whether the determination resulted in recognition of impairment for the asset's carrying amount or not.

## 2.4 Equity

### 2.4.1 Statement of changes in equity

Kredittilsynet indicated in circular 5/2008 that many issuers presented insufficient information in their statement of changes in equity in the annual financial statements for 2006. A review of the annual financial statements for 2007 showed that a number of issuers are still providing insufficient information according to IAS 1.

A number of issuers have included reserves including revaluation reserves and translation reserves in retained earnings. This does not comply with IAS 1.

Kredittilsynet observed that some issuers have not presented exchange differences as a separate component of equity, cf. IAS 21.39 c). Entities shall provide a reconciliation of the amount of such exchange differences at the beginning and end of the period as well, cf. IAS 21.52.

Pursuant to IAS 32.34 and IAS 1.76 a) vi) (revised IAS 1.79 a) vi)), an issuer shall disclose shares in the entity held by the entity or by its subsidiaries or associates. A number of issuers did not provide this information either in the balance sheet or in the notes to the annual financial statements for 2007.

IAS 1.76 b) (revised IAS 1.79 b)) requires issuers to describe the nature and purpose of each reserve within equity. A number of issuers omitted to provide such descriptions in the annual financial statements for 2007.

Kredittilsynet also refers readers to the discussion concerning observed deficiencies in the statement of changes in equity in circular 5/2008.

## 2.4.2 Capital management

Entities shall disclose information about objectives, policies and processes for managing capital for annual periods beginning on or after 1<sup>st</sup> January 2007, cf. IAS 1.124A- 124C (revised IAS 1.134-136). These disclosures must be based on the information provided internally to the entity's key management personnel. An entity must disclose whether an entity has complied with externally imposed capital requirements, and when such requirements have not been complied with the consequences of such non-compliance.

Only a minority of the annual financial statements for 2007 reviewed by Kredittilsynet included such information pursuant to IAS 1.124A- 124C.

## 2.5 Disclosure related to valuation of investment property

Kredittilsynet observed that some issuers with investment property did not provide sufficient information regarding the valuation of investment property in the financial statements for 2007.

IAS 40 *Investment Property* requires issuers that have chosen to apply a fair value model to provide comprehensive information. The information entities shall provide concerning valuations include information about the methods and key assumptions used to determine the fair value of investment property, including a statement concerning whether the determination of fair value was supported by market evidence or was based more on other factors because of the nature of the property and lack of comparable market data, cf. IAS 40.75 d).

In addition entities shall disclose the extent to which the fair value of investment property is based on valuations by an independent appraiser who holds a recognised and relevant professional qualification and has recent experience in the location and category of the investment property being valued. If there has been no such valuation, that fact shall be disclosed, cf. IAS 40.75 e).

Entities shall also disclose net gains or losses from fair value adjustments, cf. IAS 40.76 d) and the amounts from the various categories of income and cost recognised in profit or loss, including rental income and operating expenses, cf. IAS 40.75 f).

IAS 40.75 requires disclosure of the methods and significant assumptions applied in determining the fair value. A general description of the factors taken into consideration in the valuation is insufficient to fulfil the disclosure requirements. In Kredittilsynet's opinion, specific information regarding both the model and assumptions applied must be disclosed. For example, information about the applied required rate of return can be disclosed jointly for similar types of property, specified by sites, shopping centres, office buildings and location.

In addition to the specific requirements in IAS 40, further information may be required pursuant to the general article in IAS 1.116 (revised IAS 1.125) regarding estimation uncertainty.

## 2.6 Information in prospectuses, stock exchange notifications and periodic financial reporting

Kredittilsynet observed that a number of annual financial statements did not provide information about significant items and transactions needed to understand the financial statement. In some cases missing information was presented in a prospectus and/or notification. Kredittilsynet also observed instances in which the information presented in notifications and subsequent financial statements failed to concur. In one case a prospectus that included the necessary information was not available on the issuer's website.

Kredittilsynet would like to stress that even when information is available from other sources, this does not exempt issuers from their disclosure obligations. In the observed cases mentioned above, parts of the information in the prospectus and notifications should have been repeated in the annual financial statements.

## 3. The Securities Trading Act

### 3.1 Filing of annual financial reports, half-yearly financial reports and quarterly reports to Kredittilsynet

Information about filing of periodic financial reporting to Kredittilsynet, cf. the Securities Trading Act § 5-12, subsection (2), is provided in circular 5/2008, article 4.1. Reports are deemed to have been filed to Kredittilsynet once they have been stored in the official storage mechanism (OAM), cf. the Securities Trading Act § 5-12, subsection (1). Kredittilsynet observed that a number of issuers have not stored their periodic financial reporting in the OAM. Kredittilsynet would like to stress that an actual copy of the financial reporting must be stored and that it is not sufficient to store a link to another website from which the financial reporting is accessible. Kredittilsynet will have access to the stored financial reporting meaning that issuers are not required to file reports separately to Kredittilsynet, or report that the reporting has been filed. Issuers that have an obligation to file financial reporting to Kredittilsynet pursuant to other legislation must continue to do so.

### 3.2 Deadline for making an annual financial report public and filing of KRT-1003

The deadline for making an annual report public has been changed from and including the 2008 financial year. Pursuant to the Securities Trading Act § 5-5, subsection (1), an annual financial report must be made public no later than four months after the end of each financial year. Kredittilsynet would like to stress that this deadline applies to both shares and bonds issuers.

The deadline for filing reports via form KRT-1003 *Reporting from issuers of financial instruments listed on Oslo Stock Exchange* is May 15, 2009 for both shares and bonds issuers.

### 3.3 Obligation to notify according to the Securities Trading Act § 5-5, subsection (5)

Issuers have an obligation to notify Kredittilsynet if the auditor has found that the financial statements should not be approved as they stand, or has made clarifications or made audit reservations in the audit report. Such notification shall be sent as soon as the audit report is received by the issuer. Several issuers had clarifications in their audit reports in 2007, but only one of these notified Kredittilsynet pursuant to this provision.

Anne Merethe Bellamy

Siw-Mette Thomassen

**Contact people:**

Siw-Mette Thomassen, Tel. (+47) 22 93 99 46,  
E-mail: [siw-mette.thomassen@kredittilsynet.no](mailto:siw-mette.thomassen@kredittilsynet.no)

Nina Servold Oppi, Tel. (+47) 22 93 97 17,  
E-mail: [nina.servold.oppi@kredittilsynet.no](mailto:nina.servold.oppi@kredittilsynet.no)

Unni Persson Moseby, Tel. (+47) 22 93 97 22,  
E-mail: [unni.persson.moseby@kredittilsynet.no](mailto:unni.persson.moseby@kredittilsynet.no)