Federation of European Accountants
Fédération des Experts comptables Européens

Alert

Standing for trust and integrity

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Sovereign Debt Exposures

Key Issues for consideration in the half-year financial reporting

***Brussels, 20 July 2011* – FEE (Fédération des Experts-comptables Européens – Federation of European Accountants) highlights financial reporting and assurance matters relevant for the 2011 half-year reporting season.**

As widely reported, several EU countries are presently facing increased bond yields and significant credit rating downgrades. The availability of fair and transparent information about exposures of individual institutions is of key importance to mitigate uncertainties and help prevent market mistrust.

Repetition of the levels of strain that the global financial markets and the entire global economy were facing during the financial crisis in 2008-2009 may be avoided if political leaders, regulators, business leaders and the accountancy profession adopt a common approach in promoting integrity, transparency and responsibility in communication with markets.

The purpose of this FEE Alert is to highlight key issues faced by those involved with preparing half-year financial reports and auditors involved in reviewing them. It does not intend to interpret IFRS or other national accounting standards; it also does not intend to provide guidance or professional advice applicable to individual circumstances.

This Alert has been written before the Heads of State finalise their discussions on possible European interventions to address the sovereign debt crisis. Nonetheless entities have to finalise their half-year financial reports and auditors have to sign off on these reports in this uncertain economic environment.

In this context, half-year financial statements and related disclosures on exposures to countries with stressed financial positions in the eurozone are of particular importance.

This situation creates an unprecedented level of focus on the work of the European accountancy profession. FEE recognises that the public expects the profession to work at all times - including in the current difficult circumstances - in an independent and rigorous manner and with due professional scepticism.

Moreover, it will be critical to ensure that fair and transparent information is provided to users. Many in the profession are involved in preparing or reviewing half-year financial information and will play a critical role in achieving this.

Whilst it is a matter of professional judgement by preparers, on the one hand, and their auditors, on the other hand, to determine to what extent particular exposures to individual countries are impaired under IFRS or relevant national accounting standards, it is essential to ensure that the information provided allows users to apply their own judgement and make sound economic decisions based on clear understanding of the financial circumstances of the reporting entity and the risks it faces.

Therefore FEE takes this opportunity to remind preparers and their auditors that the following issues should be carefully considered in entities with exposures to sovereign debt or related exposures which follow IFRS or relevant national accounting standards:

- The disclosure of the nature and extent of exposures to individual countries with stressed financial positions will depend on the entity's specific facts and circumstances.

  This may include information describing:

  - Judgements made as to the assessment of whether there is objective evidence of impairment of financial assets, including the nature of the evidence assessed;
  - Estimation uncertainties and assumptions about the future related to the recoverability of financial assets, including the status and effect of actual and proposed supranational support or restructuring plans;
  - Significant events occurring after the half-year period that have not been reflected in the financial statements for the half-year period.

- In their half-year financial reports entities may consider including the following quantitative information, supported by appropriate explanations, for each selected country:

  - Direct exposures to sovereign debt;
  - Direct exposures to credit default swaps (CDSs) and other instruments directly referenced to sovereign debt such as financial guarantees, forward contracts, options and other derivatives;
  - Direct exposures to other counterparties from the relevant country.

- Whilst it would be difficult to quantify the indirect sovereign debt and related exposures, experience shows that these could fundamentally affect the financial position of some companies. Disclosures and explanations on such exposures may be desirable and may help mitigate longer term consequences.

- In the process of preparing and reviewing the half-year financial reports, preparers and auditors would also take into account any guidance issued by European and national regulators.

As political discussions to find solutions to the significant issues facing the eurozone are still ongoing, FEE believes that accountants and auditors should actively communicate with management and others charged with governance, including supervisory bodies, to emphasise the importance of the above points. This applies also in situations where auditors are not required to review half-year results with a view to giving independent assurance on that information. Where auditors are required to review half-year financial information they should consider the impact of the above matters on their report.

FEE calls on all stakeholders and the profession who are dealing with these difficult corporate reporting matters to rise to the challenges.

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NOTES FOR EDITORS

About FEE

FEE (Fédération des Experts-comptables Européens - Federation of European Accountants) represents 45 professional institutes of accountants and auditors from 33 European countries, including all 27 EU Member States.

In representing the profession, FEE recognises the public interest. FEE has a combined membership of more than 500.000 professional accountants working in different capacities in public practice, small and larger firms, business, public sector and education, who all contribute to a more efficient, transparent, and sustainable European economy.

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