

REPORT ON IFRS ENFORCEMENT

2007 FINANCIAL STATEMENTS

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Market Supervision

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Finanssivalvonta, or the Financial Supervisory Authority (FIN-FSA), is a new authority for supervision of Finland's financial and insurance sectors and, from 1 January 2009, responsible for most of the supervisory functions currently undertaken by the Financial Supervision Authority and the Insurance Supervision Authority. The entities supervised by the new authority include banks, insurance and pension companies as well as other companies operating in the insurance sector, investment firms, fund management companies, Finnish Central Securities Depository and the Helsinki Stock Exchange. In addition, FIN-FSA supervises the reporting requirements of listed companies and securities trading. The activities will be mainly funded by the supervised entities. The Financial Supervisory Authority operates administratively in connection with the Bank of Finland, while being independent in its decision-making. The FIN-FSA has about 220 employees, and operates from two offices, both located in Helsinki.

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1 Summary

Information disclosed in financial statements is of particular importance during market disruptions

The financial market disruption that began in the second half of 2007 reached crisis proportions in the third quarter of this year. The crisis underlines the importance of clear and transparent financial reports. Transparent financial information, especially regarding financial instruments, their fair value and the related risks, raises the level of confidence in the operability of the financial markets.

It has been assessed that financial crises influence the real economy via diminished growth expectations. In the present business environment, testing for impairment of goodwill and other assets requires that companies take particular care in estimating future cash inflows and in making assumptions and reporting on them.

Emphasis on transparency of information on financial instruments

A focal area in the enforcement of financial reporting was the assessment of compliance with *IFRS 7 Financial Instruments: Disclosures*, mandatory for the first time with respect to 2007 financial statements. In applying IFRS 7 requirements, companies must first ensure that financial statements provide such information on financial instruments as to enable investors to evaluate the impacts of such instruments on the company's financial position and performance. Secondly, companies must provide information on their risk exposures related to financial instruments.

FIN-FSA stresses the importance of company management ensuring that risk management principles, descriptions of how they are applied, and the various financial instruments are presented as an integrated part of comprehensive risk disclosure. Based on observations, information on market, liquidity and credit risk was often formulaic and lacked a clear connection with company-specific risk management principles. Furthermore, information provided on classification and fair values of financial instruments was so concise as to reduce the transparency of the information provided on financial instruments.

Monitoring of operating environment and determination of cash generating units play key roles in asset impairment testing

In the context of rapidly changing market conditions due to the financial crisis, it is essential to monitor and assess all indications of asset impairment. The importance of sensitivity analysis for impairment testing also increases as investors assess companies' profitability and equity levels.

Impairment testing, according to IAS 36, is performed at the asset level or at the level of a cash generating unit or group of units. Hence, determination of the level of cash generating unit or cash flows has a material impact on recognition of impairments. The importance of definitions and assumptions behind impairment testing is highlighted in an uncertain market situation.

Separation of intangible assets in the context of business combination is challenging

With respect to business combinations, according to FIN-FSA observations, the identification and valuation of intangible assets continues to be one of the most challenging aspects of purchase price allocation. Among other things, the separation and valuation of trademarks and identification of intangible assets related to customer relationships is challenging. Recognition of intangible assets in connection with business combinations is likely to increase under the revised IFRS 3 *Business Combinations*¹.

¹ The revised IFRS 3 shall be applied prospectively to business combinations for which the acquisition date is on or after the beginning of the first annual reporting period beginning on or after 1 July 2009.

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Room for development in interim report information on business combinations

FIN-FSA studied listed companies' IFRS reporting in interim reports by reviewing the interim reports of all listed companies for first quarter of 2008. The most frequent deficiencies in information required by IFRS standards were found in reporting under IFRS 3 *Business Combinations*. In addition, almost every fifth listed company had not presented the related accounting principle in its interim report for the first quarter of 2008. In such cases, it may remain unclear whether the company has complied with IAS 34 requirements in preparing its interim report.

New approach to identification of segments

FIN-FSA also surveyed the adoption of the new standard on segment reporting, IFRS 8 *Operating Segments*, and listed companies' evaluations of the standard's impacts. The approach of the new segment reporting standard to the determination of operating segments is different from that of the old standard. Under IFRS 8, the identification of operating segments is based on management reporting, rather than on the determination of business and geographical segments. In FIN-FSA's view, a thorough study of the principles of the standard is important for all companies, even where the reporting segments do not change materially.

Financial statements of investment firms and fund management companies

There were 20 investment firms and 20 fund management companies that fell within the scope of financial reporting enforcement. Some of these companies had deficiencies in both presentation and measurement. Half of the companies did not present a cash flow statement in their financial reporting. The cash flow statement became obligatory for these companies with respect to annual periods starting at 1.1.2007. Almost a fifth of the companies had valued the financial assets recognized in the balance sheet as available for sale at cost, instead of fair value, which is required. This resulted in an inaccurate total amount of equity for these companies.

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2 Contents and methods of enforcement

This report presents the FIN-FSA enforcement activities from the end of 2007 to October 2008. It covers enforcement of financial statements 2007 of listed companies and financial sector companies and the follow-up of first quarter 2008 interim financial statements of listed companies.

The objective of enforcement of financial reporting by FIN-FSA is to promote transparent and comparable financial information so as to aid investors in their decision making. In addition, enforcement enhances the consistent application of international financial reporting standards.

FIN-FSA enforcement is directed at Finnish companies that have issued equity or debt securities on regulated markets in the European Economic Area. Financial information on financial institutions, investment companies and fund management companies is also within the scope of FIN-FSA's enforcement. As of December 31 2007, the number of equity issuers was 133 and bond issuers 9.

Methods of enforcement

In its enforcement of financial reporting, FIN-FSA acts in accordance with CESR standards². Such enforcement may cover a listed company's full set of financial statements or only those pertaining to a pre-selected focal area. Regarding the full set of financial statements, a risk-based method of selecting companies is used. Selection is supplemented by sampling, which means that any company may be selected for enforcement at any time.

Risk-based company-specific enforcement

Risk-based selection of companies is based on CESR Standard No.1 and its application guidance. The risk concept relates to both the probability of material misstatement in financial statements and to the potential impact of such material misstatement on market confidence and investor protection (company's significance). The companies were selected for enforcement because of both a high probability of material misstatement in financial statements and a potentially large impact on market confidence and investor protection.

The probability of material misstatement is evaluated using the company-specific risk index. The risk-index regarding 2007 financial statements comprised 15 risk indicators related to e.g. the company's enforcement history, financial position and key ratios, business combinations, and ownership and financing arrangements. Evaluation of the company's significance was based on market value.

The financial statements of 16 companies selected according to the aforementioned criteria were reviewed using the disclosure checklist developed in co-operation with European enforcers. The most significant findings for the risk-based selected financial statements were in the area of business combinations (IFRS 3), associated companies (IAS 28) and joint ventures (IAS 31).

Risk-based enforcement in focal areas - thematic reviews

Enforcement of certain focal areas was performed regarding the presentation of financial instruments (IFRS 7) and impairment testing of assets under IAS 36. Regarding IFRS 7, FIN-FSA reviewed disclosure information of 16 companies, including also some listed banks. The perspective for impairment testing of assets was deepened. In selecting companies for enforcement regarding impairment testing of assets (IAS 36) the amount of goodwill, goodwill relative to equity P/B-ratio and market-based risk factors (e.g. beta) were considered. Based on these factors, impairment testing by four companies was reviewed.

² CESR (Committee of European Securities Regulators). The 1st standard by CESR "Enforcement of Standards on Financial Information in Europe" was issued on March 12th 2003 (ref. CESR/03-073), CESR's 2nd enforcement standards "Co-ordination of Enforcement Activities" was issued on 22nd of April 2004 (ref. CESR/03-317c). Additionally, CESR has issued the "Guidance for Implementation of Co-ordination of Enforcement of Financial Information" on 28th for October 2004 (ref. CESR/04-257b).

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Enforcement of prospectuses

FIN-FSA also enforces the financial information presented in prospectuses. The depth of review of accounting issues depends on FIN-FSA's evaluation of the company as a financial reporter and the nature of the transaction.

Regarding initial public offerings, the company's initial IFRS financial statements and the related significant accounting issues are thoroughly reviewed. Some of the accounting issues may be such that proper resolution is possible only in connection with ex-post enforcement of financial statements. Acceptance of the prospectus does not prevent FIN-FSA from subsequently selecting the financial statements included in the prospectus or other company financial information for enforcement at a later stage.

FIN-FSA reviewed in 2008 the financial information of 10 prospectuses. In 2007, 29 prospectuses were reviewed. Regarding the prospectuses, one company significantly altered its accounting principles for the 2008 financial statements and interim statements. In other cases, companies took into account FIN-FSA's comments regarding either the financial statements in question or those for the coming years, depending on the significance of the issue.

Other enforcement

In addition to risk-based and thematic-based enforcement, FIN-FSA surveyed the 2008 first quarter interim statements. Also reviewed were the application of new segment reporting standard (IFRS 8) and the estimated effects of the application presented by the companies in 2007 financial statements.

International co-operation

As a part of its enforcement work, FIN-FSA participates in the work of CESR's permanent operating group, CESR-FIN. CESR-FIN has task of co-ordinating the work of CESR members in enforcement and other activities regarding financial reporting.

Under CESR-FIN operates the EECS³, where the IFRS-application questions are discussed. Consistent application of IFRS and consistent enforcement decisions in Europe are ensured so that accounting questions which are significant and difficult to interpret are brought up for discussion in the EECS. However, the final case-specific enforcement decision is always made by the local enforcer.

FIN-FSA has thus far in 2008 brought up for EECS discussion eight accountings issues, relating to financial instruments, business combinations or associated companies and impairment testing of assets and classification of equity instruments. In most of those cases FIN-FSA's opinion on the accounting treatment was supported by other European enforcers.

EECS maintains a database of enforcement decisions made by different enforcers in member states. Until publication of this report, 56 decisions have been made public.

Additionally there are two ad-hoc project groups presently working under CESR-FIN. Finland participates in the working group that monitors the development of IFRS standards. Due to market turbulence, a new fair value working group was established under CESR-FIN, and FIN-FSA has also participated in that work.

FIN-FSA also participates in the work of CEBS's⁴ permanent group, EGFI⁵ and its sub-groups which handle financial reporting issues.

³ European Enforcers' Coordination Sessions

⁴ Committee of European Banking Supervisors

⁵ Expert Group of Financial Information

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3 Financial Crisis and Disclosures of Financial Instruments

IFRS 7

The current financial crisis has underscored the increasing importance of the content of financial sector companies' interim reports and annual financial statements, especially as regards financial instruments. Transparent financial information enhances investor information and thus promotes confidence in the markets. The accounting principles must be company-specific, also concerning the financial instruments. Disclosures of financial instruments must be clear and coherent.

When the market disturbance in the third quarter of 2008 became severe, IASB released the amendment on reclassification of financial instruments. This amendment harmonized reclassification requirements to correspond with the accounting requirements of the U.S. In addition, IASB has recently clarified fair value measurement guidance.⁶ IASB has also released a draft for IFRS 7 on disclosure of fair values and liquidity risk⁷. In October, European regulatory committees (CESR, CEBS and CEOPS) released a joint statement on recent developments in accounting.⁸ FIN-FSA assesses the application of reclassification requirements in companies and follows development of the accounting requirements.

In Europe, ECOFIN at the end of last year released a roadmap on the financial markets situation, which served as a basis by which both the Committee of European Banking Supervisors (CEBS)⁹ and the Committee of Securities Regulators (CESR) reviewed the situation, especially in respect to accounting standards and reporting. FIN-FSA has participated in this international joint effort. FIN-FSA has also prepared the inquiry for financial institutions in the autumn 2007 and made on-site examinations of financial institutions in the early part of 2008.

3.1 IFRS 7 renews disclosures regarding financial instruments

The purpose of IFRS 7 is to ensure that financial statements include such disclosures as to enable users of financial statements to evaluate the impacts of financial instruments on a given company's financial position and results¹⁰. Financial statements¹¹ should include information on the company's risk exposures due to financial instruments, including the extent and nature of the risks and how they are managed¹².

Financial instruments should be presented based on appropriate classes in addition to IAS 39 categories

IFRS 7 disclosure requirements are based on the categories of IAS 39 *Financial instruments: recognition and measurement*¹³ requirements. Categorization has to be done at initial recognition of assets and liabilities in B/S. Consequently, financial instruments' ongoing valuation principles – amortized cost or at fair value – are based on this original categorization.

⁶ Measuring and disclosing the fair value of financial instruments in markets that are no longer active (IASB Expert Advisory Panel)

⁷ Improving Disclosures about Financial Instruments, IFRS 7 proposed amendments.

⁸ Joint statement from CESR, CEBS and CEIOPS Regarding the latest developments in accounting (CESR 2008 106)

⁹ CESR and CEBS examined both disclosures and valuation of structured instruments both the valuation. The Documents are available CESR: <http://www.cesr.eu/index.php?page=groups&mac=0&id=13>, CEBS: <http://www.c-ebs.org/News--Communications/Latest-news/CEBS-publishes-report-on-banks'-transparency-on-ac.aspx> and follow-up report <http://www.c-ebs.org/News--Communications/Latest-news/CEBS-publishes-a-follow-up-report-on-banks-transp.aspx> and <http://www.c-ebs.org/News--Communications/Latest-news/CEBS-publishes-report-on-issues-regarding-the-valu.aspx>

¹⁰ IFRS 7.7

¹¹ Information about risks can be included in financial statements or other documents (e.g. risk reports or management reports) as long there is cross linkages between documents.

¹² IFRS 7.31. IAS 39.9 Categories of financial instruments: A financial asset or financial liability at fair value through profit or loss, held to maturity investments, Loans and receivables, available for sale financial assets,

¹³ IFRS 7.8

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Clear presentation of categories is a starting point for understanding valuation principles and the impact of risks of financial instruments on the company's financial position and results. IFRS 7 requires that each category's book value be presented at B/S or at disclosures. Companies had presented required disclosures by category mainly in tables.

In addition to categorization, the entity should decide whether financial instruments should be split into meaningful classes from the viewpoint of the information presented¹⁴, which accounts for financial instrument features such as instrument-specific features or risks involved. Especially for the sake of higher transparency of financial assets, entities should put more emphasis on information provided in financial assets classification. In doing this, it is important to ensure that categories and classes can be reconciled with information presented at B/S.

3.1.1 Listed companies' IFRS 7 reporting

Limited information disclosed on fair values

For most companies, loans and receivables and especially financial liabilities valued at amortized cost are usually the key financial instruments, along with sales receivables and payables. These long term receivables and liabilities were fair-valued at close to book value, and information on the impacts of fair value hedges was not clearly disclosed. Disclosures and fair value measurements for financial instruments at amortized cost at B/S should be based on the same methods and processes that are used for instruments valued at fair value at B/S. Overall, disclosures of fair values were quite limited, except for the methods applied to fair value derivatives.

Some companies had unlisted shares available as for sale financial assets, which were measured at fair value using different kinds of valuation methods. These companies described only narrowly their valuation methods and especially the assumptions used. The bigger the impact of fair value changes on equity, the more meaningful the information is for investors. If changing some of the assumptions used in valuation to reasonable alternative assumptions would change fair value significantly, the company should state this fact and disclose the effect of those changes¹⁵. Required information on assumptions and possible changes in them can be different from the information given on financial instruments in market risk sensitivity analyses.

Moreover, FIN-FSA's view is that companies should critically evaluate the essential unlisted share ownership in terms of how detailed a breakdown and description would be needed so as to present an accurate description of the investment.

Liquidity risk description formal

The standard requires information based on principles of managing the liquidity risk as well as maturity analyses of financial liabilities, showing the remaining contractual maturities¹⁶. Companies clearly disclosed their financial liabilities' contractual maturities. In addition, many companies disclosed the interest flows from financial liabilities and information on cash flows from derivatives.

Description of liquidity risk management principles includes information on liquidity reserves. For nearly all of the companies, these were mainly undrawn committed revolving credit facilities. Disclosures included information on amounts drawn from these facilities, and financial statements provided clear information on the amounts still available from these facilities. The best practice is to disclose when these unused facilities

¹⁴ IFRS 7.6, IFRS 7.B1-B3

¹⁵ IFRS 7.27 c)

¹⁶ IFRS 7.39

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contractually mature. FIN-FSA sees this information as an essential part of an investor's liquidity risk if liquidity risk is managed based on unused facilities.

The best practice in companies was to reveal covenants of debt arrangements, in terms of either liquidity risk or own capital management. These can affect contractual maturities of financial liabilities and so are relevant information to investors regarding.

Different practices regarding presentation of sensitivity analyses

Nearly all reviewed companies included in their financial statements sensitivity analysis disclosures of market risks. Half of the reviewed companies gave information on market risk due to financial instruments according to the standard.

The rest of the companies included sensitivity analysis information on market risk arising from actual business from off- B/S- items, where financial instruments were used as hedging instruments. Typically off- B/S- market risk consists of firm orders or highly probable estimated cash flows. These companies presented sensitivity analyses at gross, so that financial risks arising from operating business and related hedges were specific. According to FIN-FSA's view this way of presenting disclosures fulfills standard requirements and gives a considerably better overall picture of how the company is exposed to market risk, the risk management principles used and how they have been implemented in practice.

Scarcity of information on credit risk

The standard requires that companies disclose the principles applied in managing credit risk and maximum exposure before any credit enhancements and descriptions of risk decreasing portions¹⁷.

In disclosures of credit risk companies described the use of different kinds of internal and external methods to decrease credit risk such as guarantees and prepayments. The best practice is to also disclose how much credit enhancements decrease the maximum amount of credit risk.

Credit risk among manufacturing companies relates mainly to sales receivables. Companies describe credit risk arising from sales receivables mainly using tables to analyze maturity of sales receivables. The best practice is to disclose possible risk concentrations accorded with IFRS 7.34c) or classes among sales receivable where credit risk can be substantial.

Disclosure of P/L impact from derivatives unclear

P/L impact of each of the 39 IAS categories must be presented separately.¹⁸ P/L impact of IAS categories was presented clearly and at gross, except in some cases. The smaller companies were most deficient in this area.

IFRS 7 includes the requirement to present P/L impact from hedge accounting¹⁹ so that the impact on the profit and loss statement is clear. Companies disclosed hedge accounting impacts, mainly on financial income and expenses. Some companies were deficient in the presentation of hedge accounting impact on operating income, because these effects were in many cases netted against derivatives designed for trading.

3.1.2 Information regarding fair valued asset in banks

IFRS 7 disclosures presented by banks regarding information on fair valued assets were also reviewed. The relevance of the disclosures is emphasized as the disturbance situation of the financial markets is prolonged.

¹⁷ IFRS 7.36

¹⁸ IFRS 7.20

¹⁹ IFRS 7.23 d), IFRS 7.24

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Financial information produced on fair valued assets

FIN-FSA made on-site visits to banks regarding applied valuation principles and practices for fair valued measured financial instruments. In addition, observations were made on classification principles regarding financial instruments with embedded derivatives and internal instructions and process regarding impairment of available for sale financial assets. Clear needs for improvement were found in both areas. Observations gathered in on-site visits led to contacts with those banks that were expected to improve their investment valuation, impairment principles and classification.

FIN-FSA's view is that special emphasis should be placed on evaluating whether the valuations are based on an active market when fair values of financial assets are measured. When quotations are not based on an active market, IFRS 7 requires information on the valuation methods and the assumptions applied. If some of the valuations are based on indicative prices that cannot be verified from active markets, the validity of the valuation should be ensured by comparing valuations to actual deals involving other instruments with similar risk features.²⁰

Banks should improve the information disclosed on financial assets

The information on financial assets given by banks has so far been based, not only on minimum accounting requirements, but also on solvency regulations. Under solvency regulations, requirements about information on financial assets and related risks have been extensive, but the perspective and the details have differed somewhat from the IFRS 7 requirements. Banks will implement renewed solvency disclosure requirements regarding risk and risk management when preparing 2008 financial statements. In this context, banks should carefully evaluate in which respect IFRS 7 and Pillar III requirements are the same and in which respect they differ.

Classification of financial instruments: Banks classified their financial instruments mainly according to IAS 39 categories. In addition classification was made based on liquidity management practices and external ratings. The categories in most cases were not broken down into great detail, e.g. how they are split between different classes, the nature of the instrument (structured products) or the risks related to the product. FIN-FSA's view is that, in order to improve operations transparency, financial assets should be divided more clearly into different classes based on either their nature or risk. More detailed information regarding risk factors could improve the usability of sensitivity analyses.

Financial statement accounting principles and disclosures regarding the use of fair value option. If the company has decided to use the fair value option, the accounting principles should be clearly stated, including how the company fulfills the criteria for producing more relevant information²¹. Assets (loans and receivables) and liabilities valued at fair value must include disclosures, which include impacts arising from credit risk.²² The standard also requires a description of the methods used in calculating credit risk impacts.²³ When the fair value option is applied to liabilities, disclosures should include information on differences that arise from the difference between book value and contractual value at maturity.²⁴ The description of accounting principles and related disclosures were in general insufficient for meeting IFRS 7 requirements.

Sensitivity analyses: Disclosures regarding sensitivity analyses did not always include methods and assumptions, as required by IFRS 7²⁵. This information is essential for the usability of sensitivity analyses,

²⁰ IAS 39 AG.71 -72

²¹ IAS 39.9

²² IFRS 7.9-10

²³ IFRS 7.11

²⁴ IFRS 7.10 b)

²⁵ IFRS 7.40 c)

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because the presentation principles of IFRS 7 can differ in terms of methods and assumptions used in solvency management.

FIN-FSA's view is that banks should evaluate whether they have such financial instruments that are valued at fair value and in relation to which disclosures of possible changes in the related credit risk would improve the transparency of the investments. Disclosing this kind of information is important for banks that have substantial amounts of interest rate instruments valued at fair value and where market risks are impacted by not only by interest rate changes but also by changes in counterparty credit risk. Credit risk is often a more important factor in market risk than interest rate risk.

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4 Other key observations

4.1 Monitoring of business environment is key to valuation of intangible and tangible assets

Impact of the financial crisis on the real economy via slower growth prospects for the coming years

In the third quarter of 2008 great uncertainty arose as to how and for how long the crisis will impact the real economy. Although it is expected that there will be repercussions for the real economy, these may vary by market segment and areas.

Current estimates call for slower growth over the next two, three years, with the poorest growth prospects for 2009. In mid-November of 2008 it appeared that the pre-financial crisis expectations of higher inflation due to increases in food and energy prices had eased or even substantially decreased. Moreover, short-term interest rates are returning to the levels of last spring. Thus the decrease in both prices and interest rates may improve the growth prospects. In this business environment, impairment tests of goodwill and other assets require that companies take great care in estimating future cash inflows and deciding on the assumptions for testing and reporting on them. Documentation requirements must also be emphasized.

Impairment losses recognized on assets in 2007 amount to about EUR 1.8 billion

The impairment losses on assets recognized in 2007 were at a record high of some EUR 1.8 billion. Of this amount, half comprised impairment losses of goodwill and the rest related to tangible and intangible assets. The impairment losses were mainly caused by some companies' significant impairments. In 2006, the aggregate amount of impairment losses was over EUR 200 million compared to just EUR 55 million in 2005.

Attention must be paid to identification of cash-generating units

FIN-FSA examined the determination of cash generating units based on the independence of cash inflows. This determination requires managerial judgment of what is relevant for the company's information disclosure. In determining the independence of cash inflows a company considers various factors such as how management monitors the company's operations (e.g. by product line, business, individual location, district or region) or how management makes decisions on further holding or disposing of the company's assets and operations.

The future economic benefits included in goodwill are generally related to many cash generating units. In this case the goodwill is allocated to groups of units. In practice, the companies have often determined the cash generating units according to where the future economic benefits of goodwill are monitored. From the view of standard's principles this is too high a level to assess the impairment of assets other than goodwill. The consequence of this is that the cash inflows of the chosen testing level may contain both well and badly performing units' cash inflows, which may offset each other, so the impairment losses of assets are not recognized.

The implementation of IFRS 8 could produce a reallocation of goodwill. According to IAS 36, goodwill is to be allocated to a unit or group of units not larger than an operating segment determined in accordance with IFRS 8²⁶.

Active markets and the determination of the cash generating units

FIN-FSA also examined the situations where IAS 36.70-71 was applicable and where the unit in a group produces the products at an intermediate production stage for other units in the group. According to IAS 36.70,

²⁶ IFRS 8.5 defines operating segment.

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in tests of impairment a cash-generating unit is an asset or group of assets for whose output there exists an active market, even if some or all the output is used internally. IAS 36.6 defines the conditions²⁷ for the existence of an active market for the output of these assets or units according to the standard. The application of IAS 36.6 in practice can be challenging, e.g. in assessing whether willing buyers and sellers can normally be found at any time and whether the prices are available to the public.

Assessing the reasonableness of assumptions is important

The company's management assesses the reasonableness of the assumptions for its cash flow projections and examine why actual cash flows are diverged from the past cash flow projections. The assumptions must be consistent with past actual outcomes, provided that the use of past actual outcomes as the basis for the assumptions is supported by the effects of later events and conditions²⁸. The uncertainty factors related to current market conditions should be taken into account in assessing future cash flows. However, estimates of future cash flows should not include future cash inflows or outflows that are expected to arise from a future restructuring to which a company has not yet committed²⁹.

Disclosure of impairment test assumptions still deficient

Investors need to know the values assumed in projecting cash flows in IAS 36 impairment tests and how certain changes therein would cause impairment losses. The presentation of assumptions used in tests and how these fit into management's approach has improved, but it still requires improvement³⁰. The companies are asked to pay attention to these disclosures in order to facilitate the user's assessment the reliability of test outcomes.

4.2 Business combinations and classification of equity investments

Goodwill accounted for 45% of the total cost of business combinations carried out by Finnish listed companies in 2007

The total cost of business combinations in 2007 was EUR 5.3 billion (EUR 4.7 billion), and they increased the amount of goodwill by EUR 2.4 billion (EUR 1.6 billion). Goodwill accounted for 45% of the total cost of business combinations in 2007, which is considerably more than in the previous year (25%). The share of the purchase price allocated³¹ to intangible assets was 33% in 2007, which is significantly more than in the previous year (10%). Of this 33%, 14% was allocated to customer relationships, 7% to trademarks and product marks and another 7% to technology.

Identification and valuation of intangible assets is challenging

With respect to business combinations, FIN-FSA found that identification and valuation of intangible assets continues to be one of the most challenging areas in the allocation of purchase price. Among other things, the

²⁷ IAS 36.6. An active market is a market in which all the following conditions exist:

(a) the items traded with the market are homogenous;
(b) willing buyers and sellers can normally be found at any time; and
(c) prices are available to the public.

²⁸ IAS 36.34 management assesses the reasonableness of the assumptions on which its current cash flow projections are based by examining the causes of differences between past cash flow projections and actual cash flows. Management shall ensure that the assumptions on which its current cash flow projections are based are consistent with past actual outcomes, provided the effects of subsequent events or circumstances that did not exist when those actual cash flows were generated make this appropriate.

²⁹ IAS 36.44

³⁰ IAS 36.134 (d) (i) ja (ii)

³¹ Allocation of the cost of the combination varies greatly between companies. There might be significant differences in each year's division of acquisition price depending e.g. on the volume and industries involved and the characteristics and size of individual acquisitions, and so the comparative information is only indicative.

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separation and valuation of trademarks and identification of intangible assets related to customer relationships is challenging.

A trademark acquired in a business combination shall be recognized separately from goodwill as an intangible asset if it is identifiable and its fair value can be measured reliably. The intentions of the acquirer not to use the asset, for example because the acquisition was conducted to increase market share or to eliminate a competing trademark, is not a basis for zero fair value of the trademark. Discontinuance of the use of the trademark immediately after the acquisition implies zero related cash flow expectations for the group and its value for the group is fully impaired.

There could often be several intangible assets related to customer relationships acquired in a business combination: existing customer contracts, customer relationships based on those and customer lists and non-contractual customer relationships that fulfill the identifiability criterion because they are separable. Therefore, each intangible asset related to customer relationships should be assessed separately, since their economic nature, economic life and thus the fair valuation principles may differ.

According to the revised standard IFRS 3 *Business Combinations*, an intangible asset shall be recognized separately from goodwill when it is identifiable. An intangible asset is identifiable if it meets the separability criterion or the contractual-legal criterion. Reliable measurement of fair value is no longer a requirement for recognition separately from goodwill. The amended standard IAS 38 *Intangible Assets* and revised IFRS 3 also include clarified directions on when intangible assets are separable and thus on this basis for meeting the identifiability criterion. The recognition criteria for intangible assets in business combinations will therefore be clearer in the future, for example in those challenging, troublesome situations described above. The revised IFRS 3 shall be applied prospectively to business combinations for which the acquisition date is on or after the start of the first annual reporting period on or after 1 July 2009.

Classification of equity instruments in consolidated financial statements requires taking account of all special features of the investee

As part of its enforcement of financial information, FIN-FSA also paid attention to the classification of equity investments. Equity investment is treated as an investment in a subsidiary, associate or joint venture or as a financial instrument in the scope of IAS 39 *Financial instruments: recognition and measurement*. The accounting treatment is determined according to whether the investor exercises control³², significant influence³³, joint control³⁴ or none of these in the investee. The classification might be significant in respect of equity, balance sheet structure and ratios of a listed company.

Assessing the level of influence that the investor has over the investee is, according to FIN-FSA's observations, challenging, especially in cases where there are special features related to the arrangement. In addition to the share of actual and potential voting power, it is necessary that the management pays attention to all economic and other special features related to the arrangement when it uses its judgment³⁵ in assessing the de-facto nature of the influence it exercises over the investee. FIN-FSA's observations indicate that the analyses on which the judgment is based are not always sufficiently exhaustive.

Disclosures on business combinations still inadequate in many cases

According to FIN-FSA's observations, surprisingly many companies still provide inadequate disclosure on their business combinations, especially in respect to the description of factors that resulted in recognition of goodwill. The description must be sufficiently transaction-specific. This helps the users of the financial statement gain a clearer understanding of the factors that contributed to a cost that resulted in the recognition of goodwill in

³² IAS 27.4

³³ IAS 28.2

³⁴ IAS 31.3

³⁵ IAS 1.113

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connection with the acquisition. As goodwill forms a significant part of the balance sheet, it is important to disclose factors that affect its recognition. FIN-FSA urges companies to pay attention to this requirement of IFRS 3.

In several cases there were deficiencies in information regarding business combinations affected after the balance sheet date but before the financial statements were authorized for issue. Regarding these acquisitions, all information required by IFRS 3.67, such as purchase price allocation, must be disclosed³⁶.

4.3 Room for development in interim report on business combinations

FIN-FSA surveyed³⁷ listed companies' IFRS reporting in interim reports by reviewing the interim reports of all listed companies for the first quarter of 2008. The most frequent deficiencies in information required by IFRS standards were found in reporting under IFRS 3 *Business Combinations*.

When a company prepares its interim financial statements according to IAS 34, it must disclose all material information required by IFRS 3.66-67 regarding its business combinations. Materiality shall be assessed in relation to the interim period financial data³⁸. Other deficient areas in interim IFRS-reporting were in the presentation of diluted earnings per share³⁹ and information on the fact that the same accounting policies and methods are followed in the interim financial statements as in the most recent annual financial statements⁴⁰.

According to FIN-FSA's observations, almost every fifth listed company had not presented the related accounting principle in its interim report for the first quarter of 2008. According to the survey, the majority (60%) of the listed companies' interim financial statements was prepared in accordance with IAS 34 and 20% declared that their interim statement included a condensed section of tables on financial information disclosure.

FIN-FSA urges listed companies to take into account that all the disclosure requirements of IFRS must be fulfilled when a company declares that its interim financial statement is prepared according to IAS 34. The accounting principle of the interim statement must always be disclosed.

4.4 Segment information

FIN-FSA analyzed listed companies' application of the new IFRS 8 *Operating Segments* in financial statements and how the companies had disclosed information on the impact of the initial application of the standard. The listed companies shall apply IFRS 8 for periods starting on or after 1 January 2009. FIN-FSA considers segment information to be a significant part of financial statements because it provides useful information in support of investment decisions and analyses.

The approach of the new standard as regards identification of operating segments is different from that of the old standard. In accordance with IFRS 8, the identification of operating segments is based on management reporting and no longer on the determination of business and geographical segments. In FIN-FSA's view, a thorough study of the principles of the standard is important for all companies, even where the reportable segments would not change materially. In addition to the new approach to determining segments, IFRS 8 requires more disclosures, and the amounts disclosed are those reported to the management and not necessarily based on IFRS. FIN-FSA takes the view that these changes in regulation are significant, and therefore sufficient preparative work should be performed well before the application of the standard.

³⁶ IFRS 3.71

³⁷ Markkinat publication 4/2008, 10.10.2008

³⁸ IAS 34.23

³⁹ IAS 34.11

⁴⁰ IAS 34.16(a)

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The segment information is also linked to areas of companies' communication other than financial reporting under IFRS. Therefore, any possible changes in segment information should be evaluated by companies from the perspective of consistency of the whole communication.

The application of IFRS 8 can lead to the reallocation of goodwill. According to IAS 36 *Impairment of Assets*, the goodwill shall be allocated to the unit or group of units not be larger than an operating segment determined in accordance with IFRS 8⁴¹, which may differ from the previous set of segments under IAS 14. This change in regulation may impact the determination of cash generating units of group of units and thus affect the level at which goodwill is tested for impairment.

Almost all listed companies apply IFRS 8 for the first time in 2009

Under IFRS, companies must disclose information on the application of IFRS 8 in their 2007 financial statements.⁴² The 2007 financial statements showed that the majority of companies will apply IFRS 8 for the first time for periods starting on or after 1 January 2009. Less than ten companies opted for early adoption of IFRS 8 by applying the standard for periods starting in 2007 or 2008, i.e. before the mandatory application. In addition, 12 companies did not disclose any information about the application notwithstanding the requirement of the IFRSs.

Concerning the companies that announced early adoption of the standard, the majority reported more segments than previously in connection with the changeover to IFRS 8. Different reasons for the increase in reportable segments were presented by companies, as e.g. changes in components of the entity that the management monitors, changes in organizational structure and in business activities.

Half of those companies that disclosed information on the impact were expecting some impact on segment information

Under IFRS, companies are to disclose in the notes to 2007 financial statements any possible impacts of the application of IFRS 8.⁴³ Only half of the companies disclosed this information.

Half of the companies that disclosed such information expected that IFRS 8 would affect the content of information to be disclosed and/or presentation. Most descriptions were too general. Nor did companies disclose exact information on possible changes in the number of segments. In the best financial statements, the assessment of the impact comprised detailed information on the upcoming changes in segment information. In addition, some companies announced changes in reportable segments due to the application of IFRS 8. Only a few companies disclosed information on the impact on geographical disclosure or on disclosures relating to major customers.

FIN-FSA finds it essential that, in connection with the initial application of IFRS 8, companies develop their segment information in light of the objective of IFRS 8, to provide information that will enable investors to evaluate the nature and financial effects of the business activities and the economic environment in which it operates.

⁴¹ IAS 36.80

⁴² According to IAS 8.30 (a) when an entity has not applied a new IFRS that has been issued but is not yet effective, the entity shall disclose this fact

⁴³ According to IAS 8.30 (b) the entity shall disclose known or reasonable estimable information relevant to assessing the possible impact that application of the new IFRS will have on the entity's financial statements in the periods of initial application

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5 Financial statements of investment firms and fund management companies

Non-listed investment firms must prepare their financial statements according to the Act on investment firms. Investment firms must comply with the requirements based on the Act on financial institutions, with the decree issued by the law and regulations and guidelines issued by FIN-FSA. Fund management companies shall prepare their financial statements according to the Mutual fund act and the decree issued under the law. The recognition and measurement requirements of financial statements of fund management companies are prescribed by the Act on financial institutions. The financial statement forms in fund management companies have changed for annual periods as from 1 January 2008 and are consistent with other companies in the financial sector, such as banks and investment firms.

Within the scope of financial reporting enforcement there were about 20 investment companies and almost 20 fund management companies. In some of these companies there were deficiencies concerning both presentation and measurement. About a half of the companies did not present a cash flow statement in their financial reporting. To present the cash flow statement became obligatory for these companies for annual periods as from 1 January 2007. A fifth of the companies had not measured their financial instruments according to the requirements. The instruments recognized in the balance sheet as available for sale were valued at cost instead of fair value. Thus the total amount of equity of these companies was erroneous.

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Appendix 1. Largest goodwill amounts at 31 December 2007 and 2006

2007	Company	Goodwill EUR m	2006	Company	Goodwill EUR m
1	SanomaWSOY	1 433	1	UPM	1 514
2	Nokia	1 384	2	SanomaWSOY	1 393
3	UPM	1 163	3	Stora Enso	907
4	Elisa	774	4	Elisa	772
5	Metso	772	5	Sampo	599
6	Stockmann	720	6	Kemira	581
7	Carcotec	670	7	KONE	557
8	Kemira	627	8	Nokia	532
9	Kone	577	9	Huhtamäki	525
10	OKO	504	10	Cargotec	513
11	Stora Enso	503	11	Metso	498
12	Huhtamäki	472	12	OKO Pankki	494
13	Wärtsilä	445	13	TietoEnator	448
14	Tietoenator	416	14	Wärtsilä	417
15	Amer Sports	271	15	Outokumpu	404
16	YIT	241	16	M-real	376
17	Ahlstrom	180	17	Amer Sports	290
18	M-real	172	18	YIT	249
19	Cramo	152	19	Cramo	153
20	Atria	152	20	Kesko	131

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Appendix 2. Largest ratios of goodwill to equity at 31 December 2007 and 2006

2007			2006		
	Company	Goodwill / equity %		Company	Goodwill / equity %
1	Turvatiimi	304	1	Turvatiimi	206
2	Suomen Terveystalo	180	2	SYSOPENDIGIA	136
3	Evia	143	3	Salcomp	125
4	Affecto	134	4	Affecto	111
5	Digia	130	5	SanomaWSOY	105
6	Stockmann	121	6	Ixonos	103
7	Talentum	107	7	Keskisuomalainen	102
8	SanomaWSOY	106	8	Tiimari	100
9	Etteplan	100	9	KONE	80
10	Ixonos	98	10	Etteplan	79
11	Salcomp	97	11	Cencorp	77
12	Tiimari	94	12	Talentum	74
13	Tietoenator	88	13	Evia	73
14	Cencorp	85	14	TietoEnator	72
15	Solteq	83	15	Solteq	68
16	Keskisuomalainen	83	16	Huhtamäki	61
17	Kone	77	17	Lassila&Tikanoja	60
18	Carcotec	75	18	Suominen Yhtymä	60
19	Elisa	75	19	Elisa	59
20	Huhtamäki	61	20	Cargotec	59

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Appendix 3. Companies with largest acquisitions in 2007 and 2006

2007			Total acquisition cost EUR m	Goodwill generated by acquisitions EUR m
	Company	Acquiree		
1	Nokia	Formation of Nokia Siemens Networks	5 500(**)	803
2	Stockmann	Lindex AB	851	722
3	Ahlstrom	Spunlace nonwovens business of Orlandi Group, consumer wipes business of Fiberweb plc, Fabriano Filter Media SpA, 60% of Brazilian speciality paper production plant from Votorantim Celulose e Papel	223	87
4	Cargotec	Several smaller acquisitions such as Indital Construction Machinery Ltd, Kalmar Intia Pvt. Ltd and BG Crane Pty. Ltd	198	166
5	Fiskars	Iittala Group Oyj, others	176	79
6	HKScan	Swedish Meats' business (Scan AB)	162	32
7	Suomen Terveystalo	Medivire Työterveyspalvelut Oy, others	136	105
8	Atria Yhtymä	AB Sardus, others	129	95
9	Trainers' House (*)	Trainers' House Oy	75	44
10	Sanoma-WSOY	Printcenter Oy, Noodi Oy, Rosetta Holding B.V., SportUp Dinland Oy, Auto24, others	68	42

(*) until 31 Dec 2007 Satama Interactive Oyj

(**) the Group's contributed networks business was valued at EUR 5 500 million.

2006			Total acquisition cost EUR m	Goodwill generated by acquisitions EUR m
	Company	Acquiree		
1	Sponda	Kapiteeli Oyj	960	28
2	Fortum	E.ON Finland Oyj, others	818	0
3	Nokia	Intellisync Corporation, others	691	488
4	Metso	Aker Kvaerner's Pulping and Power businesses, others	359	284
5	Stora Enso	Arapoti Group, others	330	0
6	Cramo	Cramo Holding B.V.	200	139
7	Rautaruukki	OOO Ventall, others	150	61
8	Kemira (*)	OOO Kraski Tekst, Lanxess –Group's paper chemicals business	137	32
9	Componenta	Döktas Dökümcülük Sanayi ve Ticaret A.S.	111	41
10	Cargotec	BMH Marine AB, operations of East Coast Cranes and Electrical Contracting Inc., others	103	68

(*) Acquisitions include Cytec Industries Inc.'s water treatment and acryl amide business, but no information was available on the acquisition and so it is not included in the amounts above.

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Appendix 4.**Revised IFRS standard clarifies accounting treatment of business combinations**

IASB published the revised IFRS 3 *Business Combinations* standard in January 2008. The most significant changes compared to IFRS 4, published in 2004, concern the acquisition model.

One of the most significant changes is that a company will in future have the possibility of choosing one of two options for measuring non-controlling interest. Entity company can choose the current model and measure the non-controlling interest (previously minority interest) at the fair value of their portion of identifiable assets and liabilities. According to the new option, non-controlling interest can be measured at its full fair value.

The revised IFRS 3 clarifies the criteria for recognition of the acquiree's assets and liabilities. Henceforth, an asset or liability must meet the definitions of the Framework for an asset or liability at acquisition. Transaction costs will be expensed as incurred, which could also be before the acquisition date.

Contingent consideration will henceforth be recognized at its fair value already at acquisition date as part of the original acquisition price. Contingent consideration will thus be recognized at an earlier stage in future. This is considered to produce more accurate information on the overall impacts of the business combination.

Regarding business combinations achieved in stages, the moment of transfer of control is emphasized. At the time of transfer of control, possible earlier ownership interest in the acquiree is measured at fair value through profit and loss. Acquisitions after control is transferred are treated as transactions between shareholders (so-called *economic entity approach*) and the purchase price allocation, and the profits are not impacted by these transactions.

The revised IFRS 3 is to be applied on or after 1 July 2009. Earlier application is permitted, in which case amended IAS 27 must be applied at the same time. Earlier application must be disclosed.

Revising the IFRS 3 standard will clarify the accounting treatment of business combinations by eliminating alternative accounting treatments in many situations. The revised accounting guidelines also lead to simpler accounting treatments, for example regarding business combinations realized in stages. It is to be expected that the revised standard will lead to improved quality of information, on which basis an investor can more easily get an overall conception of the nature and economic impact of the acquisition.