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Decision ref.EECS/0209-01: Reclassification

Financial year end: 31 March 2009 / Pre-clearance
Category of issue: Available for Sale financial assets
Standard involved: IAS 39
Date of the decision: 12 November 2008

Description of the issuer's accounting treatment

The issuer is a listed holding company with interests in banking and private equity. On 1st December 2008, the company published its half-yearly financial statements for the period to 30 September 2008.

In the light of the deterioration of the markets, the issuer sought to apply the amendments to IAS 39 published by the IASB on 13 October 2008 to reclassify - in its half-yearly financial statements - its Available for Sale financial instruments into the category "loans and receivables" on the basis that it has the intention and the ability to hold those financial instruments for the foreseeable future.

The assessment of whether these Available for Sale financial instruments met the conditions to be classified as loans and receivables was to be made at the date of reclassification.

The issuer asked the enforcer to confirm whether this treatment is compliant with the amendments to IAS 39.

The enforcement decision

The enforcer did confirm that the treatment is compliant with the amendment to IAS 39. The enforcer also indicated to the issuer that it should apply the amendments to IFRS 7 and make thorough disclosures of the reclassification.

Rationale for the enforcement decision

The revised IAS 39 paragraph 50E states:

"A financial asset classified as available for sale that would have met the definition of loans and receivables (if it had not been designated as available for sale) may be reclassified out of the available-for-sale category to the loans and receivables category if the entity has the intention and ability to hold the financial asset for the foreseeable future or until maturity."

This paragraph does not state explicitly on which date the assessment of whether an Available for Sale financial instrument meets the definition of a loan and receivable has to be made (as indicated in IAS 39 paragraph 9, "loans and receivables are non-derivative financial assets with fixed or determinable payments that are not quoted in an active market"). In particular, the paragraph does not explicitly state that it has to be made at initial recognition of the financial instrument (contrary to paragraph 50D). Therefore, in this case, the enforcer considered that it could accept the decision of the issuer to assess the conditions at the date of reclassification.

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Decision ref.EECS/0209-02: Share based payment

Financial year end: 31 December 2006
Category of issue: Share based payment
Standard involved: IFRS 2
Date of the decision: 24 April 2008



Description of the issuer's accounting treatment

The issuer had three different employee share purchase plans (ESPP). Under plans 1 and 3, all employees were invited to participate in a savings plan whereby a certain amount was withdrawn from their net monthly salaries during a year and transferred into a separate account. The balance of this account was used to purchase shares after a one year service period at a 15 % discount to the fair value at the start of the plan or the fair value at the end of the plan. Under plan 2, eligible employees were invited to participate in a savings plan whereby they could contribute a limited amount of cash up-front into a separate account, which was used to purchase shares after a one year service period at a 30 % discount to the fair value at the start of the plan or the fair value at the end of the plan.

The issuer was of the opinion that the ESPP plans were share based payments within the scope of IFRS 2, and that, in principle, they should be measured at fair value in accordance with IFRS 2 paragraph 11. However, as the issuer was of the opinion that the fair value of the ESPP programs could not be reliably measured, the issuer had therefore accounted for the plans using the intrinsic value method in accordance with IFRS 2 paragraph 24.

The issuer argued that it had no basis on which to estimate a reliable fair value at the inception of the plan as there was uncertainty about how many shares the employees would be entitled to buy and what the future market price of those shares would be.

The enforcement decision

In the enforcer's opinion, the ESPP plans could be reliably measured, and the plans, therefore, should have been measured at fair value in accordance with IFRS 2 paragraph 11.

Rationale for the enforcement decision

According to IFRS 2 paragraph 24 an entity may, in rare cases, be unable to estimate reliably the fair value of the equity instruments granted at the measurement date. In these rare cases only, the entity is required to measure the option to employees at intrinsic value. IFRS 2 paragraph BC 144 gives unlisted or newly listed companies as examples of entities that might not be able to estimate reliably the fair value of share options at the grant date.

The issuer's ESPP plans are similar to those described in US GAAP, specifically, FAS 123 R appendix A and FASB Technical Bulletin 97-1 "Accounting for Statement 123 for Certain Employee Stock Purchase Plans with a Lock-Back option". In the enforcer's opinion as there are valuation methods that can be used to reliably measure the issuer's ESPP plans, the enforcer concluded that they should have been measured at fair value in accordance with IFRS 2 paragraph 11.

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Decision ref.EECS/0209-03: Capital, Control

Financial year end: 31 December 2007

Category of issue: Capital, Control

Standard involved: IFRS 5, IAS 8

Date of the decision: 31 March 2008

Description of the issuer's accounting treatment

At the beginning of 2007 the issuer had a direct holding of 67% (interest) in entity B.

In September 2007, entity B issued new shares which were wholly subscribed for by a new investor (entity C). As a consequence, after the increase in capital, the issuer retained an interest of 44% (30% of voting rights) in its former subsidiary B. At the same time, the shareholders of entity B signed an agreement providing new governance rules for entity B. Based on this new agreement, the



issuer was no longer to be represented on entity B's board or participate in its management. The issuer, therefore, considered that it had lost control of entity B.

As a consequence, commencing in October 2007, the issuer stopped consolidating entity B on a line by line basis and adopted the equity method of accounting to reflect its interest in B.

The issuer also considered that its decision not to subscribe to the issue of new shares was equivalent to a decision to disinvest in entity B. The issuer argued that the decision not to invest clearly showed its new intention not to recover the investment in B principally through continuing use of the asset.

Due to the fact that entity B is a separate line of business (with separate cash flows, management and customers), the issuer considered that the results of entity B for the period beginning January 1, 2007 and ending September 30, 2007 should be presented based on principles provided by IFRS 5 (including restatement of the 2006 comparative figures).

There was a question whether, in these circumstances, the issuer can present the results of entity B for the period ending on September 30, 2007 based on the principles of IFRS 5 "Non-current Assets Held for Sale and Discontinued Operations".

The enforcement decision

The enforcer concluded that the issuer's presentation, based on IFRS 5 principles (specifically IFRS 5 paragraphs 2 and 4), was acceptable.

Rationale for the enforcement decision

The enforcer decided that the presentation was acceptable for the following reasons:

- the issue of dilution is not addressed by IFRS (neither in IFRS 3, nor in IFRS 5 or IAS 27),
- the decision not to subscribe to the issue of new shares of entity B is clearly a change in the strategy of the issuer,
- by deciding not to subscribe to the issue of new shares of entity B, the issuer agreed to the dilution and the loss of control (which, in economic terms, is similar to a decision to sell shares while retaining a continuing interest in the entity),
- entity B represents a separate line of business (separate cash flows, management and customers) (IFRS 5 paragraphs 31-32),
- information disclosed on IFRS 5 principles highlights the impacts of entity B on the issuer's 2007 (for the 9 month period) and 2006 (for the 12 month period) profit and loss statements (IFRS 5 paragraphs 33-34),
- an agreement between entity B's shareholders confirms that the issuer has lost control over its former subsidiary.

Therefore, in the absence of a specific Standard or Interpretation applying to this situation, the enforcer considered, based on IAS 8 paragraph 10 and 11.a, that IFRS 5 could be used by analogy.

In coming to its decision, the enforcer also considered the requirements of IAS 27 paragraphs 32-37 (amended January 2008), and reached the conclusion that the presentation based on IFRS 5 principles selected by the issuer was consistent with the accounting treatment required by the amended standard when a parent company loses control of a subsidiary.

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Decision ref.EECS/0209-04 Control

Financial year end: 31 December 2008

Category of issue: Control

Standard involved: IAS 27



Date of the decision: 13 June 2008

Description of the issuer's accounting treatment

The issuer, a significant industrial and services group, owns 35,4% of entity B, a newly listed company.

The capital of entity B is distributed as follows:

- The issuer: 35%
- Institutional investors: 12%
- Public: 53%%

When entity B was admitted to trading in June 2008, a 5-year renewable shareholders' agreement was signed between the issuer and the Institutional Investors ("the parties"), the objective being to ensure the development of entity B by:

- Establishing the governance policy
- Guaranteeing a stable ownership

According to the agreement:

- The board of directors comprises 18 members: 9 members are appointed by the issuer, 5 members are appointed by the Institutional Investors, 4 members are appointed by "the parties" (both the issuer and the Institutional Investors) and the Chairman of the Board of Directors;
- The Chairman of the board of directors is appointed by the issuer; he has a casting vote where votes are otherwise equal;
- The Chairman of the board of directors appoints the CEO;
- All current decisions of the board of directors are made by simple majority;
- A qualified majority is necessary for decisions relating to capital, statutory requirements and extraordinary distribution of dividends;
- The parties have pre-emption rights if one party wants to sell its shares in the issuer.

The prospectus issued by entity B for admission to trading clearly stated that it was the objective of the issuer to retain control

Prior to listing, the issuer had transferred to a separate entity (entity B) all water and waste activities in the group (the "spin-out"). After the spin-out, the issuer still owned almost 100% of the capital and voting rights of entity B. Then the issuer distributed - and therefore admitted to trading - 65% of the shares of entity B to its own shareholders (other than itself), proportionally to their holdings in the issuer's capital (the "distribution").

The issuer is of the opinion that it has control over entity B at 31 December 2008.

The enforcement decision

The enforcer agreed that the issuer controlled entity B at 31 December 2008.

Rationale for the enforcement decision

Control is defined in IAS 27 as the power to govern the operating and financial policies of an entity or business so as to obtain benefits from its activities.

According to IAS 27 paragraph 13 there is a presumption that an entity controls another if it owns, directly or indirectly through subsidiaries, more than half of the voting power of that entity unless it can be clearly demonstrated that such ownership does not constitute control. However, according to the same paragraph, control also exists when the parent owns less half or less of the voting power of an entity when there is, inter alia:

- Power to govern the financial and operating policies of the other entity under a statute or an agreement (IAS 27 paragraph 13.b);



- Power to appoint or remove the majority of the members of the board of directors or equivalent governing body of the entity (IAS 27 paragraph 13.c);
- Power to cast the majority of votes at meetings of the board of directors or equivalent governing body of the entity (IAS 27 paragraph 13.d);

Under the shareholders' agreement, the issuer has the power to appoint more than half of the board members, including the Chairman, and, therefore, has the power to govern the financial and operating policies of entity B, since all decisions of the board of directors are made by way of simple majority.

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Decision ref.EECS/0209-05: Business Combinations, reverse acquisitions

Financial year end: 31 December 2008

Category of issue: Business Combinations, reverse acquisitions

Standard involved: IFRS 3

Date of the decision: 13 June 2008

Description of the issuer's accounting treatment

The issuer and entity B, another listed company, entered into a business combination in July 2008 that took the form of a merger. According to the merger agreement, the issuer is the legal acquirer. The issuer issued around 1.2 million new shares in exchange for shares in entity B. There was no cash consideration.

Before the transaction, the capital of both entities was distributed as follows:

The issuer

- Controlling Shareholder A: 80%
- Public: 20%

Entity B

- Public: 66,7%
- Institutional investors: 33,3%

Prior to the transaction, the fair value of entity B was significantly greater than the fair value of the issuer.

After the transaction, the former shareholders of the issuer have a 44.5% stake of the voting rights of the combined entity and the former shareholders of entity B have a stake of 55.5%. The controlling shareholder, A, owns 35,7% of the combined entity.

The participation of the controlling shareholder A in the combined entity ("the golden share") is regulated by a national decree. According to this decree, shareholder A can oppose any decision by the issuer which could be considered contrary to the national vital interest in the energy sector, particularly regarding the continuity and security of the energy supply. However, this decree does not give any right to shareholder A to govern the financial and operating policies of the issuer as such. It does, however, give A the right to appoint 7 out of a 25 person Board.

Under the terms of the purchase agreement, the CEO of entity B is appointed as the CEO of the combined entity. The CEO has a casting vote in the event of other votes being equal. The Board of Directors comprises the CEO and 24 other members: 10 members appointed by the issuer (including 7 members appointed by shareholder A), 10 members appointed by entity B, 3 members appointed by employees and 1 member representing the other shareholders.



The issuer proposed to account for the transaction as a business combination and identified B as the acquirer.

The enforcement decision

The enforcer accepted the accounting treatment of the issuer.

Rationale for the enforcement decision

IFRS 3 requires an acquirer to be identified in all business combinations, the acquirer being the combining entity that obtains control of the other combined entity. Guidance to be applied in determining the acquirer is provided in paragraphs 19 to 21 of the standard.

Control is defined as the power to govern the financial and operating policies of an entity or business so as to obtain benefits from its activities. There is a presumption that control exists when an entity owns, either directly or indirectly, more than one half of the voting rights, unless it can be clearly demonstrated that such ownership does not constitute control.

In this case, it is presumed that the shareholders of entity B have obtained control since, in terms of voting rights, their stake amounts to 55.5% after the transaction. The existence of a significant individual shareholder (shareholder A) was, nevertheless carefully considered by both the issuer and the enforcer.

IFRS 3, subparagraphs a to d of paragraph 19 consider circumstances where a combining entity might obtain control over another even if it does not acquire more than half of the voting rights. The facts of the case were compared with these circumstances:

- Shareholder A does not own more than half of the voting rights of the combined entity;
- It does not have the power over half of the voting rights by virtue of an agreement (IFRS 3 paragraph 19.a);
- It does not have the power to govern the financial and operating policies of the other entity under a statute or an agreement (IFRS 3 paragraph 19.b)
- It does not have the power to appoint or remove the majority of the members of the board of directors or equivalent governing body of the combined entity (IFRS 3 paragraph 19.c). Shareholder A only appoints 7 members out of 24.
- It does not have the power to cast the majority of votes at meetings of the board of directors or equivalent governing body of the other entity (IFRS 3 paragraph 19.d)

The enforcer therefore agreed that shareholder A, with 35.7% of the voting rights, did not have control over the combined entity.

In coming to their decision, the issuer and the enforcer also considered the criteria set out in IFRS 3 paragraphs 20 and 21 which provide further guidance on how to identify the acquirer in a business combination. As the fair value of B was significantly greater than the issuer, paragraph 20.a confirmed entity B as the acquirer. However, the issuance of 1.2 million new shares by the issuer could have pointed towards the issuer as the acquirer.

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Decision ref.EECS/0209-06: Equity instruments

Financial year end: 30 June 2007

Category of issue: Equity instruments, Minority interests, Put option, puttable instrument

Standard involved: IAS 32

Date of the decision: 18 September 2008

Description of the issuer's accounting treatment



The issuer has written put options each of which contains an obligation on the issuer to purchase the minority holdings in a subsidiary. Each option was written as part of a business combination and is exercisable during specified periods at prices determined by reference to the performance of the relevant subsidiary. In its 2007 accounts the company disclosed a contingent liability for the best estimate of the value of the redemption amount of the minority put options using current levels of profitability.

The enforcement decision

The enforcer concluded that the company's treatment of minority put options as contingent liabilities was not in accordance with IAS 32 paragraph 23 which requires a liability to be recorded for all contracts that contain an obligation to purchase own equity instruments for cash.

Rationale for the enforcement decision

According to IAS 32 paragraph 23 minority put options are contracts that contain an obligation for an entity to purchase its own equity instruments for cash or another financial asset. As these contracts give rise to a financial liability for the present value of the redemption amount, this liability is required to be recognised in the balance sheet itself rather than as a contingent liability in the notes to the accounts.

While IAS 32 is clear as to the recognition of the liability, the enforcer was aware that, at the time, there were divergent accounting practices in respect of the corresponding accounting entry when the liability is first recognised and when the amount of the liability is revised.

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Decision ref.EECS/0209-10: Equity instruments, preference shares

Financial year end: 30 June 2007

Category of issue: Equity instruments, preference shares

Standard involved: IAS 32

Date of the decision: 18 September 2008

Description of the issuer's accounting treatment

The issuer presented non-redeemable preference shares as equity instruments in its balance sheet. The terms of issue of the instruments give the holders a contractual right to an annual fixed net cash dividend and the entitlement to a participating dividend based on any dividends paid on ordinary shares. Both the fixed and participating dividends were presented as dividends, below profit after taxation, in the income statement.

The issuer invoked IAS 1 paragraph 17, explaining that presentation of the preference shares with a liability component in compliance with IAS 32 would be so misleading in the circumstances that it would conflict with the objective of financial statements set out in the IASB's Framework for the Preparation and Presentation of Financial Statements.

The enforcement decision

The enforcer did not agree that departure from IAS 32 was warranted.

Rationale for the enforcement decision

Compliance with IAS 32 (as revised in 2003) would require the preference shares to be treated as compound financial instruments with both an equity and liability component. The value of the equity component is the residual amount after deducting the separately determined liability component from the fair value of the instrument as a whole (paragraph 31).



Under IAS 32 substantially all of the carrying value of the issuer's preference shares would be allocated to the liability component and the fixed net cash dividend would be treated as a finance cost.

IAS 1 paragraph 17 requires departure from a requirement of a standard only in the extremely rare circumstances where management conclude that compliance would be so misleading that it would conflict with the objective of financial statements set out in the Framework.

The issuer argued that presentation of the preference shares in accordance with IAS 32 would have been misleading because it would not reflect the nature of the instruments as having characteristics of permanent capital providing participation in future income and gains.

IAS 1 paragraph 15 (c) requires additional disclosures when compliance with the specific requirements in IFRS is insufficient to enable a user to understand the impact of particular transactions or conditions on financial position and financial performance.

In the enforcer's view, a fair presentation could have been achieved by complying with IAS 32 and providing additional disclosures to explain the characteristics of the preference shares.

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