



European Securities and
Markets Authority

Report

20th Extract from the EECS's Database of Enforcement



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The decisions included in this extract were taken by national enforcers in the period from March 2014 to June 2016. ESMA will continue publishing further extracts from the database on a regular basis, with the next extract expected to be published in the first half of 2017.

List of abbreviations and acronyms used in this report

CGU	Cash-Generating Unit
CU	Currency Unit
EEA	European Economic Area
EECS	European Enforcers Coordination Sessions
IAS	International Accounting Standards
IFRS IC	International Financial Reporting Standards Interpretation Committee

The European Securities and Markets Authority (ESMA) is publishing extracts from its confidential database of enforcement decisions on financial statements, with the aim of strengthening supervisory convergence and providing issuers and users of financial statements with relevant information on the appropriate application of the International Financial Reporting Standards (IFRS).

According to its founding regulation, ESMA shall act in the field of financial reporting to ensure the effective and consistent application of European Securities and Markets legislation. In order to fulfil these responsibilities, ESMA organises the European Enforcers Coordination Sessions (EECS), a forum of 41 European enforcers from 28 Member States and 2 countries in the European Economic Area (EEA) with responsibilities in the area of supervision and enforcement of financial information.

With responsibility for coordination of supervision of approximately 6 300 issuers listed on European regulated markets preparing IFRS financial statements, EECS currently constitutes the largest regional enforcers' network with supervision responsibilities for IFRS. Through EECS, European enforcers discuss and share their experience on the application and enforcement of IFRS. In particular, they discuss significant enforcement cases before and/or after decisions are taken in order to promote a consistent approach to the application of IFRS. In addition, EECS produces technical advice on the issuance of ESMA Statements and opinions on accounting matters which deserve specific focus. It also reviews accounting practices applied by European issuers to enable ESMA to monitor market developments and changes in those practices.

In taking enforcement decisions, European enforcers apply their judgement, knowledge and experience to the circumstances of the cases that they consider. Relevant factors may include other areas of national law beyond the accounting requirements. Interested parties should therefore consider carefully the circumstances when reading the cases. As IFRS are principles based, there can be no one particular way of dealing with numerous situations which may seem similar but in substance are different. Decisions taken by enforcers do not provide generally applicable interpretations of IFRS; this remains the role of the IFRS Interpretations Committee (IFRS IC). These decisions are based on the IFRS requirements valid at the time of the IFRS financial statements and may be superseded by future developments in IFRS.

The publication of selected enforcement decisions will inform market participants about which accounting treatments European enforcers may consider as complying with IFRS; i.e. whether the treatments considered are within the accepted range of those permitted by IFRS. Such publication, together with the rationale behind the decisions, will contribute to a consistent application of IFRS in the EEA.

In accordance with the provisions of the ESMA Guidelines on the enforcement of financial information, cases submitted to the enforcement database are considered to be appropriate for publication if they fulfil one or more of the following criteria:

- The decision refers to a complex accounting issue or an issue that could lead to different applications of IFRS;
 - The decision relates to a relatively widespread issue among issuers or within a certain type of business and, thereby, may be of interest to other enforcers or third parties;
 - The decision addresses an issue on which there is no experience or on which enforcers have inconsistent experiences;
 - The decision has been taken on the basis of a provision not covered by an accounting standard.
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I. Decision ref EECS/0216-01 – Qualitative disclosures of the risks arising from financial instruments

Financial year end: 31 December 2015

Category of issue: Disclosures on financial instruments; qualitative disclosures on nature and extent of risks arising from financial instruments and sensitivity analysis disclosures.

Standards or requirements involved: IFRS 7 *Financial Instruments: Disclosures*

Description of the issuer's accounting treatment

1. In December 2015 the issuer purchased a portfolio of loans for CU 379M from a financial institution. The loans were acquired at a substantial discount to their nominal value of CU 1,700M reflecting their distressed state at the time of the acquisition. All of the loans were past due and were in default. The loans were secured on property assets of the borrowers.
2. The issuer disclosed that its objective in purchasing the portfolio of loans was to generate future returns for the issuer through a combination of:
 - Acquisition of collateral assets for inclusion as inventory in its development portfolio;
 - Disposal of collateral assets over time to achieve a redemption of a loan at a value greater than the acquisition cost; and
 - Income from the underlying property asset portfolio.
3. The loan portfolio was categorised as loans and receivables and after initial recognition the assets were measured at amortised cost using the effective interest method. The issuer did not provide the qualitative or the sensitivity analysis disclosures relating to the property market risk inherent in the acquired portfolio of loans.
4. The issuer indicated to the enforcer that it considered the disclosures in the financial statements to be sufficient for users to have an understanding of the nature of the loan portfolio and the related risks.

The enforcement decision

5. The enforcer did not agree with the issuer's view. The issuer's financial statements should have described the issuer's objectives, policies and processes for managing property market risk and the methods used to measure that risk, together with a detailed description as to how the exposures to property market risk arose. In addition, the issuer should have also provided an appropriate sensitivity analysis for property market risk together with supplementary disclosures.

Rationale for the enforcement decision

6. According to paragraph 33 of IFRS 7, an entity shall make qualitative disclosures for each type of risk arising from financial instruments. In the specific case the value and the future cash flows of the

distressed loans are based on the value of the underlying property collateral. Therefore, the market risk of property has a significant impact on the value of the loan portfolio. Paragraph 40 of IFRS 7 requires an entity to disclose a sensitivity analysis for each type of market risk to which the entity is exposed. As the loan portfolio amounted to 67% of the issuer's total assets, the enforcer considered the disclosures regarding the market risk of property to be important information for the users of the financial statements.

II. Decision ref EECS/0216-02 – Disclosure of significant judgements and assumptions in determining the existence of significant influence

Financial period end: 31 December 2014

Category of issue: Significant influence, disclosure of interests in other entities

Standards or requirements involved: IFRS 12 *Disclosure of Interests in Other Entities*

Description of the issuer's accounting treatment

7. The issuer holds more than 20% of the voting rights in entity X but no representation on entity X' Management or Supervisory Boards. A controlling shareholder holds over 60% of the voting rights in entity X. Resolutions at the general meeting, including the election and removal of shareholders' representatives in the Supervisory Board and the distribution of profits are adopted by a simple majority. No material transactions between the issuer and entity X have occurred or are expected to occur and there was no interchange of managerial personnel. The issuer has no possibility of participating in the policy-making processes of entity X apart from exercising its voting right in the general meetings, which are however dominated by the controlling shareholder.
8. Based on this fact pattern, the issuer concluded that it could be clearly demonstrated that it does not have significant influence over entity X. Yet, the issuer did not disclose, in its financial statements the significant judgements and assumptions on which this was based.

The enforcement decision

9. The enforcer asked the issuer to disclose the considerations that led to the conclusion that it did not exercise significant influence over entity X.

Rationale for the enforcement decision

10. Paragraph 7 of IFRS 12 requires an entity to disclose information about significant judgements and assumptions it has made to determine whether it has significant influence over another entity. According to paragraph 9 of IFRS 12, to comply with the requirement in paragraph 7, an entity has to disclose the considerations that led it to conclude that it does not have significant influence even though it holds 20% or more of the voting rights of another company.

III. Decision ref EECS/0216-03 – Disclosures relating to determination of value in use

Financial year end: 31 December 2014

Category of issue: Disclosures relating to impairment test

Standards or requirements involved: IAS 36 *Impairment of Assets*

Description of the issuer's accounting treatment

11. The issuer is a credit institute that, following the acquisition of another credit institute in 2003 recognised goodwill of CU 1,907M. No impairment of goodwill has been recognised in the past. Nor did the impairment test in the financial year 2014 result in any impairment of goodwill.

12. In the 2014 annual financial statements, the issuer provided the following information:

- Carrying amount of goodwill allocated to each CGU;
- Discount rate applied to the cash flow projections and its composition;
- Growth rate in the forecast period and beyond.

13. Furthermore, the financial statements contained an explanation that the expected future cash flows were estimated for a forecast period and that the expected cash flows for periods beyond that were represented by a terminal value. It was disclosed that when estimating the cash flows: the budget for the following year, the business plans and the expected changes regarding solvency needs were taken into account. The issuer furthermore provided a sensitivity analysis in which it demonstrated the amount by which the growth rate or the discount rate would need to change in order for the unit's recoverable amount to be equal to its carrying amount.

The enforcement decision

14. The enforcer concluded that: (i) the issuer's disclosures did not provide information on all the key assumptions on which basis management had based its determination of value in use and that (ii) the disclosures should have been more specific.

Rationale for the enforcement decision

15. Paragraph 134(d)(i) of IAS 36 requires that information on each key assumption on which the management has based its cash flow projections should be disclosed. However, no details were provided regarding the expected loan impairment ratio, which has a high impact on the CGU's recoverable amount. As the loan impairment ratio therefore is a key assumption, and as a reasonably possible change in this key assumption would cause the carrying amount to exceed the recoverable amount, the issuer should have provided a sensitivity analysis showing the impact of such changes, as required by paragraph 134(f) of IAS 36.

16. According to paragraph 134(d)(ii), management's approach to determining the values assigned to each key assumption should be disclosed. However, the financial statements did not contain any description either on how the management determined the values assigned to each key assumption nor whether those values reflected past experience or were consistent with external sources of information.

IV. Decision ref EECS/0216-04 – Recognition of losses on loans upon conversion to shares

Financial year end: 31 December 2014

Category of issue: Impairment of financial assets; transfers that qualify for derecognition

Standards or requirements involved: IAS 39 *Financial Instruments: Recognition and Measurement*

17. The issuer is a savings bank with a long term relationship with entity A, a fish farm, both as lender and shareholder. Prior to 2004, the issuer loaned money to entity B; however, after entity B suffered continuous operating losses, it was acquired by the issuer. In 2004, the issuer sold entity B to entity A (a thinly capitalised, newly founded company). The issuer provided all the financing to entity A for this transaction. It also provided entity A with a credit facility sufficient to cover several years of estimated future operating losses. In the following years, entity A suffered, as expected, significant operating losses. The issuer participated in several efforts to refinance entity A. It provided fresh loans and subsequently exchanged these loans for shares. At the end of 2014, the issuer held shares of entity A classified as AFS, in addition to having a significant loan receivable, which was measured at amortised cost.
18. The issuer recognised an impairment loss on the loans to entity A, in 2009. In the course of the efforts to refinance entity A during the period 2010 to 2014, other shareholders made capital contributions in cash. In most of these capital increases, the share price used to calculate the exchange rate for the loans was two to five times higher than the subscription price for shareholders offering contributions in the form of fresh cash. Entity A also made unsuccessful attempts to attract new investors by offering them a lower share subscription price than the one used in the conversion of the issuer's loans. This indicated that the fair value of the shares received in the conversion was considerably lower than the carrying value of the converted loans.
19. However, the exchange of loans for shares of entity A between 2010 and 2014 did not lead to any further impairment losses on the loans. The issuer accounted for the exchange of its loan investments for equity by reducing the carrying amount of the loans, with an offsetting increase in the value of the AFS investment. The AFS investment, however, were impaired in the same year in which they were acquired and the losses were presented in the statement of profit or loss for the period as 'net change in value of financial instruments'.

The enforcement decision

20. The enforcer disagreed with the issuer's accounting presentation. The exchange of the loans for shares led to derecognition of the loans. Upon derecognition, the difference between the carrying amount of

the loans and the fair value of the shares received should have been presented as a loss on loans instead of as 'net change in value of financial instruments'.

Rationale for the enforcement decision

21. The forgiveness of the loans in exchange for shares in entity A led to their derecognition. For financial assets carried at amortised cost, a gain or loss is recognised when the financial asset is derecognised. Pursuant to paragraph 26 of IAS 39, upon derecognition, the difference between the loans' carrying amount and the fair value of the shares received, should have been recognised as a gain or loss.

V. Decision ref EECS/0216-05 – Presentation of equal and opposite gains and losses in the statement of profit or loss and other comprehensive income for the period

Financial year end: 31 December 2014

Category of issue: Offsetting of gains and losses from financial instruments

Standards or requirements involved: IAS 1 *Presentation of Financial Statements*

Description of the issuer's accounting treatment

22. The issuer facilitates investments by clients who want to gain exposure to the underlying securities (principally Asian stocks) by issuing structured notes and warrants. The issuer's ultimate parent and controlling entity is a leading international investment bank. The principal activity of the issuer is issuing structured notes and warrants to clients.

23. The proceeds received from the issuance of securities are lent to other group undertakings and are used to purchase prepaid equity securities contracts and other financial instruments from other group undertakings. Furthermore, the issuer enters into derivative contracts with other group undertakings. The fair value of the issuer's liabilities (i.e. the securities by the issuer) is determined by the fair value of the financial assets. The fair value gains or losses recognised on financial instruments (assets and liabilities) are not presented in the statement of profit or loss and other comprehensive income for the period and this information is not disclosed in the notes to the financial statements. The issuer's rationale for this presentation is because it believes it has no exposure to market risk. The net outcome of the investment strategy pursued by the issuer is such that any gains and losses on financial assets and financial liabilities will exactly offset each other giving a net nil result for the year. The issuer presented no quantitative data in the statement of profit or loss and other comprehensive income for the period and disclosed no analysis of offsetting in the notes, even though the exactly corresponding net fair value gain from financial assets and the net fair value loss from financial liabilities during the year amounted before offsetting to CU 1.5 billion.

The enforcement decision

24. The enforcer did not accept the issuer's presentation in the financial statements. The issuer should have disclosed the gross gains or losses from financial assets separately from the losses or gains from the financial liabilities.

Rationale for the enforcement decision

25. According to paragraph 85 of IAS 1, an entity shall present additional line items, headings and subtotals in the statement of profit or loss and other comprehensive income when such presentation is relevant to an understanding of the entity's financial performance. In the view of the enforcer, an analysis of the gross gains or losses from financial assets in the statement of profit or loss and other comprehensive income for the period is important information for users of the financial information. The fair value of the financial assets determines the fair value of the securities issued by the issuer (i.e. the financial liabilities).

26. Furthermore, the paragraphs 32 to 35 of IAS 1, describe under which circumstances an entity shall offset assets and liabilities or income and expenses. According to paragraph 32 of IAS 1 an entity shall not offset assets and liabilities or income and expenses, unless it is required or permitted by an IFRS. Given that the gains or losses from financial instruments are material, the issuer's net nil presentation and the absence of disclosure in the notes to the financial statements did not provide sufficient information necessary for users to gain an understanding of the financial performance and did not comply, in full, with the requirements of paragraphs 32 to 35 of IAS 1, the enforcer concluded that in the case at hand, offsetting would not be appropriate.

VI. Decision ref EECS/0216-06 – Reclassification of capitalised milestone payments by a pharmaceutical company to the statement of profit or loss

Financial year end: 30 June 2015

Category of issue: Intangible assets, change in accounting estimates, impairment of assets

Standards or requirements involved: IAS 8 *Accounting Policies, Changes in Accounting Estimates and Errors*, IAS 38 *Intangible Assets*

Description of the issuer's accounting treatment

27. The issuer is a pharmaceutical company which develops new products in cooperation with other companies. The issuer often acquires a stake in development projects that have already reached phase 3, when final approval of safety and efficacy is given (i.e. the last phase before a new drug is approved by the competent authorities for use by the general populace). When acquiring a stake in the projects, the issuer makes an upfront payment and agrees a series of payments on achieving determined milestones in the process, both before and after the product is given final approval by the relevant authorities.

28. The payments for the acquisition of stakes in development projects were considered by the issuer to be acquisitions of separate intangible assets. As the price that the issuer paid to acquire the intangible assets reflects its expectation that the expected future economic benefits embodied in the asset will flow to the entity, the probability criterion to recognise an intangible asset was considered to be fulfilled.

Furthermore, before 30 June 2015, the issuer considered that the milestone payments would fulfil the criteria for recognition as intangible assets, because the payments were a part of the costs for the product rights.

29. In light of a new strategic plan and other internal considerations, the issuer decided that all capitalised milestone payments that had been effected in the past, before receiving market registration approval, had to be expensed as research and development costs as of 30 June 2015. According to the issuer, this would represent a change in accounting estimates, and therefore, the effect had to be recognised prospectively by 'reclassifying' the capitalised milestone payments to the statement of profit or loss for the period in which the change occurred.

The enforcement decision

30. The enforcer disagreed with the issuer's accounting treatment: reclassifying intangible assets to research and development costs does not constitute a change in accounting estimates. If the issuer concluded that the intangible assets' carrying amounts exceeded their recoverable amounts, it should have recognised an impairment loss.

Rationale for the enforcement decision

31. The enforcer assessed whether the recognition criteria in paragraphs 21 to 24 of IAS 38 or the recognition criteria for internally generated intangible assets were fulfilled at the time the issuer capitalised the intangible assets. If not, the issuer would have had to have recognised the effects from the correction of an error retrospectively, in accordance with paragraph 5 of IAS 8, as if the prior error had never occurred. However, given the specific facts and circumstances of the case, the enforcer concluded that the recognition criteria were fulfilled at the time of first recognition.
32. According to paragraph 112 of IAS 38, an intangible asset shall be derecognised only on disposal or when no future economic benefits are expected from its use or disposal. Neither test for derecognition was met by the issuer in this case. Therefore, it was not appropriate to derecognise the intangible assets.
33. Doubts regarding the recoverability of the intangible asset should have led the issuer to assess whether the intangible assets would be impaired. According to paragraph 111 of IAS 38, IAS 36 applies to determine whether an intangible asset is impaired.

VII. Decision ref EECS/0216-07 – Legal requirements that prevent a shareholder from exercising its rights

Financial year end: 31 December 2014

Category of issue: Control over an investee

Standards or requirements involved: IFRS 10 *Consolidated Financial Statements*

Description of the issuer's accounting treatment

34. The issuer is a savings bank that held 48.3% of the equity interest in entity B at the end of 2014. Entity B was a company engaged in investing in regional businesses for capital appreciation purposes. Entity B had 102 shareholders, of which 60 held individually less than 0.1% of the equity interest. The three largest shareholders in entity B, apart from the issuer, held: 13.3%, 8.6% and 3.7% of entity B's shares respectively. The shareholder holding 3.7% of the shares in entity B, was the savings bank's foundation, which held approximately 35% of the shares in the issuer. The foundation was a related party to the issuer, however, it did not control it. There were no potential voting rights in entity B and no shareholders' agreements that granted one shareholder additional rights. The historic attendance at the annual shareholder meetings (including proxy) has been in the range of 72% to 81%. In general, the annual shareholder meetings decided on few items and the decisions were typically not disputed. There was no indication of a fight for power or shareholder activism.
35. Decisions to buy or sell equity interests in investees and perform the day-to-day management of the investment portfolio consisting of regional businesses can be taken by entity B's management and board of directors alone and do not require the general meeting's consent. The general meeting's consent would only be required if a capital increase was necessary.
36. The board of directors in entity B consisted of five voting members and an alternate board director which was always in attendance. Although the issuer held 48.3% of the shares in entity B, its only board member was its CEO, who was entity B's alternate director. The chairman of the board of entity B was the CEO of the savings bank's foundation, a position he acquired after retiring as the CEO of the issuer. The second largest shareholder in entity B (holding 13.3% of the votes) was represented on the board, while the three remaining voting board members were representatives from businesses that entity B held significant investments in. None of the key management personnel in entity B was a current or previous employee of the issuer. The issuer concluded that it held significant influence over entity B but did not control it.

The enforcement decision

37. The enforcer agreed with the issuer. Based on the specific facts and circumstances, the issuer did not control entity B.

Rationale for the enforcement decision

38. The issuer did not hold more than half of the voting rights. Nevertheless, due to its large shareholding in relation to the other holders and the fact that the savings bank's foundation would not normally have

interests opposing the issuer, the enforcer concluded that the issuer had power over the general meetings of entity B. However, the enforcer concluded that having the majority of the voting rights would not result in the possibility to direct the relevant activities of entity B which is according to paragraph B9 of IFRS 10 a prerequisite for having power over an investee.

39. In this specific situation the relevant activities of entity B are primarily related to decisions to buy or sell equity interests in investees and perform the day-to-day management of the investment portfolio. These decisions can be taken by entity B's management and board of directors alone and the issuer had at no point in time a majority on the entity's board of directors.
40. Normally, the issuer could be expected to have a sufficiently dominant voting interest to call an extraordinary meeting and replace the existing board with a board consisting of a majority of members nominated by the issuer. However, legal limitations in the issuer's jurisdiction bar the issuer from taking a majority position on the board. Mutual savings banks are, in the issuer's jurisdiction, prohibited from managing entities they have invested in, when they are involved in other types of business than banking. According to paragraph B23(a)(vii) of IFRS 10, legal or regulatory requirements that prevent the holder from exercising its rights indicate that a right is not substantive. For this reason, the enforcer concluded that the issuer did not control entity B.

VIII. Decision ref EECS/0216-08 – Determining whether an entity is an investment entity

Financial year end: 31 December 2014

Category of issue: Investment entity; equity method

Standards or requirements involved: IFRS 10 *Consolidated Financial Statements*

Description of the issuer's accounting treatment

41. The issuer, a savings bank, is the same as in decision EECS/0216-07. The issuer held 48.3% of the shares in entity B, which was engaged in investing in regional businesses for capital appreciation. The majority of entity B's investments were stakes in the investee's equity of between 20%-50%. Entity B had 102 shareholders of which 60 held individually less than 0.1% of the equity interest. The three largest shareholders in entity B, apart from the issuer, held: 13.3%, 8.6% and 3.7% of entity B's shares respectively. The issuer had significant influence over entity B.
42. Entity B prepared stand-alone financial statements according to local GAAP, in which its investment portfolio was accounted for at the lower of cost and fair value. Entity B had in the last couple of years prepared and shared with its board of directors a semi-annual estimate of the overall fair value of its investment portfolio. This report specified the value per investment, however, from the report it was evident that for many investments, the acquisition cost had been used as a proxy for fair value. For some investments, the fair value had been estimated, but only to a limited degree, whenever the methods and assumptions were evident.
43. The issuer concluded that entity B was an investment entity according to IFRS 10. It adjusted its share of the profit or loss of the associate to take into account the changes in estimates of the fair value of

entity B's investment portfolio. When estimating the fair value of entity B's investment portfolio, the issuer used the estimate that entity B made available to its board of directors, but made additional high level adjustments.

The enforcement decision

44. The enforcer disagreed with the issuer's accounting treatment. Entity B did not fulfil the definition of an investment entity and the issuer should have accounted for its stake in entity B applying the equity method without adjusting its share in the associate's profit or loss to account for changes in the fair value of the investee's investments.

Rationale for the enforcement decision

45. The criteria to identify an investment entity are set out in paragraph 27 of IFRS 10. Paragraphs B85A to B85M of IFRS 10, provide the relevant application guidance. According to paragraph 27(c) of IFRS 10, an investment entity is an entity that measures and evaluates the performance of substantially all its investments on a fair value basis. According to paragraph B85K of IFRS 10, this would be demonstrated if an entity provides investors with fair value information and measures substantially all of its investments at fair value in its financial statements whenever fair value is permitted. Furthermore, an investment entity would report fair value information internally to the entity's key management personnel, who would use fair value as the primary measurement attribute to evaluate the performance of substantially all of its investments as well as to make investment decisions.
46. The issuer shared the semi-annual estimate of the portfolio's fair value only with the board of directors but not with the investors that were not represented in the board of directors. In addition, the enforcer's investigations showed that periodical updates on operational and financial performance had been the primary measurement for management and the board of directors to evaluate performance rather than considering the investments' fair values. The enforcer, therefore, concluded that entity B did not meet the requirements in paragraph 27(c) of IFRS 10 and hence, was not an investment entity.

IX. Decision ref EECS/0216-09 – Depreciation of vessels in the oil and gas industry

Financial year end: 31 December 2014

Category of issue: Depreciation methods; usage method of depreciation

Standards or requirements involved: IAS 16 *Property, Plant and Equipment*

47. The issuer provides floating production services to the oil and gas industry and specialises in building, operating and leasing FPSO (Floating Production, Storage and Offloading) vessels. Up to and including 2013, the issuer depreciated the vessels using a straight-line method with a useful life equal to the total contract period for each vessel, typically over 15 years. According to the issuer, a shift towards significantly shorter durations of the lease contracts could be observed and, furthermore, several vessels could be redeployed after the end of their lease contracts. The issuer concluded that it would be therefore appropriate to change its depreciation methods for the hulls and their marine systems (typically, a converted and upgraded oil tanker or a newly built hull including the relevant marine

systems) and the process equipment and utility systems of the FPSOs (topside equipment such as power plant, gas treatment, gas compression, separation systems, water injection, etc.).

48. Under the revised depreciation policy, the issuer employed a usage method of depreciation, whereby the depreciation charge was measured based on the number of production days. This resulted in a straight-line depreciation over the useful life of the asset in periods of operation, and in no depreciation if the vessel was laid up and reclassified to be a conversion candidate. In order to be reclassified to a conversion candidate, the issuer defined a set of additional restrictions, especially that the vessel was maintained and kept ready for use, that there was a high probability that the vessel would be redeployed and that the expected lay-up would be for less than two years. If not all of these conditions would be fulfilled, the FPSO would be continued to be depreciated also during the lay-up.
49. The non-recoverable equipment on the vessels, which is tailor-made for the specific oil field and would normally have no value if the FPSO were to be redeployed to a different field, was in any case still depreciated using the straight-line method, with a useful life equal to the duration of the lease contract.

The enforcement decision

50. The enforcer disagreed with the issuer's accounting treatment. An asset with a limited useful life should be depreciated in such a way that the financial statements reflect the consumption of the asset's service potential. Ceasing to depreciate the laid-up vessels while they are idle does not reflect the consumption of the vessels' service potential appropriately.

Rationale for the enforcement decision

51. According to paragraph 55 of IAS 16, the depreciation of an asset begins when it is available for use, and ceases at the earlier of the date that the asset is classified as held for sale or the date the asset is derecognised. Therefore, depreciation does not cease when the asset becomes idle or is retired from active use. This paragraph further explains that under the usage method of depreciation the depreciation charge can be zero while there is no production. However, the objective of a depreciation method is to approximate the consumption of the asset's service potential. For the usage method of depreciation to best reflect the pattern of consumption, there needs to be a strong correlation between the degree of use of the asset and the amount of consumption of future economic benefits from the asset. This requires a certain degree of precision in estimating the total service capacity of the asset.
52. For FPSOs that are not in active use and are laid-up until a new lease contract can be concluded, the total service capacity would be unknown and would likely fluctuate over the lifetime of the asset. Therefore, the FPSO leasing company cannot estimate the future pattern of consumption of the benefits embodied in the FPSO. For example, if an FPSO's owner cannot secure a new lease contract for the vessel, the service capacity would be zero, as there is no alternative use. Likewise, if the vessel is redeployed to another field, the service capacity of the vessel would be reduced due to the high degree of customisation in the FPSO industry. The customisation of FPSOs is one of the issuer's main activities. Careful consideration of the weather conditions, oil quality, gas solutions, environmental concerns, regulatory measures, etc. is required to find the optimal solution on the vessel for each specific field. Consequently, the necessity for customisation of the FPSO entails that a conversion candidate would

have a lower service capacity after redeployment or would need modifications, causing existing equipment to be obsolete.

53. Moreover, for a usage method of depreciation to best reflect the consumption of future economic benefits, the asset in question should not be exposed to a material risk of obsolescence or wear during periods of inactivity. The enforcer concluded that for leased FPSOs this would not be the case as:

- The likelihood of obsolescence and wear can be expected to increase with time. The issuer's depreciation method would lead to not depreciating laid-up FPSOs for up to two years. The enforcer determined that it would be unlikely that an FPSO's estimated economic benefit would not be reduced during such a span of time.
- The useful life of an asset cannot be extended infinitely by maintenance. While maintenance can extend the useful life of an asset, it is unlikely to make it infinite because, eventually, it will be uneconomic to maintain the asset.
- Increasingly complicated regulatory obligations escalate the costs in the FPSO industry significantly. When redeploying FPSOs, regulatory changes require significant modifications to the asset. This supports the enforcer's conclusion that an FPSO is exposed to both technological and regulatory obsolescence over time.

X. Decision ref EECS/0216-10 – Application of value in use methodology in impairment testing

Financial year end: 31 December 2012

Category of issue: Impairment of assets

Standards or requirements involved: IAS 8 *Accounting Policies, Changes in Accounting Estimates and Errors*; IAS 36 *Impairment of Assets*

Description of the issuer's accounting treatment

54. The issuer is active in the extractive industry. When testing for impairment, the issuer determined a single recoverable amount based on a value in use methodology. In accordance with paragraph 32 of IAS 36, this point estimate reflected all the relevant estimation uncertainty in either the cash flows or the discount rate. In order to determine management's best estimate of future cash flows, the issuer performed both a macro analysis and an estimation of possible variations in the amount and timing of the future cash flows together with other assumptions relating to the specific asset being tested (as required by paragraph 30(b) of IAS 36).

55. According to the issuer's impairment policy applied in the financial statements, an interval with the initial value in use point estimate as midpoint and a radius of between 15% and 30% (depending on the tested asset or CGU) of the initial value in use point estimate had to be determined. The issuer's policy was to recognise an impairment loss only if the carrying amount of the asset was not within the calculated interval. In such case, the issuer would impair the asset to its recoverable amount, based on value in use. For example, if the CGU's initial value in use point estimate was CU 100 and the radius was

determined to be 15% of the initial value in use point estimate, the interval would be between CU 85 and CU 115. If the carrying amount was CU 120, the issuer would recognise an impairment loss of CU 20. However, if the carrying amount was only CU 110, the issuer would not recognise an impairment loss.

56. The rationale for the issuer's use of an interval for the purposes of impairment testing was based on a statistical argument that when the probability distribution of a value in use estimate is not known, all value in use estimates within such a 15-30% interval around the initial point estimate will be equally probable. The issuer considers that the valuation of assets in the extractive industry is significantly uncertain and could not be adequately addressed by a single point estimate.
57. The enforcer identified 24 impairment tests, relating to multiple CGUs, carried out in the period between 2009 and 2012, where the initial value in use estimate was below the carrying amount but where the application of an interval resulted in no impairment. During the same period there were two instances that would have led to possible reversals of impairments if the interval had not been applied. Both in relation to the frequency and materiality, the effects were largest in the beginning of the four-year period during which the principle was applied by the issuer.

The enforcement decision

58. The enforcer disagreed with the issuer and considered that the use of such an interval for the value in use estimates introduced the concept of a threshold before recognising impairment losses that is not in accordance with IAS 36.

Rationale for the enforcement decision

59. The enforcer considered that, although value in use estimates are inherently uncertain, the economic uncertainties the issuer operating in the extractive industry is facing are not that dissimilar from uncertainties that other types of issuers face. Paragraph A3(c) of IAS 36 requires preparers to reflect this uncertainty in the value in use estimate through the discount rate applied or by reflecting a range of outcomes when estimating future cash flows.
60. As the uncertainty in the value in use calculation is already taken into account when estimating the cash flows or the discount rates, paragraphs 32 and A2 of IAS 36 require the computation of a single best estimate of value in use which represents the weighted average of all possible outcomes. The enforcer considered that weighted average was a statistical term that could only be interpreted as a single number and hence value in use shall be estimated as a single estimate and not as an interval. The issuer's initial estimate, before applying an interval, was considered by the enforcer as a value in use estimate in accordance with IAS 36. If the carrying amount of the asset tested is below this estimate, the issuer should record an impairment loss in accordance with paragraph 59 of IAS 36.
61. Finally, the enforcer considered that the financial statements did not contain adequate disclosure of the issuer's accounting policy regarding the use of intervals in determining the recoverable amount and recognising impairment losses.

XI. Decision ref EECS/0216-11 – Recognition of onerous contract provisions

Financial year end: 31 December 2012

Category of issue: Provisions

Standards or requirements involved: IAS 36 *Impairment of Assets*; IAS 37 *Provisions, Contingent Liabilities and Contingent Assets*

Description of the issuer's accounting treatment

62. The issuer is active in the extractive industry. In the first decade of the 21st century, the issuer purchased one long-term LNG sales contract and two long term take-or-pay capacity contracts at a LNG import facility in the US. The acquisition cost was allocated to the acquired LNG sales contract, which was recognised as an intangible asset. The issuer included these three contracts, as well as certain trading contracts for piped gas in the US related to the re-gasified imported LNG volumes, in a single CGU.
63. The take-or-pay contract requires the issuer to make payments irrespective of actual usage. When fundamental changes in gas markets indicated a lower expected usage of the take-or-pay contracts in the following years, the issuer recognised in 2010 an impairment loss on the carrying amount of the CGU and recognised an IAS 37 onerous contract provision for the capacity contracts.
64. In the following year, further changes in prices made the issuer sell the volumes under the LNG gas contract to other markets than the US. Valued with the higher market reference price for these alternative markets, the value of the LNG contract surpassed that of the onerous import capacity contracts, and by mid-2011 all previous impairments and provisions relating to the CGU were therefore reversed. This was despite the fact that the issuer revised in parallel its expected usage percentage of the capacity contracts in the US for their remaining duration to virtually nil. At that time the issuer evaluated whether to split the capacity contracts from their original CGU and record separate onerous contract provisions under IAS 37, but concluded against it.
65. The issuer considered that the terminal capacity contracts were still integral to the CGU, central to the business case and dedicated to the LNG contract in accordance with paragraph 69 of IAS 37. CGUs shall be defined consistently over time and paragraph 72 of IAS 36 states that subsequent changes to a CGU must be justified. The issuer regarded changes to the internally established price assumptions to be the most significant change in factual circumstances from the time of the initial identification of the CGU, and that this was not sufficient to justify a change in the CGU.
66. The issuer concluded that to redefine the CGU and recognise a separate onerous contract provision, management must either have made a decision not to use the terminal capacity, involving permanent and/or irreversible non-usage, or, alternatively, that expectations of no utilisation had to be sustained and evidenced over an extended period of time.
67. In the first quarter of 2013, the issuer renegotiated its remaining take-or-pay commitments with the owner of the import terminal, involving an early termination for parts of the contract volumes in 2017. In its 2013 first quarter interim financial statements the issuer split the take-or-pay US import terminal

capacity contracts from the CGU and recognised a separate onerous contract provision equal to the net present value of all remaining capacity payment obligations.

The enforcement decision

68. The enforcer disagreed with the issuer and considered that the identification of the CGU should have been changed, separating and recognising material onerous contract provisions for the take-or-pay import capacity contracts, in a financial reporting period prior to the first quarter of 2013.

Rationale for the enforcement decision

69. The enforcer concluded that the issuer's stated threshold for what were considered justifiable reasons to change the composition of the CGU was higher than what would be a reasonable application of paragraph 72 of IAS 36.

70. To justify a change according to paragraph 72 of IAS 36, the reason would have to have substance. The enforcer agrees with the issuer that subsequent changes to economic assumptions that do not modify the expected utilisation of a component of the CGU significantly would typically not justify a change in the composition of the CGU. However, in this case, the changes in economic assumptions reduce the expected usage of the LNG import facility to virtually nil. Only if there is an expectation of actual usage of the LNG import facility it can be concluded that the components of the CGU are dedicated to each other and that the cash inflows are not largely independent of each other. With an expected usage of the LNG import capacity for its remaining duration of virtually nil, the enforcer found that these contracts can no longer be regarded as an integral part of the process flow or contributing to the cash inflows generated by other contracts in the CGU.

71. The enforcer took into consideration that the price variations causing the change in expected usage to virtually nil were neither merely changes in the issuer's internal price assumptions, nor short-term volatility reflecting temporary supply/demand imbalances, but are expected to be long lasting.

72. The enforcer concluded that the developments subsequent to mid-2011 further confirm the need to redefine the CGU and to establish separate provisions for the capacity contracts. These include the non-usage of the LNG import facility for part of 2011 and throughout 2012, as well as a further strengthening of the negative trend in the long term forward price spreads.

XII. Decision ref EECS/0216-12 – Identification of cash-generating units

Financial year end: 31 December 2012

Category of issue: Cash-generating unit

Standards or requirements involved: IAS 36 *Impairment of Assets*

Description of the issuer's accounting treatment

73. The issuer is active in the extractive industry. One of the issuer's most material exploration and production assets, in respect of book values, is its interest in the unconventional shale play A in the

United States of America (US). A shale play is defined as an area consisting of a single or multiple reservoirs related to the same geological feature.

74. The issuer tested for impairment the assets relating to shale play A, which was defined as one CGU. On the basis of its geological and commercial assessment, the issuer considered the entire shale play as an immature asset in early development and viewed it as a single exploration and evaluation asset.
75. The issuer considered that each individual well did not generate cash flows independently from each other because the output flows through a common processing system. The pipeline system is such that the products are moved around easily, with no allocation of the production from specific areas to specific markets. The process of interconnection is continuous and across the entire shale play.
76. Based on paragraph 69 of IAS 36, the issuer argued that from an operational standpoint, the shale play was viewed and managed as a single business unit, as investment decisions were made on the basis of the entire field, funding was allocated to the highest value acreage of the play at any given point in time and the cash flows were directly dependent on management's decision on where the contracted drilling rigs were directed. Decisions to divest smaller non-core areas were a result of economic evaluations of the entire play.
77. The management of production and transportation to different markets created interdependencies. As such, the issuer considered the shale play as one CGU, even though the maturation and development of the asset could lead to more CGUs in the future.

The enforcement decision

78. The enforcer disagreed with the issuer, and considered that more than one CGU should have been identified in shale play A for it to be compliant with the requirements in IAS 36.

Rationale for the enforcement decision

79. Identification of assets in a CGU based on paragraph 6 of IAS 36 involves judgement, and is the result of a bottom-up process, as per paragraph 68 of IAS 36.
80. In estimating the resources in shale play A, the US Energy Information Agency ("EIA") identified eight individually assessed plays (labelled 'distinct plays') in order to capture differences in geologic and reservoir conditions and projected performance.
81. Unlike for conventional reservoirs, the different parts of the reservoir rock in a shale play do not communicate with each other, as the resources are trapped in the source rock itself. Even over short distances there will be little or no interdependencies for the productivity between individual wells drilled into the same impervious rock.
82. To ascertain the smallest identifiable group of asset that generates cash inflows that are largely independent of the cash flows from other groups of assets, a bottom-up analysis needs to be performed, starting from the individual well. In the analysis, infrastructure aspects may be relevant in order to evaluate whether there are independent cash flows. For conventional fields, certain infrastructure

aspects will, for example, often cause satellites to be part of an extended field CGU. The enforcer found that parts of the issuer's arguments relating to shared infrastructure are also present in shale plays.

83. The enforcer believed that for unconventional onshore assets a cluster of wells together with a local gathering system (small pipelines bringing gas to a mainline pipe) and any local processing facilities, usually may serve as a starting point for further analysis. Within such local systems, if the gathering pipeline, the gas processing plant or the compressor connecting the gathering pipelines to the mainline breaks down, all the wells linked to the gathering system will effectively be shut in. If this was the case, the cash inflows from the wells in such a local system would then not be independent of each other. However, in the specific case at hand the enforcer found that there were no flows between the southern and northern parts of the shale play A and that they therefore in fact are independent from each other.
84. The enforcer further found that, within shale play A, several trading hubs with willing buyers and sellers for both the natural gas and most fractions of the wet gas produced from shale play A existed, some also with forward markets. This indicated that more local areas could generate separately identifiable cash inflows.
85. In addition, the enforcer's analysis showed that the issuer monitored, made strategies, operated, allocated resources and made decisions on acquisitions, continuation or disposals at a more granular level than shale play A as a whole. According to paragraph 69 of IAS 36, this again indicates that there are several cash inflows largely independent from each other.

XIII. Decision ref EECS/0216-13 – Purchase of a car fleet with an agreed buy-back agreement

Financial year end: 31 December 2015

Category of issue: Determining whether an Arrangement contains a Lease; classification of lease arrangements; buy-back agreement

Standards or requirements involved: IAS 8 *Accounting Policies, Changes in Accounting Estimates and Errors*; IAS 17 *Leases*; IAS 32 *Financial Instruments: Presentation* IFRIC 4 *Determining whether an Arrangement contains a Lease*

Description of the issuer's accounting treatment

86. The issuer operates in the car rental industry. A part of its fleet was bought from a car manufacturer and the parties entered into put and call options with a duration of less than 12 months. According to these agreements, the issuer was contractually entitled to sell the vehicle to the manufacturer at an agreed-upon price, which is a put option. If the put option would not be exercised by the issuer, the car manufacturer was contractually obliged to exercise a call option to buy back the vehicles. Consequently, in all circumstances, the car manufacturer re-purchased all the vehicles back and the issuer was authorised to use the vehicles only for a limited period of time.
87. The repurchase prices for the vehicles were based on their acquisition prices and adjusted depending on the duration of the agreement. Moreover, the repurchase price would be adjusted only if the terms of the contracts were not respected (e.g. if a certain number of driven kilometres would be exceeded or

in case the car would be damaged). Hence, the agreed strike prices of the options were essentially fixed prices and not fair values.

88. The issuer was of the opinion that no existing IFRSs applied to the accounting for buy-back agreements and that it was thus necessary to develop an accounting policy in accordance with paragraph 10 of IAS 8. To account for the consideration paid to the car manufacturer, the issuer recognised (i) a receivable representing the agreed-upon repurchase price for the vehicles and (ii) an asset named 'deferred depreciation expense on vehicles', being the difference between the consideration paid to the car manufacturer for the purchase of the vehicles and the amount of the receivable. The 'deferred depreciation expense on vehicles' asset was amortised on a straight-line basis over the length of the agreement. The receivable would be derecognised when the vehicle was returned to the car manufacturer and the repurchase price received. If the vehicle was stolen or damaged during the contract, a corresponding impairment loss on the receivable was recognised.

The enforcement decision

89. The enforcer disagreed with the issuer's assessment that no existing IFRSs applied to the transaction. The transaction is in scope of IAS 17 and should be accounted for accordingly. However, the enforcer agreed with the issuer's accounting treatment and presentation as the issuers' accounting treatment of recognising both PP&E and a financial asset in relation to the transaction was consistent with IFRS.

Rationale for the enforcement decision

90. According to paragraph 6 of IFRIC 4, the determination whether an arrangement is, or contains, a lease, shall be based on the substance of the arrangement and requires the assessment of whether:

- fulfilment of the arrangement is dependent on the use of a specific asset; and
- the arrangement conveys a right to use the asset.

91. Both conditions were fulfilled, thus the arrangement is a lease and should be accounted for in accordance with IAS 17. Further the enforcer assessed whether the lease should be classified as an operating or a finance lease. For this purpose, the enforcer analysed whether the arrangement transfers substantially all the risks and rewards incidental to ownership of the vehicles to the issuer as lessee. Furthermore, the enforcer determined that the arrangement differs from the examples in the paragraphs 10 and the indicators in paragraph 11 of IAS 17 of situations that could lead to finance lease classification. For instance, the enforcer concluded that the vehicles would be resold to the car manufacturer for an essentially fixed price after a year or less, which is less than the useful life of the vehicles.

92. Thus, the enforcer came to the conclusion that not substantially all risks and rewards incidental to the ownership of the vehicles were transferred to the issuer and as such the lease should be classified as an operating lease. The difference between the consideration paid to the car manufacturer for the purchase of the vehicles and the amount to be received from the car manufacturer for the buy-back, constitutes prepaid lease payments to be recognised over the lease term. The buy-back agreement gives rise to a financial asset in accordance with paragraph 11 of IAS 32. In accordance with paragraph

9 of IAS 39, this financial asset qualifies as a receivable. The issuers' accounting treatment of recognising both PP&E and a financial asset in relation to the transaction was, therefore, consistent with IFRS.

XIV. Decision ref EECS/0216-14 – Recognition of deferred tax assets for unused tax losses

Financial year end: 31 December 2014

Category of issue: Unused tax losses; convincing evidence

Standards or requirements involved: IAS 12 *Income taxes*

Description of the issuer's accounting treatment

93. The issuer is a construction company with two subsidiaries in Russia: A and B. Low oil and gas prices, geopolitical tensions and ongoing international sanctions contributed in 2014 to a challenging economic environment in Russia. Furthermore, the exchange rate of the Russian Rouble against the Euro dropped significantly (more than 35% from 1 December 2013 to 31 December 2014) and the Russian inflation rate reached double digits.

94. Subsidiary A had acquired a land plot in a Russian exclave and had planned to develop it and build a commercial centre. However, the initiation of the construction works was postponed beyond 2014 because of the difficult economic environment. Subsidiary B was a construction company. Both Russian subsidiaries encountered significant losses in their financial statements, which, in the case of subsidiary B, also led to negative equity. They also built up unused tax losses.

95. The issuer recognised in its 2014 consolidated financial statements deferred tax assets of CU 2m related to the unused tax losses of the two Russian subsidiaries. However, it did not disclose in its financial statements the nature of the evidence supporting their recognition.

The enforcement decision

96. The enforcer disagreed with the issuer's accounting treatment as the issuer could not provide convincing evidence that sufficient taxable profit would be available against which the unused tax losses can be utilised by the entity. Therefore, no deferred tax asset for the unused tax losses should have been recognised.

Rationale for the enforcement decision

97. According to paragraph 34 of IAS 12, a deferred tax asset shall only be recognised to the extent that it is probable that future taxable profits will be available against which unused tax losses can be utilised. According to paragraph 35 of IAS 12 the existence of unused losses is a strong evidence that future taxable profit may not be available. If an entity has a history of recent losses, an entity has to provide convincing evidence that sufficient taxable profit will be available to utilise the unused tax losses.

98. No convincing evidence was disclosed in the financial statements showing that the unused tax losses could be utilised by the entities in future. In the course of its investigation, the enforcer ascertained that

one of the major factors of the losses in both entities was Russia's economic crisis (including the decline of the Russian Rouble's exchange rate). The enforcer was not provided with any convincing evidence that this situation would reverse in the foreseeable future. Furthermore, the enforcer determined that for subsidiary B no projection of the future taxable income was available. The enforcer assessed the issuer's planning for subsidiary A and concluded, based on the challenging economic environment and the fact that the construction of the commercial centre was postponed and might eventually be abandoned entirely, that the planning did not constitute convincing evidence that the tax losses could be utilised by subsidiary A.