ESMA
European Securities and Markets Authority

29 March 2023
ESMA32-63-1465

Report

27th Extract from the EECS's Database of Enforcement

ESMA
European Securities and Markets Authority

Table of Contents

Executive Summary 3
I.Decision ref EECS/0123-01 – Sale and leaseback of an asset in a single-asset entity .5
II.Decision ref EECS/0123-02 – Aggregation of several operating segments into one reporting segment 6
III.Decision ref EECS/0123-03 – Recognition of an internally generated intangible asset in a pharmaceutical project..8
IV.Decision ref EECS/0123-04 – Exchange of non-monetary assets 10
V.Decision ref EECS/0123-05 – Lease payments disclosures 14
VI.Decision ref EECS/0123-06 – Disaggregation of revenue..15
VII.Decision ref EECS/0123-07 – Climate risk disclosures in impairment tests 17
VIII.Decision ref EECS/0123-08 – Climate risk disclosures in financial statements 18
IX.Decision ref EECS/0123-09 – Credit risk disclosures for financial instruments 20
X.Decision ref EECS/0123-10 – Reclassification of financial assets 22
XI.Decision ref EECS/0123-11 – Reclassification of financial assets 24
XII.Decision ref EECS/0123-12 – Classification of SPAC warrants 26

The decisions included in this report were taken by national enforcers in the period from December 2020 to January 2023. ESMA will continue to publish further extracts from the database on a regular basis.

ESMA
European Securities and Markets Authority

List of abbreviations and acronyms used in this report

BC	Basis for Conclusions
COVID-19	Coronavirus Disease 2019
EAD	Exposure at Default
ECL	Expected Credit Loss
EEA	European Economic Area
EECS	European Enforcers Coordination Sessions
ESMA	European Securities and Markets Authority
FLI	Forward-Looking Information
FVOCI	Fair Value through Other Comprehensive Income
IAS	International Accounting Standards
IASB	International Accounting Standards Board
IFRS IC	International Financial Reporting Interpretations Committee
IFRS	International Financial Reporting Standards
Repo	Repurchase Agreement
USA	United States of America
SICR	Significant Increase in Credit Risk
SPAC	Special Purpose Acquisition Company

ESMA
European Securities and Markets Authority

Executive Summary

The European Securities and Markets Authority (ESMA) publishes 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 legislation.

In order to fulfil these responsibilities, ESMA organises the European Enforcers Coordination Sessions (EECS), a forum of 38 European enforcers from all European Economic Area (EEA) countries with responsibilities in the area of enforcement of financial information.

With responsibility for the coordination of supervision of almost 4,100 issuers listed on the regulated markets in the EEA preparing IFRS financial statements, EECS 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 ESMA Statements and Opinions on accounting matters and reviews accounting practices applied by European issuers to enable ESMA to monitor market developments and practices.

In taking enforcement decisions, European enforcers apply their judgement, knowledge and experience to the facts and circumstances of the individual cases they consider. Relevant factors may also include other areas of national law beyond the accounting requirements. Interested parties should, therefore, carefully consider the circumstances when reading the cases. As IFRS are principles-based, there can be no one single 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). The decisions published in each extract are based on the IFRS requirements valid at the time of the IFRS financial statements and may be superseded by subsequent developments in IFRS.

The publication of selected enforcement decisions informs 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, contributes to a consistent application of IFRS in the EEA.

In accordance with the provisions of the ESMA Guidelines on 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:

ESMA
European Securities and Markets Authority

- 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, and
- The decision has been taken on the basis of a provision not covered by an accounting standard.

ESMA
European Securities and Markets Authority

I. Decision ref EECS/0123-01 – Sale and leaseback of an asset in a single-asset entity

Financial year end: 31 December 2020
Category of issue: Sale and leaseback; corporate wrapper; disclosure of accounting policies
Standards or requirements involved: IFRS 10 *Consolidated Financial Statements,* IFRS 16 *Leases,* IAS 1 *Presentation of Financial Statements*.

Description of the issuer's accounting treatment

1. The issuer, a savings bank, sold its headquarters building and leased it back in 2020. The issuer facilitated the sale by disposing of a wholly owned subsidiary with a single asset (the headquarters). The issuer's financial statements as of 31 December 2020 indicated that the issuer leased back the sold headquarters but did not provide details on the accounting treatment applied.
2. Upon request, the issuer explained that the transaction was accounted for as a sale of shares in accordance with paragraph 25 of IFRS 10 (loss of control of a subsidiary). The right-of-use asset and the lease liability related to the leased back headquarters were recognised separately, i.e., the sale and leaseback principles set out in paragraph 98 of IFRS 16 were not applied to this transaction. The issuer recognised a material gain on the transaction in 2020.
3. The issuer referred to the IFRS IC's September 2020[1] tentative agenda decision and the IFRS IC's February 2021[2] subsequent recommendation to the IASB to undertake a narrow-scope standard setting project addressing the sale and leaseback of an asset in a single-asset entity. The issuer argued that the sale of the headquarters was more complex than the case discussed by the IFRS IC because it also comprised, for example, working capital and tax positions.
4. Given the IFRS IC had not concluded on the issue but referred the matter to the IASB, and as this process was still ongoing, the issuer considered that applying IFRS 10 instead of IFRS 16 was appropriate.

The enforcement decision

5. Given the open status of the IFRS IC's submission addressing a similar fact pattern and subsequent recommendation to the IASB, the enforcer accepted the accounting treatment followed by the issuer. However, in the enforcer's view, the issuer should have disclosed the accounting policies applied in its financial statements.

[1] Sale and Leaseback of an Asset in a Single-Asset Entity (IFRS 10 Consolidated Financial Statements and IFRS 16 Leases)—Agenda Paper 2 (IFRS - IFRIC Update September 2020).
[2] IFRS - IFRIC Update February 2021.

ESMA
European Securities and Markets Authority

Rationale for the enforcement decision

6. During the IFRS IC agenda process in 2020, the IFRS IC discussed several alternatives for corporate wrapper sale and leaseback transactions but reached no conclusion. Given (i) the different alternatives regarding the accounting treatment applicable to such transactions, (ii) the materiality of the gain recognised, and (iii) the potential impact that the initial recognition and subsequent accounting for the recognised right-of-use asset and lease liability for the headquarters could have in subsequent financial statements, the enforcer considered that the accounting policies applied by the issuer regarding such transactions were material.
7. Therefore, the enforcer required the issuer to disclose this information in accordance with paragraphs 117 and 122 of IAS 1. In addition, the enforcer required the issuer to include information concerning the gain or loss on disposal of a subsidiary in the notes as required by paragraph 19 of IFRS 12 *Disclosure of Interests in Other Entities*.

II. Decision ref EECS/0123-02 – Aggregation of several operating segments into one reporting segment

Financial year end: 31 December 2019
Category of issue: Aggregation of operating segments; similar economic characteristics
Standards of requirements involved: IFRS 8 *Operating Segments*

Description of the issuer's accounting treatment

8. The issuer is a confectionery company. Its products are divided into two categories. In its segment reporting note, the issuer identified five operating segments: "Country A", "Country B+C", "Country D", "Country E+F" and "Country G & International". In its 2019 annual report, the issuer aggregated the five operating segments into one reportable segment and therefore did not separately disclose the information required by IFRS 8 for each operating segment.

9. The issuer's decision to aggregate the five operating segments into one reportable segment was based solely on the qualitative criteria a) – e) set out in paragraph 12 of IFRS 8. The issuer considered that these criteria were met, taking into account the following considerations:

   - the nature of sugar and chocolate confectionery, pastilles, nuts and chewing gum products was similar, which together form the concept of products for inexpensive cold snacks between main meals,
   - the nature of the production process was similar and centrally managed, facilitating the concentration of the production facilities and achieving economies of scale and cost efficiency,

- the types of customers for the issuer's products were similar. Traditional market segmentation based on age, gender, income, etc. is of little relevance to brand positioning in the confectionery market,
- in all main markets, the issuer had its own sales and distribution organisation, and
- the regulatory environment for food was comparable across the issuer's markets and, therefore, was not a relevant criterion for the issuer.

10. While the long-term average gross margin in each operating segment differed up to approximately 20%, the EBIT margin differed up to approximately 15% and the net sales volume differed up to approximately 115 MEUR (which was material for the issuer). The issuer disregarded the requirement of paragraph 12 that the aggregated segments should have similar economic characteristics.

11. In this respect, the issuer considered that the quantitative criterion related to average gross margin was not relevant to its type of business because this indicator for each individual operating segments was impacted by the mix of the issuer's product categories.

The enforcement decision

12. The enforcer concluded that the aggregation of operating segments made by the issuer did not meet the requirements of IFRS 8 and required the issuer to present several segments in its segment information note within the financial statements.

Rationale for the enforcement decision

13. The enforcer disagreed with the issuer's assessment regarding the aggregation of operating segments. The enforcer considered that the issuer should have made the assessment of both the economic characteristics of operating segments and the qualitative criteria when aggregating operating segments into one reportable segment according to paragraph 12 of IFRS 8. The issuer's argument that qualitative criteria take precedence over the quantitative criteria was not in accordance with the requirements of paragraph 12.

14. The enforcer concluded that the issuer's operating segments cannot be considered similar because there were significant differences in the economic characteristics of the issuer's reportable segments, such as gross margin and EBIT margin.

ESMA
European Securities and Markets Authority

III. Decision ref EECS/0123-03 – Recognition of an internally generated intangible asset in a pharmaceutical project

Financial year end: 31 December 2020
Category of issue: Intangible asset; development costs
Standards or requirements involved: IAS 38 *Intangible Assets*

Description of the issuer's accounting treatment

15. The issuer is a pharmaceutical company that develops drugs for the treatment of rare diseases, with no operational revenues from sales. In 2019 and 2020, the issuer announced a strategic concentration of its financial and personnel resources into two drug candidates: A and B, both for the treatment of rare diseases. The issuer classified the different stages of drug development as clinical Phase I to III, whereby clinical Phase III implied a large-scale trial to verify the previously achieved results. Regulatory review and approval require a positive outcome of the clinical Phase III trials. According to the issuer, at the year-end, Candidate A was in clinical Phase I and candidate B was being prepared for clinical Phase I trials.

16. Furthermore, the issuer also had a development project for another drug, candidate C, which was classified as a "non-core asset". Candidate C had orphan drug designation[3] in Europe and the USA, as well as an Investigational New Drug approval[4] and fast track designation for clinical development in the USA. The issuer classified this project as a clinical Phase I project transitioning to enter clinical Phase II. According to the issuer, the remaining development period (Phase II) was expected to start in 2022, clinical Phase III was intended to start in 2024, and regulatory approval was expected for 2028. The issuer was in discussions with partners for collaboration to ensure financial support for the project to carry out clinical Phase II, but no firm commitment had been reached. Around 90% of the total cost to complete the project to obtain regulatory approval was expected to be incurred in clinical Phase III.

17. The issuer had expensed all costs related to candidates A and B. For candidate C, development costs incurred within the period 2013-2017 were recognised as an intangible asset in the issuer's financial statements throughout that period, while the costs related to candidate C incurred from April 2017 onwards were expensed.

18. The issuer recognised an intangible asset for candidate C based on expenditures at a development stage prior to market (regulatory) approval. The issuer argued that IAS 38 does not explicitly require regulatory approval to recognise an asset and referred to management's judgement. In explaining why candidate C's accounting treatment differed

[3] A drug intended for the treatment, prevention or diagnosis of a rare disease or condition which may not be profitable to produce without government assistance.
[4] Permission to start human clinical trials and to ship an experimental drug across US state lines (usually to clinical investigators) before a marketing application for the drug has been approved.

from candidates A and B, it also referred to paragraph 2.27 of the Conceptual Framework, which states that “comparability is not uniformity (..) Comparability of financial statements is not enhanced by making unlike things look alike (..)”.

19. According to the issuer, an external valuation of the risk-adjusted net present value of the future economic benefits of the project for IAS 36 purposes supported the carrying value. Furthermore, the issuer assumed that the project had reached a stage where a disposal of the whole project was an option to gain future economic benefits and referred to ongoing discussions with potential partners and acquirees.

The enforcement decision

20. The enforcer disagreed with the issuer and considered that there were significant uncertainties regarding completion of the candidate C project, both in terms of technical feasibility and financial resources. The enforcer considered that the recognition criteria set out in paragraph 57 of IAS 38 were not met. Therefore, the enforcer required the issuer to derecognise the intangible asset related to drug candidate C.

Rationale for the enforcement decision

21. The enforcer noted that in 2013-2017, when the capitalised costs were incurred, candidate C was in clinical Phase I, a very early stage of drug development. At the reporting date, candidate C was ready to enter in clinical Phase II, which was planned for 2022 but was not yet sufficiently funded to initiate the next step. At the same time, the technical feasibility of completing the intangible asset remained highly uncertain.

22. According to paragraph 57 of IAS 38 an intangible asset arising from the development phase of an internal project shall be recognised if, and only if, an entity can demonstrate that it meets all the criteria laid out in this paragraph. The enforcer was of the view that the issuer did not meet the criteria set out in a), d) and e) of paragraph 57 of IAS 38.

    On criteria a): the technical feasibility of completing the intangible asset.

23. The final regulatory approval of candidate C depended on external parties in the USA and in the EU who were not controlled by the issuer. The fact that candidate C had orphan drug designation and fast track approval did not affect regulatory requirements as such, but only the status in the market after approval and the priority in the approval process. The issuer’s remaining development activities were subject to a complex verification and registration process requiring a significant amount of work and time. Hence, the enforcer concluded that the technical feasibility of candidate C was not ensured at that time.

    On criteria d): generating probable future economic benefits.

24. The issuer presented an external high-level valuation report that supported the carrying value for IAS 36 purposes. According to the report, the valuation was based on (i) the

successful completion of the project, (ii) sufficient external financing during the project period, and (iii) a sufficient market for candidate C after regulatory approval. The valuation involved significant uncertainties in relation to the timetable, estimated costs, future regulatory approvals and market conditions. Therefore, the enforcer considered it to be highly questionable, whether future economic benefits could have been considered probable at the time the costs were incurred and capitalised (i.e., between 2013-2017).

On criteria e): availability of adequate technical, financial, and other resources to complete the project.

25. The issuer had no cash flows from sales and thus reported continuously negative operational cash flows due to the development costs related to candidates A and B. The issuer also had negative operational cash flow and practically no revenue between 2013-2017. The development costs were financed by continuous capital contributions from shareholders. To start clinical Phase II development for candidate C, the issuer was seeking external financing through partners or a potential (partial) sale of the project. The issuer had not demonstrated its ability to secure financial resources by obtaining lenders' willingness to fund the future development of candidate C (in relation to paragraph 61 of IAS 38). In this respect, the issuer indicated that the search for financial partners and collaborators was the major reason for the delay of the project.

IV. Decision ref EECS/0123-04 – Exchange of non-monetary assets

Financial year end: 30 June 2021
Category of issue: Exchange of assets; commercial substance of an exchange transaction; reliable measurement
Standards or requirements involved: IAS 38 *Intangible Assets*

Description of the issuer's accounting treatment

26. The issuer is a football club. In June 2021, the issuer acquired registration rights for two players from Football Club A for 12 MEUR and 3 MEUR (15 MEUR in total) and recognised these rights as intangible assets under IAS 38. At the same time, the issuer sold registration rights for two other players to Football Club A, for 11 MEUR and 4 MEUR (15 MEUR in total). The transactions were executed on the basis of four separate legal contracts dated 30 June 2021.

27. With the sale of registration rights, the issuer recognised net gains of 11 MEUR and 4 MEUR (15 MEUR in total) as the players, to whom the rights related, were "home-grown" in the issuer's academy and their registration rights were measured at nil. This represented 20% of the total net gains on the disposal of registration rights and 43% of the issuer's profit for the financial year.

28. The registration rights acquired by the issuer were recognised in its financial statements at 15 MEUR, although, prior to their disposal, they were recognised at nil in the financial statements of Football Club A as they were also academy players.

29. The issuer explained that the gains on the disposal of the registration rights were recognised in accordance with IFRS 15 as all risks and rewards inherent to the rights were substantially transferred. The issuer considered that each contract should be analysed as a separate unit of account as the players were expected to have different impacts on the teams' sporting performance and would, most likely, have different transfer values in the future.

30. In the issuer's opinion, the four transactions were independent from each other and therefore, did not constitute an exchange of assets. According to the issuer, the negotiations were conducted independently from each other, the agreed transaction values were independently determined and based on the valuation of the assets as deemed appropriate by the parties.

31. In response to the enforcer's request to provide rationale and supporting evidence for each player's transaction value, the issuer presented an internal "scouting report" supporting the acquiring decision. The one-page report contained only a qualitative evaluation of the players, including a description of key sportive characteristics and a qualitative global score (e.g., "AB" or "AB+"). The issuer confirmed that the two acquired players are currently playing in the issuer's second team (team B), similar to their previous situation in Football Club A.

32. The enforcer understood that the gains recognised by the issuer were of particular importance to the issuer to comply with the UEFA regulations in relation to financial fair play, particularly taking into account its fragile financial situation, as its equity was negative as of 30 June 2021.

The enforcement decision

33. The enforcer concluded that the four separate legal contracts between the issuer and Football Club A should have been examined as a whole to ensure that the financial statements faithfully represented the substance of the transactions. The transactions constituted an exchange of non-monetary (intangible) assets under the provisions of paragraph 45 of IAS 38.

34. The enforcer considered that it was not possible to reliably measure the fair value of the assets received by the issuer and the assets given up. Therefore, in accordance with paragraph 45 of IAS 38, the issuer should have measured the acquired registration rights at recognition at the carrying amount of the assets given up (i.e., at nil). Consequently, no gain should have been recognised in the issuer's statement of profit or loss.

Rationale for the enforcement decision

35. In accordance with paragraph 15 of IAS 1, and in line with the Conceptual Framework, faithful representation of the effects of transactions, other events and conditions is a *condition sine qua non* for the financial statements to fairly represent the financial position, the financial performance and the cash flows of an entity.

36. The enforcer noted that according to paragraph 2.12 of the Conceptual Framework, “financial information must not only represent relevant phenomena, but it must also faithfully represent the substance of the phenomena that it purports to represent”. Paragraph 4.59 states that financial statements must report the substance of the rights and obligations created by the terms of a contract for an entity that is a party to that contract. Additionally, paragraph 4.62 states that a group of contracts may achieve or be designed to achieve an overall commercial effect. To report the substance of such contracts, it may be necessary to examine the set of rights and obligations arising from those contracts as a whole.

37. Taking into consideration that:

    a) the transactions’ date and counterparts in respect of the registration rights were the same,
    b) the total amounts of the acquisition and the disposal total were also the same (both 15 MEUR),
    c) the payments and receivables dates matched exactly, with identical amounts on each date (both 15 MEUR), and
    d) there were no cash inflows or outflows related to the transactions, as the parties executed a direct compensation of the receivable and payable amounts

    the enforcer concluded that the four separate legal contracts signed between the issuer and Football Club A should have been considered together as a whole to ensure that the financial statements faithfully reflected the substance of the transactions. As a result of this examination, the enforcer concluded, taking into account explanations in paragraph 45 of IAS 38, that the issuer’s transactions should have been accounted for as an exchange of non-monetary (intangible) assets.

38. Paragraph 24 of IAS 38 requires an intangible asset to be measured initially at cost. In an exchange of non-monetary assets, where the purchase consideration is neither in the form of cash nor in other monetary assets, the cost is measured at fair value, provided that the exchange transaction has substance, and the fair value can be reliably determined (paragraph 45). The IASB included the “reliable measurement” test for the use of fair value to minimise the risk that entities could “manufacture” gains by attributing inflated values to the assets exchanged (paragraph BC 23 of IAS 16).

39. Further guidance is included in paragraph 47 of IAS 38: The fair value of an intangible asset is reliably measurable if (a) the variability in the range of reasonably fair value measurements is not significant for that asset or (b) the probabilities of the various estimates within the range can be reasonably assessed and used when measuring fair value. If an entity is able to measure reliably the fair value of either the asset received or the asset given up, then the fair value of the asset given up is used to measure cost unless the fair value of the asset received is more clearly evident.

40. In the enforcer's view, the guidance in paragraph 47 of IAS 38 implies that adequate evidence of the fair value must necessarily entail a quantitative analysis and include detailed information about the valuation inputs and methods used. In this case, the issuer did not provide supporting evidence that demonstrated the use of a structured methodology to calculate the fair value of the rights, i.e., capable of identifying a range of reasonable fair value measurements, assessing and using the probabilities of the various estimates when determining the fair value. The enforcer concluded that the issuer did not provide an acceptable basis for the fair value underlying the transactions.

41. In addition, neither the enforcer nor the issuer could identify registration rights transactions for players with similar characteristics within this range of amounts. Most of such transactions in recent years were executed at nil and the average transaction amount was 0.4 MEUR.

42. As a part of the analysis made, the enforcer also consulted a website providing information on players' transfer market commonly used by the industry whereby the "valuations" for the players acquired by the issuer were 0.5 MEUR and 0.4 MEUR, respectively. The enforcer observed that not only did the information included on the website not support the issuer's valuations, but it also did not provide indications on the inputs that were used to assess the fair value of the registration rights of players. Although in the enforcer's view, the information on the website may be considered as an indicator, it does not provide sufficient evidence of fair value in accordance with IFRS because no information was provided on the inputs and methodologies underlying the valuations.

43. Based on these considerations, the enforcer concluded that the contractual amounts agreed between the parties did not reflect fair values of the registration rights sold or acquired and no evidence had been identified that it was possible to reliably determine the fair values of sold and acquired rights. Therefore, the acquired rights should have been measured at the carrying amount of the disposed rights (i.e., at nil).

44. On the basis of the guidance in paragraph 46 of IAS 38, the enforcer considered that arguments could also be found to challenge whether the transaction had commercial substance. However, no final conclusion was made in this regard, as – given the above analysis of the fair value reliability – this analysis would not have affected the enforcer's conclusion regarding the reliability of the measurement of the acquired rights.

V. Decision ref EECS/0123-05 – Lease payments disclosures

Financial year end: 31 December 2020
Category of issue: Disclosures related to leases payments
Standards or requirements involved: IFRS 16 *Leases*

Description of the issuer's accounting treatment

45. The issuer is in the retail sector, operating more than 300 stores. The right-of-use assets represent around 30% of the total assets. Most of the lease contracts include clauses whereby the issuer should pay a significant variable consideration if the annual revenue of an individual store exceeds a pre-determined threshold. Therefore, the issuer is significantly exposed to variable payments.

46. During the COVID-19 pandemic, the issuer's operations were significantly impacted and a significant number of stores was closed. Against this backdrop, the issuer agreed with the lessors several rent concessions to decrease fixed and variable lease payments.

47. In its annual financial statements, the issuer provided narrative information regarding the rent concessions and the fact that the issuer applied the exemptions prescribed in paragraph 6 together with the practical expedient of paragraph 46A of IFRS 16 in relation to low value and short-term leases. The issuer disclosed the total amount paid related to leases payments in aggregate in the statement of profit or loss of the year and did not provide further information in the notes.

The enforcement decision

48. The enforcer concluded that the issuer should have disclosed a breakdown of the lease payments in the notes to the financial statements separately disaggregating (i) variable payments, (ii) short term leases payments, (iii) low value leases, and (iv) rent concessions leases.

Rationale for the enforcement decision

49. The enforcer noted that given (i) the business model of the issuer (retail sector and operating mainly in leased stores), and (ii) the issuer's exposure to variable lease payments and short-term leases (via the lease contracts), the issuer should have provided disaggregated information in the notes regarding lease payments to enable investors' understanding of the material amounts recognised in the statement of profit or loss and to estimate future cash flows arising from lease contracts.

50. According to paragraph 53 of IFRS 16, a lessee should disclose the following amounts for the reporting period:

(c) the expense relating to short-term leases accounted for applying paragraph 6 of IFRS 16. This expense need not include the expense relating to leases with a lease term of one month or less;

(d) the expense relating to leases of low-value assets accounted for applying paragraph 6 of IFRS 16. This expense shall not include the expense relating to short-term leases of low-value assets included in paragraph 53(c) of IFRS 16;

(e) the expense relating to variable lease payments not included in the measurement of lease liabilities.

51. Furthermore, paragraph 59 (b) of IFRS 16 requires a lessee to disclose additional qualitative and quantitative information that helps users of financial statements assess future cash outflows to which the lessee is potentially exposed to and that are not reflected in the measurement of lease liabilities. This includes exposure arising from variable lease payments.

52. Finally, in accordance with paragraph 60A of IFRS 16, the issuer should also have separately disclosed the amount recognised in profit or loss for the reporting period to reflect changes in lease payments that arise from rent concessions to which the lessee has applied the practical expedient in paragraph 46A.

VI. Decision ref EECS/0123-06 – Disaggregation of revenue

Financial year end: 31 December 2021
Category of issue: Disaggregation of revenue
Standards of requirements involved: IFRS 15 *Revenue from Contracts with Customers*

Description of the issuer's accounting treatment

53. The issuer operates in the animal health sector serving both the livestock and pet care markets. The issuer develops and sells veterinary drugs and non-medicinal products in Europe, the Americas and the Asia Pacific region.

54. In the notes, the issuer only provided a disaggregation of revenue according to its geographical operating segments (Europe, Americas and Asia Pacific).

55. Given the material impact of IFRS 15 for the issuer, the enforcer required the issuer to provide an analysis of the criteria used for the disaggregation of revenue in accordance with paragraphs 114 and B87-B89 of IFRS 15.

56. The issuer argued that (i) the disaggregation of revenue other than by geographical segment, i.e., by market (livestock/pets), does not provide information that is relevant for users of financial statements, (ii) it has only one significant type of activity, animal health,

for which all revenues are generated, and (iii) cash flows arising from its activities are affected by the same economic factors.

The enforcement decision

57. The enforcer concluded that the issuer's disclosures related to revenue disaggregation in financial statements were not sufficient to meet the requirements of paragraphs 114 and B87-B89 of IFRS 15. In light of the importance of the revenue-related disclosures in enabling investors to understand the issuer's profitability and to estimate future cash flows, the enforcer concluded that the missing disclosures constituted a material departure from the IFRS requirements.

Rationale for the enforcement decision

58. The enforcer disagreed with the issuer's view and the arguments provided explaining why further disaggregation of revenue was not necessary. In the enforcer's view, the economic factors that drive revenue in each market (livestock/pet) were not identical. The enforcer noted that while revenue from livestock products primarily depends on the economics of livestock and agriculture (which can be significantly impacted by animal pandemics or changes in consumers' eating habits), revenue arising from the sale of pet products depends on other factors (such as the purchasing power of pet owners).

59. To support this conclusion, the enforcer noted that the issuer had disclosed in its prospectus the fact that both markets evolved differently during the year under examination (i.e., the revenue related to pet products grew 10%, while the revenue related to livestock decreased 4%).

60. Furthermore, the enforcer noted that outside of the financial statements, in the management report, the issuer disclosed quantitative information on the portion of revenue arising from livestock products and the portion of revenue derived from pet products.

61. According to paragraph 114 of IFRS 15, 'an entity shall apply the guidance in paragraphs B87–B89 when selecting the categories to use to disaggregate revenue'. Furthermore, paragraph B88 of IFRS 15 states that "when selecting the type of category (or categories) to use to disaggregate revenue, an entity shall consider how information about the entity's revenue has been presented for other purposes, including all of the following: (a) disclosures presented outside the financial statements (for example, in earnings releases, annual reports or investor presentations).'

62. The enforcer concluded that the disaggregation of revenue by main type of products (pet vs. livestock) disclosed by the issuer in the management report should have been included in the financial statements to comply with the requirements of IFRS 15.

ESMA
European Securities and Markets Authority

VII. Decision ref EECS/0123-07 – Climate risk disclosures in impairment tests

Financial year end: 31 December 2021
Category of issue: Climate risk disclosures, impairment tests disclosures
Standards of requirements involved: IAS 36 *Impairment of Assets,* IAS 1 *Presentation of Financial Statements*

Description of the issuer's accounting treatment

63. The issuer manages airports in several locations. According to the issuer's annual financial report, the issuer's operations are highly exposed to climate change because they entail significant CO_2 emissions.

64. In the non-financial section of its annual financial report, the issuer included detailed information on how climate change affects its business and provided information regarding its commitments to reduce CO_2 emissions by 2025 to comply with national regulations regarding climate change impacts. As part of its commitments, the issuer disclosed the following 2025 objectives:

- to reduce CO_2 emissions by about 10% per taxiing flight,
- to define a maximum CO_2 budget for each major development project,
- to consume 10% of low-carbon energy in total (both in terminals and in airport runways), and
- to consume 40% of low-carbon energy, excluding take-off and landing.

65. When examining the issuer's financial statements, and more specifically the disclosures on impairment tests, the enforcer noted that the issuer did not refer to financial impacts related to its CO_2 reduction commitments.

66. Upon request, the issuer confirmed that the CO_2 reduction commitments were considered when performing impairment tests of non-financial assets.

The enforcement decision

67. The enforcer concluded that the issuer's disclosures related to impairment tests and its exposure to climate risks were not sufficient to meet the requirements of IAS 36.When assessing the materiality of the missing disclosures, the enforcer considered qualitative and quantitative factors such as (i) the amount of goodwill and intangible assets with indefinite useful lives which was material in the issuer's financial statements, (ii) the issuer's high exposure to climate risks, and (iii) the lack of consistency and coherence between the commitments disclosed in the non-financial section of the management report and the information disclosed in the financial statements. The enforcer concluded that the missing disclosures constituted a material departure from IFRS requirements.

Rationale for the enforcement decision

68. The enforcer analysed the impairment tests performed by the issuer. While the enforcer concurred that the impairment tests carried out did not point to the need to recognise an impairment loss, the enforcer considered that, in accordance with paragraph 134 of IAS 36, the issuer should have disclosed more information on how climate change and CO_2 reduction commitments were factored into the impairment tests carried out for goodwill and intangible assets with indefinite useful lives.

69. In particular, the enforcer considered that the disclosures provided by the issuer on the assumptions used in the impairment tests were not sufficient to enable an understanding of whether and how the CO_2 reduction commitments and climate change were taken into account in the determination of the value in use of the cash generating units.

70. More specifically, to comply with the requirements of paragraph 134(d)(i) and (ii) of IAS 36 and paragraphs 125 to 127 and 129 of IAS 1, the enforcer required the issuer to:

- specify that the costs of the carbon emission commitments are considered in its free cash flows projections as they are not considered to be linked to future restructuring and will not improve or enhance the asset's performance (paragraph 45 of IAS 36),
- explain the modification of the airport traffic hypothesis (one of the key assumptions considered by the issuer) and the external sources used with further explanations on the expected impacts of environmental transition on the traffic, and
- explain how the modification of the airport traffic affects the growth rate (paragraph 134 (d) (iv) of IAS 36.134).

71. Finally, the enforcer also required the issuer to include a sensitivity analysis of the recoverable amounts to a reasonable variation of the assumptions used which were related to climate change (mainly airport traffic and annual growth rate) as required by paragraph 134 (f) of IAS 36 and outlined in paragraph 129 of IAS 1.

VIII. Decision ref EECS/0123-08 – Climate risk disclosures in financial statements

Financial year end: 31 December 2021
Category of issue: Climate risk disclosures, sources of estimation uncertainty
Standards of requirements involved: IAS 1 *Presentation of Financial Statements*.

Description of the issuer's accounting treatment

72. The issuer is an international shipping company operating in the transportation of refined oil products. The issuer operates a fleet of owned and leased vessels. The entire fleet is considered a single cash-generating unit. The fleet's recoverable amount is defined as the higher of its fair value less costs to sell and its value in use, which is the net present value of the cash flows from the vessels' remaining useful lives.

ESMA
European Securities and Markets Authority

73. In its non-financial statement included in the 2021 annual financial report, the issuer presented ‘Climate change related risks and opportunities’, including:

- future environmental regulations and directives,
- supply and demand disruptions for transported commodities, and
- re-routing risks.

74. In the note regarding accounting policies in the 2021 financial statements, the issuer stated that *“The carrying value of vessels may significantly differ from their market value. It is affected by the Management’s assessment of the remaining useful lives of the vessels, their residual value and indicators of impairment.*”

75. However, the issuer did not provide any further information in relation to climate-related matters in the notes to the financial statements.

76. Upon request, the issuer confirmed that it had considered climate-related risks in the 2021 financial statements and that the recoverable amount of the fleet was not significantly affected by climate-related matters.

The enforcement decision

77. The enforcer concluded that issuer’s disclosures in financial statements were not sufficient to meet the requirements of IAS 1 on significant accounting policies, judgements and sources of estimation uncertainty.

78. When assessing the materiality of the missing disclosures, the enforcer considered qualitative and quantitative factors such as (i) the materiality of the amount of tangible assets (and related depreciation) in the issuer’s financial statements, (ii) the issuer’s high exposure to climate change, and (iii) the lack of consistency and coherence between the risks disclosed in the non-financial section in the management report related to climate change and the information included in the financial statements. The enforcer concluded that the missing disclosures constituted a material departure from IFRS requirements.

Rationale for the enforcement decision

79. Based on the information presented in its non-financial statement, the issuer’s industry and the emphasis given by the issuer to climate risks, the enforcer concluded that climate risks were material to the issuer.

80. Furthermore, the enforcer accepted the explanations provided by the issuer regarding the useful lives of the vessels, as well as the judgements and assumptions used when carrying out impairment tests. Nevertheless, the enforcer was of the view that climate risks were a major source of estimation uncertainty. As such, the issuer should have

disclosed further information that would allow users of financial statements to understand the judgements made by management and the assumptions used.

81. In accordance with paragraph 122 of IAS 1, an entity shall disclose the judgements (apart from those involving estimations) that management has made in the process of applying the entity's accounting policies and that have the most significant effect on the amounts recognised in the financial statements.

82. In accordance with paragraph 125 of IAS 1, an entity shall disclose information about the assumptions it makes about the future, and other major sources of estimation uncertainty at the end of the reporting period that have a significant risk of resulting in a material adjustment to the carrying amounts of assets and liabilities within the next financial year.

83. Therefore, the enforcer required the issuer to include more information regarding climate-related risks in the notes to the financial statements. In particular, the issuer was required to disclose:

- the use of any climate-related factors as sources of estimation uncertainty or causes for significant judgements regarding the assets in the scope of IAS 16, and
- information as to whether (i) the issuer considered climate change when assessing whether the expected useful lives of non-current assets and (ii) their estimated residual values should be revised and why.

IX. Decision ref EECS/0123-09 – Credit risk disclosures for financial instruments

Financial year end: 31 December 2019
Category of issue: Credit risk, financial instruments disclosures
Standards of requirements involved: IFRS 7 *Financial Instruments: Disclosures*

Description of the issuer's accounting treatment

84. The issuer is a large banking group. When assessing the compliance of the issuer's disclosures on the nature and extent of credit risk arising from financial instruments in its consolidated financial statements with the requirements of IFRS 7, the enforcer made the following observations:

- The issuer did not provide detailed information on the incorporation of the forward-looking information (FLI) in the determination of expected credit losses (ECL). Moreover, the issuer did not disclose information about the different macroeconomic scenarios used.
- The issuer did not explain significant changes in the gross carrying amounts of financial instruments during the reporting period, nor did he link them to the changes in loss allowance disclosed in accordance with paragraph 35H of IFRS 7.

- The information provided by the issuer in relation to the significant increase in credit risk (SICR) was limited. In particular, the issuer did not disclose the quantitative criteria applied for the transfers from stage 1 to stage 2. This relates, in particular, to the significant restructured exposures at stage 2, for which, in accordance with paragraph 5.5.12 of IFRS 9 *Financial Instruments*, an assessment as to whether there was a SICR was required. In addition, the issuer did not provide details on the application of a probation period for transfers back exposures from stage 2 to stage 1 (such as an internal rating improvement).
- The quantitative information on ECL required by paragraph 35H of IFRS 7 could not be reconciled to the amounts in the statement of financial position. In addition, the enforcer noted that the contractual amounts outstanding disclosed in the notes to the financial statements were determined in accordance with regulatory requirements and differed from the exposures at default (EAD) used to calculate ECL in accordance with IFRS 9.
- The quantitative credit risk disclosures on insurance investments included intra-group transactions.

The enforcement decision

85. The enforcer concluded that issuer's disclosures about the nature and extent of credit risk arising from financial instruments including the issuer's credit management practices were not sufficient to meet the requirements of IFRS 7. When assessing the materiality of the missing disclosures, the enforcer considered the fact that the identified shortcomings were related to several aspects of the credit risk disclosures, and concluded that, taken together, they constituted a material departure from the IFRS requirements.

Rationale for the enforcement decision

86. The enforcer concluded that the disclosures prepared by the issuer were not sufficient to enable users to fully evaluate the nature and extent of credit risk arising from the issuer's financial instruments (paragraph 31 of IFRS 7).

87. The enforcer noted that paragraph 35G of IFRS 7 requires an explanation of the inputs, assumptions and estimation techniques used to apply the requirements in Section 5.5 of IFRS 9. In particular, with respect to FLI, an entity shall disclose how this information has been incorporated into the determination of ECL, including the use of macroeconomic information. The enforcer required the issuer to disclose FLI used into the determination of ECL and to provide additional explanations of the macroeconomic scenarios used.

88. To enable users of financial statements to understand the changes in the loss allowance disclosed in accordance with paragraph 35H, paragraph 35I of IFRS 7 requires an entity to provide an explanation of how significant changes in the gross carrying amount of financial instruments during the period contributed to changes in the loss allowance. The

enforcer considered that this requirement was not met by the issuer and disagreed with the issuer's reasoning that an entity may choose not to disclose this information.

89. Paragraph 35F of IFRS 7 requires entities to explain their credit risk management practices and how they relate to the recognition and measurement of ECL. In particular, an entity shall disclose how it determines whether the credit risk of financial instruments has increased significantly since initial recognition. The enforcer considered that additional information should have been provided on the SICR, such as quantitative criteria applied to stage transfers (transfer from stage 1 to stage 2, in particular for restructured exposures) as well as the existence of a probation period for transfers back from stage 2 to stage 1.

90. Paragraph 35B(b) of IFRS 7 requires consistency between credit risk disclosures and amounts presented on the statement of financial position and in the income statement when it states that the disclosures made in accordance with paragraphs 35F - 35N shall enable users of financial statements to understand the effect of credit risk on the amount, timing and uncertainty of future cash flows. To achieve this objective, quantitative and qualitative information shall be provided that allows users of financial statements to evaluate the amounts in the financial statements arising from ECL, including changes in the amount of ECL and the reasons for those changes. The enforcer considered that the issuer's disclosures did not comply with these requirements and required the issuer to reconcile the amounts in the notes to the financial statements with the amounts in the statement of financial position and the income statement. In addition, the enforcer required the issuer to provide explanations about significant changes in ECL during the reporting period, as prescribed by paragraph 35I.

91. Finally, with respect to the insurance investment figures that included intra-group exposures that were not consistent with other disclosures, the enforcer noted that inclusion of intra-group transactions was not compliant with the requirements of IFRS 10. The enforcer, therefore, required the issuer to correct the disclosed quantitative disclosures.

X. Decision ref EECS/0123-10 – Reclassification of financial assets

Financial year end: 31 December 2022
Category of issue: Classification of financial instruments, reclassification of financial assets, changes in business model for managing financial assets
Standards or requirements involved: IFRS 9 *Financial Instruments*

Description of the issuer's accounting treatment

92. The issuer, a bank, disclosed in its interim financial report for the first half of 2022 a change in business model for managing a sub-portfolio of private corporate bonds from "held to collect and sell" to "held to collect". The bonds, which were measured at fair value through other comprehensive income (FVOCI) up to the end of the first half of 2022, were

consequently reclassified into the amortised cost category on the first day of the following interim period (second half of 2022). Hence, the issuer removed material net losses from these bonds accumulated in OCI from equity and adjusted the fair value of the bonds on the reclassification date (paragraph 5.6.5 of IFRS 9).

93. The issuer gave two main reasons for changing the business model: (i) a change in its business structure and (ii) the need for stability of the available excess of capital. In 2021, the group disposed of a significant interest in a group insurance company, reducing its share in the company's capital and losing the control over the company. This meant ceasing a relevant group activity with recurring income from insurance policies.

94. In addition, the issuer made an irrevocable election to present in OCI subsequent changes in the fair value of the retained investment in the insurance company which created a higher risk of capital volatility. According to the issuer, the prudential regulator expressed its concern as to the need to keep the available excess of capital stable over time, especially after the disposal of the insurance business line. The issuer considered that there was a higher structural volatility in its remaining business activities, since it had become less diversified and with lower steady income.

95. The issuer explained that these circumstances as well as the legal and economic need to adapt to the new risk and income profile caused the change in the business model for managing a sub-portfolio of private corporate debt with a maturity of more than 3.5 years, held within a business model with the objective of both collecting contractual cash flows and selling financial assets. The decision to keep these instruments on the statement of financial position until their maturity with the aim of collecting the contractual cash flows was approved by the issuer's Assets and Liabilities Committee, which comprised the chairman and executive members of the Board of Directors and some of the issuer's senior management members. This was the first time that the issuer changed its business model for managing financial assets since IFRS 9 became effective.

The enforcement decision

96. The enforcer disagreed with the issuer and considered that the issuer's changes in the management of financial assets did not meet the requirements included in paragraph B4.4.1 of IFRS 9 and, therefore, the condition in paragraph 4.4.1 of IFRS 9 for reclassification was not fulfilled.

Rationale for the enforcement decision

97. The enforcer noted that, in accordance with paragraph B4.4.1 of IFRS 9, a change in the business model that results in a reclassification of financial assets is determined by the entity's senior management as a result of external or internal changes and must be significant to the entity's operations and demonstrable to external parties. Therefore, the

change in the business model for managing financial assets should be derived directly from external or internal changes and be significant to the operations of the issuer.

98. In this case, the change in the management of financial assets did not result directly from the disposal of the interest in the insurance subsidiary as there was no clear link between the sale of the insurance business and the new purpose of the reclassified assets that would require a change in portfolio management. Therefore, the enforcer considered that the issuer's change in the way it managed some financial assets was primarily driven by accounting regulatory capital considerations, as the underlying motivation was to counter the emerging OCI volatility and to address regulatory requirements. Both aspects are closely related to the measurement of the assets and not to an actual change in the issuer's operations.

99. The enforcer concluded that the financial assets identified by the issuer as being subject to the change in business model did not constitute a clearly distinguishable sub-portfolio affected by the disposal of the insurance company, but rather particular financial assets included in a broader portfolio for which a change of intention had occurred. In accordance with paragraph B.4.4.3(a) of IFRS 9 this did not qualify as a change in business model.

100. In addition to failing to meet the demonstrability criterion in paragraph B4.4.1 of IFRS 9, the enforcer observed that the issuer did not provide evidence as referred to in B4.1.2B of IFRS 9, such as changes in the internal evaluation and reporting system, or changes in the managers' remuneration policy.

XI. Decision ref EECS/0123-11 – Reclassification of financial assets

Financial year end: 31 December 2022
Category of issue: Classification of financial instruments, reclassification of financial assets, changes in business model for managing financial assets
Standards or requirements involved: IFRS 9 *Financial Instruments*

Description of the issuer's accounting treatment

101. The issuer is a banking group with several subsidiaries within and outside the EU. Historically, the issuer has managed its investments in bonds (mainly investment grade government bonds; the "treasury portfolio") on an opportunistic basis: seeking to enhance returns while providing liquidity when needed. As a result, the business model for the treasury portfolio was "held to collect and sell". In the past, this strategy resulted in significant and frequent sales.

102. After replacing almost all members of the management board in June 2021, the issuer, under the lead of new management, initiated a transformation programme to boost growth in certain focus areas and to quickly reduce other non-focus areas. The business transformation to these focus areas began as early as in 2015 and was accompanied by organisational changes to significantly reduce operational expenses. According to the

issuer, an effect of this transformation was that less liquidity was needed from the treasury portfolio.

103. A new treasury investment strategy was approved in a management board meeting in April 2022 and a supervisory board meeting in May 2022. According to the new strategy, the group intended to keep the bonds until maturity to generate interest income. As the EU group entities can cover any liquidity needs by conducting repurchase agreement (repo) transactions with the ECB without the need to sell bonds, the treasury portfolio for these group entities under the new strategy was held to collect cash flows from principal and interest. Additionally, some changes have been made to (i) the remuneration policy for the treasury managers, (ii) the limit structure in the risk management and (iii) internal reporting to reflect the changes in the business model and accounting. The issuer communicated some details of this new strategy during an external presentation of the bank's results for the Q1 2022 in May 2022.

104. With the new strategy, the issuer argued that the criteria for reclassifying the treasury portfolio of the EU entities from the business model "held to collect and sell" to the business model "held to collect" were met. Therefore, the issuer considered that it should account for the reclassification of the treasury portfolio of the EU entities on the first day of the first reporting period following the change in business model (1 July 2022).

105. The banking group had reported significant losses from the fair value changes of the treasury portfolio in OCI, driven mainly by the general market development in the first two quarters of 2022.

The enforcement decision

106. The enforcer disagreed with the issuer and considered that the issuer's changes in the management of financial assets did not meet the requirements of paragraph B4.4.1 of IFRS 9, in particular due to the lack of significance to the entity's operations and demonstrability to external parties, and therefore the reclassification condition in paragraph 4.4.1 of IFRS 9 was not fulfilled.

Rationale for the enforcement decision

107. The enforcer noted that paragraph B4.4.1 of IFRS 9 states that changes in the business model are expected to be very infrequent and establishes high hurdles for a change in the business model that leads to a reclassification of financial assets. Such a change, which is determined by the entity's senior management, must be significant to the entity's operations, demonstrable to external parties and is only possible if the entity begins or ceases to perform an activity that is significant to its operations (e.g., acquires, disposes or terminates a business line).

108. The enforcer also noted that a change in business model in accordance with paragraph B4.4.1 of IFRS 9 does not result from a mere reassessment of the business model using the criteria for the original classification set out in paragraphs B4.1.1 to B4.1.6 of IFRS 9 (although this could affect the classification of newly purchased financial assets).

109. The enforcer concluded that the changes referred to by the issuer are neither significant to the entity's operations, nor demonstrable to external parties. Although under the new treasury investment strategy the issuer intends to hold the bonds until maturity, the treasury portfolio will continue to be used to generate liquidity (i.e., direct sales of bonds will be replaced by repo transactions with the ECB). The objective of the portfolio remains the same: to generate liquidity when needed while managing the yield on the portfolio.

110. Assessing significance to an entity's operations is not merely a quantitative assessment of the volume of the affected portfolio or the related fair value changes, but it requires an assessment of the impact of a change to an entity's operations and business activities. For this reason, the standard requires that a new activity starts or a previous activity ceases that is significant to the entity's operations. The activity that should start or ceases refers to a fundamental change to the business of the entity, such as when a new line of business is started, or a previous existing line of business is ceased (see the examples mentioned in paragraph B4.4.1 of IFRS 9).

111. Consequently, the changes made by the issuer in relation to the treasury portfolio cannot be regarded as having a significant impact on the way the issuer's business is operated for the purposes of paragraph B4.4.1 of IFRS 9. The mere discontinuation (or commencement) of selling financial assets or the implementation of a change in an investment strategy cannot, in itself, be seen as the cessation (or beginning) of an activity that is significant to an entity's operations. The enforcer considered that the change in the way the treasury portfolio was managed by the issuer merely constituted a change in intention.

112. Finally, the enforcer considered that the criterion related to 'demonstrability to external parties' was also not fulfilled by the issuer. A mere communication of a change does not satisfy this criterion, as the change itself needs to be clearly visible to external parties.

XII. Decision ref EECS/0123-12 – Classification of SPAC warrants

Financial year end: 31 December 2021
Category of issue: SPAC, share-based payment transactions, classification of financial instruments
Standards or requirements involved: IAS 32 *Financial Instruments: Presentation,* IFRS 9 *Financial Instruments*

Description of the issuer's accounting treatment

113. The issuer resulted from a transaction in which a special purpose acquisition company (SPAC) "A" (listed company), acquired a target company "B" by issuing equity instruments to exchange for the shares owned by the shareholders of B. As company A is not a business and the transaction is not a business combination under IFRS 3, the issuer concluded that the transaction should be treated as a share-based payment transaction and accounted for in accordance with IFRS 2. The issuer, however, applied the guidance in IFRS 3 for reverse acquisitions by analogy in order to identify the acquirer. As such, given that the former shareholders of B controlled the combined entity (i.e., the issuer) after the transaction, the issuer identified company B as the accounting acquirer.

114. Prior to the transaction, two kinds of warrants were issued by company A: public warrants and founder warrants. The public warrants were issued with the public shares in the form of units, each consisting of one public share and a third of a public warrant at a price of 10.00 EUR per unit. Each public warrant entitles its holder to subscribe for one public share, with a stated exercise price of 11.50 EUR (subject to anti-dilution adjustments).

115. The public warrants could be exercised 30 days after the date of the completion of the business combination. They would expire five years from that date, or earlier upon redemption or liquidation. The issuer could have redeemed the public warrants upon at least 30 days' notice at a redemption price of 0.01 EUR if certain conditions relating to the development of the closing price of its public shares were met. At 31 December 2021, these conditions were not met.

116. The founder warrants had substantially the same terms as the public warrants, including the same stated exercise price, except that they could not be redeemed and could always be exercised on a cashless basis while held by SPAC founders. These were not listed on any stock exchange.

117. In its 2021 financial statements, the issuer accounted for the public and founder warrants as a share-based payment transaction in accordance with the requirements of IFRS 2, considering the warrants as part of the deemed issuance of financial instruments by company B for the acquisition of the net assets of company A.

118. As the redemption of the public warrants in cash would be at the discretion of the issuer, the warrant holders did not expect the entity to redeem the warrants in cash, and, as there was no history of cash settlements of these instruments, the issuer concluded that no liability to settle both types of warrants in cash and or other assets was incurred. Consequently, in accordance with paragraph 34 of IFRS 2, the transaction could be treated as an equity-settled share-based payment transaction. Applying paragraph 43 of IFRS 2, the issuer then concluded that the public warrants equity-settled share-based payment arrangement was included in the transferred consideration for the calculation of the IFRS 2 expense at the date of the merger.

ESMA
European Securities and Markets Authority

119. As the founder warrants cannot be redeemed in cash or other assets, they were classified by the issuer as equity instruments.

The enforcement decision

120. The enforcer required the issuer to change the accounting treatment of the public and founder warrants in its future consolidated financial statements and to classify and account for them based on the requirements of IAS 32, rather than IFRS 2. As a result, the warrants should be classified as financial liabilities because the “fixed-for-fixed” condition in paragraph 22 of IAS 32 was not met.

Rationale for the enforcement decision

121. The enforcer noted that, as at 31 December 2021, there was diversity in practice regarding the accounting treatment of warrants issued by SPACs, which was highlighted in particular by publications of several audit firms. Moreover, at its March 2022 meeting, the IFRS IC discussed some issues related to the classification of warrants where the fact pattern considered was similar to the situation faced by the issuer. The final agenda decision of the IFRS IC was published on 24 October 2022.

122. On the question of which accounting standard, IFRS 2 or IAS 32/IFRS 9, shall be applied to warrants, the IFRS IC stated that "in the fact pattern discussed, the SPAC’s founder shareholders and public investors are not SPAC employees, nor will they provide services to the entity after the acquisition. Instead, the SPAC's founder shareholders and public investors hold the warrants solely in their capacity as owners of the SPAC. Therefore, if the facts and circumstances are such that the entity assumes the SPAC warrants to be part of the acquisition, the entity applies IAS 32 to determine whether the warrants are financial liabilities or equity instruments".

123. As the holders of the public and founder warrants in the case under review were not SPAC employees and did not provide services to the issuer after the transaction, the enforcer concluded that the fact pattern was comparable to the case discussed by the IFRS IC. Given that the public and founder warrants were held by the same legal entity before and after the transaction, the accounting for the warrants shall not be affected by the transaction.

124. Therefore, the enforcer required the issuer to change the accounting treatment of the warrants in its future consolidated financial statements. As the number of equity instruments to be issued in exchange for warrants was not fixed and it was based on the difference between the share price and the exercise price, the “fixed-for-fixed” condition in paragraph 22 of IAS 32 was not met. Therefore, applying the requirements of IAS 32 rather than IFRS 2 to the public and founder warrants will result in the change in their classification from equity to liabilities.