ESMA
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Report

28th Extract from the FRWG (EECS)'s Database of Enforcement

Table of Contents

The decisions included in this report were taken by national enforcers in the period from June 2022 to July 2023. ESMA will continue to publish further extracts from the database on a regular basis.

List of abbreviations and acronyms used in this report

BC	Basis for Conclusions
CO_2	Carbon Dioxide
EEA	European Economic Area
FRWG (EECS)	Financial Reporting Working Group (European Enforcers Coordination Sessions)
ESMA	European Securities and Markets Authority
EBITDA	Earnings Before Interest Tax Depreciation and Amortisation
IAS	International Accounting Standards
IASB	International Accounting Standards Board
IFRS IC	IFRS Interpretations Committee
IFRS	International Financial Reporting Standards
LLC	Limited Liability Company
PPA	Power Purchase Agreement

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.

To fulfil these responsibilities, ESMA organises the Financial Reporting Working Group (European Enforcers Coordination Sessions) (FRWG (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, FRWG (EECS) constitutes the largest regional enforcers' network with supervision responsibilities for IFRS.

Through FRWG (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 to promote a consistent approach to the application of IFRS. In addition, FRWG (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 single way of dealing with situations which may seem similar but in substance are different.

Decisions taken by European 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 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 consistent application of IFRS in the EEA.

In accordance with the provisions of the ESMA Guidelines on Enforcement of Financial Information[1], 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, and
- The decision has been taken on the basis of a provision not covered by an accounting standard.

[1] ESMA32-50-218 Guidelines – On enforcement of financial information, 4 February 2020

I. Decision ref EECS/0124-01 – Earn-out payments related to business combinations

Financial year end: 31 December 2021
Category of issue: Business combinations; employee remuneration
Standards or requirements involved: IFRS 3 *Business Combinations*

Description of the issuer's accounting treatment

1. The issuer, a computer services company, acquired 100% of the shares of consulting company A, whereby approximately 25% of the total consideration for the acquisition was fixed and the remaining 75% was dependent on future financial results of the consulting company A (the contingent consideration). The share purchase agreement stipulated that, to receive the full payment related to the contingent consideration price, the vendors of consulting company A could not voluntarily leave employment with the consulting company A within three years starting from the date of acquisition (the earn-out period).

2. The issuer determined that the clauses in the share purchase agreement regarding the vendors' obligation to continue working for the consulting company A lacked economic substance because:

   a) the vendors would only forfeit the contingent consideration if they voluntarily left consulting company A or if dismissed due to gross misconduct or fraud (in any other cases of dismissal, the vendors retained the right to the earn-out),

   b) after the acquisition date, some of the vendors reached an agreement with the issuer to terminate their employment without losing their earn-out rights, and,

   c) the vendors did not sell any shares to the issuer as the issuer acquired the shares of consulting company A *via* a holding company (corporate wrapper), 100% owned by the vendors.

3. Finally, the issuer was of the view that all indicators set out in paragraphs B55(a)-(h) of IFRS 3 would need to be fulfilled.

4. As a result, the issuer considered the earn-out payments as part of the acquisition price.

The enforcement decision

5. The enforcer disagreed with the view that the clauses requiring the vendors to continue their employment with consulting company A lacked economic substance. Therefore, the enforcer required the issuer to account for the earn-out as remuneration for post-combination services in accordance with paragraph B55(a) of IFRS 3 and to exclude the earn-out from the acquisition price of consulting company A.

Rationale for the enforcement decision

6. The enforcer noted that, according to paragraph 52 (b) of IFRS 3, a transaction that remunerates employees or former owners of the acquiree for future services is likely to be a separate transaction. Furthermore, according to paragraph B55(a) of IFRS 3 (and taking into consideration the IFRS IC agenda decision from January 2013[2]), a contingent consideration arrangement in which payments to an employee are forfeited upon termination of employment is remuneration for post-combination services, and not part of the consideration for an acquisition.

7. In the opinion of the enforcer, ensuring that the full amount of an earn-out would be paid if the seller is dismissed from the acquired company without cause is a common protective right. Therefore, the enforcer concluded that the clauses regarding continuing employment had economic substance and were legally binding. If the issuer were to dismiss the vendors of consulting company A with cause or the vendors choose to leave voluntarily, then the vendors would not have the right to the full amount of the earn-out which demonstrated that it should be accounted for as remuneration and not as part of the acquisition price of the business combination.

8. Finally, the enforcer considered that the fact that consulting company A was acquired via a holding company (corporate wrapper) owned by the vendors did not change the economic substance of the transaction and thus it should not impact the accounting treatment followed.

II. Decision ref EECS/0124-02 – Classification of a put-option liability related to a business combination

Financial year end: 31 December 2021
Category of issue: Put options on minority shares; remuneration for post-combination services
Standards or requirements involved: IAS 32 *Financial Instruments: Presentation*; IFRS 3 *Business Combinations*

Description of the issuer's accounting treatment

9. The issuer, a home building and renovation company, acquired 51% of a smaller group A in the same industry towards the end of 2021. The acquisition was a business combination within the scope of IFRS 3. Two previous founders, who retained a 49% (noncontrolling) interest in group A, became employees of the new group.

10. As part of the business combination, the two minority shareholders received put options allowing them to sell their remaining shares to the issuer. The option for the first 29% of

[2] January 2013 IFRIC Update

the shares would become exercisable in 2024, and the other 20% would become exercisable at the earlier of the end of 2024 or when the original founders left the employment of the issuer. The exercise price included a discount in case the vendors left group A.

11. In accordance with paragraph 23 of IAS 32, the issuer recognised a financial liability for the put options granted and measured it at recognition date, taking into account the full exercise price of options (e.g. without considering the discount).

The enforcement decision

12. The enforcer did not agree with the accounting treatment of the issuer and required the issuer to account for:

    a) a financial liability corresponding to the estimated exercise price of the put options reduced by the discount (i.e. the price that would be paid if the vendors left the company), and,

    b) the remaining contingent payment as a remuneration expense (employee benefit) over time, on a pro rata basis, considering the guidance in paragraph B55(a) of IFRS 3.

Rationale for the enforcement decision

13. Paragraph 23 of IAS 32 generally requires the recognition of a financial liability when an entity has an obligation to pay cash in the future to purchase the minority's shares, even if the payment of that cash is conditional on the option being exercised by the holder. However, the enforcer disagreed that the full amount of payment to minority shareholders (exercise price of options) should be attributed to the minority shares to be acquired by issuer. The enforcer noted that part of this payment would only be due if the original founders did not leave the employment of group A. Therefore, the enforcer concluded that part of the amount should be considered as remuneration of the original founders for their services after the acquisition of group A and should not be part of the consideration for the minority shares.

14. The enforcer noted that IFRS 3 includes specific guidance on whether an arrangement for payments to employees or selling shareholders is part of the consideration exchange for the acquiree or is a separate transaction from the business combination. Specifically, paragraph B55(a) of IFRS 3 states that a contingent consideration arrangement in which the payments are automatically forfeited if employment terminates is remuneration for post-combination services.

15. In the enforcer's view, the guidance in paragraph B55(a) of IFRS 3 should be applied in this case given the similarities of the discount applied in these transactions and a remuneration for future services. In particular, the discount to the exercise price of the put option should be treated in the same way as the payment that is automatically forfeited on

termination of employment referred to in paragraph B55(a). A financial liability in accordance with paragraph 23 of IAS 32 should be measured taking into account the estimated exercise price of the put options reduced by discount related to the remuneration for post business combination services.

III. Decision ref EECS/0124-03 – Recognition and measurement of distribution rights

Financial year end: 31 December 2021
Category of issue: Intangible assets
Standards or requirements involved: IAS 38 *Intangible Assets*

Description of the issuer's accounting treatment

16. The issuer, a telecommunication services company, entered a five-year contract to acquire the non-exclusive rights to broadcast specific sports channels owned and developed by a supplier. The contract comprised distribution rights, whereby the issuer had the right and the obligation to display the channels, but no right to edit or to re-sell the material. The distribution fee paid by the issuer comprised, *inter alia*, a fixed fee per season, payable in two instalments (70% on or before August of each relevant season and 30% on or before January of each relevant season).

17. The issuer accounted for this contract as follows. In August of each year covered by the contract, the issuer:

    a) recognised the total amount of the fixed fee for one season at the time of the first payment and presented it as a non-current intangible asset. This intangible asset was subsequently amortised over the duration of the season and presented in the statement of profit or loss in the line-item *Depreciation and amortisation*. The expense had therefore no impact on EBITDA (an important performance indicator in the industry).

    b) recognised and presented the amount to be paid in January (30% instalment) as a liability.

18. According to the issuer, this accounting treatment was appropriate because the amount recognised as a non-current intangible asset related to a "right and an obligation to display content"; however, the issuer had no right to modify the material. Furthermore, the issuer was of the view that the distribution rights should only be recognised when sufficient details about the sporting events were known, which occurred at the beginning of each sports' season. The issuer noted that only at that point, it would know (i) the exact the number of sport matches, (ii) when and where the sport matches would take place, and (iii) which teams would compete.

The enforcement decision

19. In light of the underlying rights and obligations defined in the contract, the enforcer agreed with the recognition of an intangible asset representing the distribution rights related to the sporting events. However, the enforcer considered that the issuer should have recognised a five-year distribution right as an intangible asset and a liability for the remaining five-year payments. Consequently, the issuer was requested to account for these changes retrospectively.

Rationale for the enforcement decision

20. The enforcer concluded that the nature of the underlying resource controlled by the entity, as outlined under paragraph 13 of IAS 38, was essential to determining the correct accounting treatment. The enforcer observed that in similar fact patterns two different views are held in practice:

    a) the underlying resource is the related intellectual property, whereby the producer owns and controls the intellectual property, and the distributor does not. Therefore, a distributor adopting this view does not recognise the intangible asset and there is an executory contract for each season, and,

    b) the underlying resource is the right to broadcast within the remit of the contract, whereby control over distribution over the contract period leads to the recognition of an intangible asset. The identifiability of the intangible asset arises from contractual rights, according to paragraph 12(b) of IAS 38.

21. In light of the provisions included in the contract, the enforcer considered the accounting treatment based on view b) above was acceptable given that (i) the issuer had a right to display the channels within the remit of the contract, and (ii) other market participants were restricted from controlling the benefits of the distribution rights, because competitors would have had to pay a similar price to acquire the right. Therefore, the enforcer agreed with the issuer's conclusion that the distribution rights fulfilled the criteria set out in paragraph 12(b) and 13 of IAS 38. However, the enforcer noted that, given that the distribution rights arose from contractual rights, the identifiability of this intangible asset was not dependent on details regarding the sporting events (which were set-up at the beginning of each season).

22. Consequently, the accounting treatment followed by the issuer in its 2021 financial statements was not in line with this approach because the issuer had not recognised the full five-year distribution rights in the year they were acquired, along with a corresponding liability for all remaining contractual payments.

IV. Decision ref EECS/0124-04 – Loss of control

Financial year end: 31 December 2017
Category of issue: Control
Standards or requirements involved: IFRS 10 *Consolidated Financial Statements*

Description of the issuer's accounting treatment

23. The issuer, a global industrial company, established a 100%-owned and consolidated subsidiary (company A) whose purpose was to construct and lease out a building to a government body. In November 2017, the issuer signed a contract (with an effective date of April 2018) to sell around 60% of the shares of company A to an external party (the acquirer). The risks and rewards in company A were transferred to the acquirer after the completion of the building construction (construction phase), at which point the lease began (leasing phase).

24. Several contracts were signed between company A and the issuer relating to the construction phase, which stipulated, *inter alia*, that the issuer was responsible for the finalisation of the construction of the building. Although the price for the construction was fixed, the issuer would incur monetary penalties if the construction was not completed as scheduled. Additionally, another contract provided that any profits and all obligations of company A during the construction phase were due to, and assumed by, the issuer.

25. The building construction was completed by the end of 2018, approximately a year after the issuer entered the contracts with the acquirer.

26. Although the issuer was the sole shareholder of company A at the reporting date, the issuer deconsolidated company A from its consolidated financial statements as of 31 December 2017 and recognised a material gain. The issuer deemed that it had lost control over company A in 2017 because it no longer had substantive voting rights and power over the relevant activities of company A given the sales contract dated November 2017 and the requirement for the acquirer's approval. In the issuer's view, the relevant activities were the construction and subsequent leasing of the building, as well as the financing of the construction activities.

27. According to the sales contract, the acquirers were granted the right to approve material future business transactions and activities (e.g., appointment of the general manager, setting of shareholders' resolutions). The issuer could only undertake major investments, financing and personnel decisions in consultation with the acquirers. However, the acquirers were not able to establish new strategies or business models. The sales contract did not significantly impact the construction contract signed between the issuer and company A.

28. The issuer considered that its power to direct the relevant activities was limited because it could no longer take certain decisions without the consent of the acquirers.

The enforcement decision

29. The enforcer was of the view that, as of the reporting date, the issuer did not lose control over company A upon signing the sales contract. Therefore, the issuer should not have deconsolidated company A, nor should the issuer have recognised the gain from deconsolidation in 2017. Due to the deconsolidation of company A, the issuer did not comply with paragraph 6 *et seq.* of IFRS 10.

Rationale for the enforcement decision

30. The issuer established and structured company A with the sole business purpose of constructing and then leasing a building to a government body. The issuer was the sole shareholder and manager of the project company until the effective date of the sales contract. Company A was legally and economically integrated in the issuer's group through business relationships based on the several contractual agreements (e.g., cash-pooling agreements).

31. In the period between signing and the effective date of the sales contract, company A served the prime business interest of the issuer. The relevant activities of the company A in the construction phase were related to the construction of the building. The issuer directed the relevant activities in the construction phase and, therefore, in accordance with paragraph B13 of IFRS 10, the issuer had to consolidate company A until the construction had been completed. Given the limited scope of company A's business purpose, it was not relevant that the issuer could not unilaterally engage in other business combinations or undertake major investments.

32. The rights granted to the acquirer were in substance protective rights as outlined in paragraphs 14, B9 and B26 – B28 of IFRS 10. Their rights ensured that the construction agreement, which the issuer must fulfil, were not altered in the period between signing the contract and completion of the construction.

33. The multiple contractual agreements signed between the parties ensured that the issuer had the ability to use its power to influence company A's returns, and thus, the enforcer concluded that, during the construction phase, the issuer controlled company A as set out in paragraph 6 of IFRS 10.

34. The issuer was exposed and had rights to variable returns from its involvement with company A. Notably, until the completion of building, the issuer had the right to assume any profits generated and the obligation to assume any losses incurred arising from company A. Moreover, although the sales price of the building was fixed, the issuer would need to pay a monthly penalty in case of delays beyond the delivery date. Thus, the issuer was subject to variable returns.

V. Decision ref EECS/0124-05 – Assessment of control

Financial year end: 31 December 2017
Category of issue: Control; Joint ventures
Standards or requirements involved: IFRS 10 *Consolidated Financial Statements*; IFRS 11 *Joint Arrangements*

Description of the issuer's accounting treatment

35. The issuer, a global industrial company, held a 45% interest in a construction company (company A) located in a Middle Eastern country in the legal form of a Limited Liability Company (LLC). Prior to 2016, company A's management board consisted of three members, each one representing company A's shareholders (the issuer, shareholder B and shareholder C).

36. In 2016, shareholder C withdrew and sold its interest in company A to shareholder B, a citizen of the country where the company was located. At the same date, the issuer took over shareholder C's loans to company A and assumed guarantees and similar obligations provided to company A's creditors (banks) and customers (as guarantor). Therefore, the issuer took over all substantial risks relating to company A.

37. After these transactions:

    a) shareholder B held a 55% interest in company A (under local law, a national of the country in which the company was located must own at least 51% of the shares of a mainland LLC entity),

    b) the issuer received a purchase option for all of shareholder B's shares, and,

    c) the number of the management board members held by the issuer was increased from one to two (out of three board members).

38. In addition, according to company A's memorandum of association: (i) resolutions of the management board required a majority vote of the present board members, (ii) resolutions on "board reserved matters", which included, in particular, the adoption of the annual business plan, the approval of transactions outside the business plan and the appointment or the dismissal of the managing director responsible for the day-to-day management, required the approval of the board members designated by both shareholders), and (iii) the managing director to be appointed by the board was proposed by the issuer. In case of a deadlock situation with respect to resolutions of "board reserved matters", the matter was to be referred to an independent arbitration board.

39. The purchase option price was based on a contractually specified calculation using a multiple of EBITDA. The purchase option could be exercised at any time. Once exercised, the shares would have to be transferred to the issuer within 45 days.

40. In light of the above changes, the issuer concluded that it did not control company A because:

a) an approval of the board member of shareholder B was required for the "board reserved matters", which covered the relevant activities listed in paragraph B12 of IFRS 10,

b) the purchase option did not result in a substantive right, as the selling shareholder had 45 days to transfer the shares if the option was exercised, and,

c) given the existing share transfer restrictions imposed by local law, the issuer could not hold more than 49% of the voting rights.

41. Instead, the issuer considered that, together with shareholder B, it had joint control over company A and, thus, it accounted for its interest in company A as a joint venture under IFRS 11 *Joint Arrangements* by using the equity method.

The enforcement decision

42. The enforcer was of the view that the issuer's accounting treatment did not comply with paragraphs 6, 8, B13, B19, B24, B47 and B65 of IFRS 10. The issuer had control over company A since 2016 and, thus, had to fully consolidate the company in its financial statements.

Rationale for the enforcement decision

43. The enforcer agreed with the issuer that the approval of the annual business plan was the decision that directed the most relevant activities of company A and consequently its variable returns as set out in paragraphs B12 of IFRS 10.

44. However, while the enforcer agreed that decisions regarding the approval of the annual business plan required an agreement of both shareholders (i.e., by their respective management board members), it was also of the view that other rights and risks should be considered when assessing control over company A. The enforcer especially considered the favourable purchase option over shareholder B's shares and the asymmetric risk position resulting from the shareholder loans and guarantees. In particular, by exercising the purchase option, the issuer had the ability to resolve a deadlock situation relating to the "board reserved matters". Therefore, joint control did not exist.

45. Further regarding the application of IFRS 10, despite the 45 days that were required to transfer the shares, shareholder B would not be able to change the existing relevant policies of the company A before the shares were transferred to the issuer. The enforcer referred to examples 3B and 3D in paragraph B24 of IFRS 10.

46. The enforcer was of the view that the purchase option was substantive. According to paragraph B47 of IFRS 10, potential voting rights are considered only if the rights are substantive rights. Based on the terms and conditions of the purchase option, the option

was substantive because (i) the purchase option could be exercised if needed, (ii) no exercise restrictions existed and (iii) exercising the option was beneficial for the issuer to resolve any deadlock situation.

47. Furthermore, the enforcer noted that the transfer restrictions in local law did not entail that the purchase option lacked economic substance because the issuer continued to have the ability to replace shareholder B. It would be possible to agree between the issuer and a new shareholder (a national citizen or another company of the country in which the company is located) that, with exception of protective rights (e.g., liquidation of the company), all significant management decisions would be made by the issuer. In this respect, paragraph B65 of IFRS 10 was also relevant because it indicates that if the removal right is held by only one party, that party has control as a principal.

48. Finally, to reinforce its view, the enforcer also highlighted the following indicators that the issuer had more than just a passive interest in the investee, which, in combination with other rights, may indicate power:

    a) the issuer had the right to nominate two of three board directors including the managing director of company A, responsible for the execution of the business plan and the day-to-day operations was always selected and proposed by the issuer,

    b) company A's operations depended largely on the issuer financing arrangements, and the issuer guaranteed a significant portion of company A´s obligations (paragraph B19(b)(i)(ii) of IFRS 10), and

    c) the issuer's risk exposure was disproportionately greater than its voting rights as the issuer bore substantially all the risks through guarantees and loans (paragraph B19(d) of IFRS 10).

49. According to paragraphs B19 and B20 of IFRS 10, the greater the exposure to risks is with one investor, the more this indicates that power is with that investor.

VI. Decision ref EECS/0124-06 – Principal vs. agent

Financial year end: 31 December 2018
Category of issue: Principal vs. agent; recognition of revenue from resale of third-party licences
Standards or requirements involved: IFRS 15 *Revenue from Contracts with Customers*

Description of the issuer's accounting treatment

50. The issuer is an IT provider offering a wide spectrum of products and services, including the sale of standard software licences. When selling software licences, the issuer acted as an authorised sales partner of software developers. Under the agreement between the software developer and the issuer (Partner Agreement), the issuer was granted a non-

exclusive right to resell software licenses to customers. The agreement required the issuer to provide pre-sale advisory services to ensure that customers received a suitable software solution and purchased a sufficient number of licences.

51. After receiving a purchase commitment from the customer, the issuer submitted orders for software licences to the software developer, which the latter could accept or reject. According to the issuer, the issuer had complete discretion to negotiate prices for the software with customers (except for some special discounts for particular customers that must be passed through). The issuer's payment to the software developer was not contingent on the receipt of payments from customers.

52. In the software licensing agreement (Software Agreement) between the software developer and the end customer, the software developer granted the customer the right to use the software and assured the functionality of the software. Following the pre-sale advisory service, an offer for a certain number of software licences and the acceptance of the offer by the customer, a sales contract would be concluded between the issuer and the customer. The pre-sale advisory service did not create an obligation for the customer to purchase the software licence.

53. The issuer considered that the specified goods or services provided to the customer (paragraph B34A(a) of IFRS 15) were a bundle consisting of the software licence and the pre-sale advice. In the issuer's view, the customer could only benefit from the combination of the licence and the pre-sale advice. Moreover, the issuer pointed out that (i) the software licence could not be acquired without the pre-sale advisory service, (ii) the issuer provided a significant service of integrating the software licence with the consultation into a combined output "suitable software solution" and (iii) the software licence and the pre-sale advisory service were highly interdependent and interrelated.

54. The issuer concluded that it controlled the specified goods or services provided to the customer before they were transferred to the customer (paragraphs B34A(b) and B35A(c) of IFRS 15). As a result, the issuer considered itself the principal (paragraph B35 of IFRS 15) and recognised revenue on a gross basis (paragraph B35B of IFRS 15).

The enforcement decision

55. The enforcer did not agree with the issuer's accounting treatment and concluded that (i) pre-sale advisory services and software licences were two distinct goods or services and (ii) with regards to the software licences, the issuer acted as an agent of the software developer. The recognition of revenue on a gross basis was, therefore, not consistent with requirements of paragraph B36 of IFRS 15.

Rationale for the enforcement decision

56. With respect to the identification of the specified goods or services to be provided to the customer, the enforcer noted that:

a) the customer did not have a contract for advisory services with the issuer and the pre-sale advisory service was performed before the customer decided whether to buy the software licence,

b) the provision of the pre-sale advisory service required in the Partner Agreement ensured that the customer purchased a sufficient number of licences, which also represented the interests of the software developer,

c) the pre-sale advisory service was not a significant service of integration because it did not alter the software licences in any way, and,

d) the inability of certain customers to purchase the software licence without the involvement of an authorised partner was a sales decision of the software developer and not evidence for the indivisibility of the bundle.

57. As a result, the enforcer considered the software licence to be a distinct good provided to the customer.

58. As to whether the issuer controlled the software licences before they were transferred to the customers, the enforcer noted that:

a) the software developer was primarily responsible for fulfilling the promise, as it provided access to the software and assured its functionality (paragraph B37(a) of IFRS 15),

b) the issuer had only insignificant inventory risk (paragraph B37(b) of IFRS 15),

c) the issuer's discretion in establishing prices was very limited given that specific discounts granted by the software developer had to be passed through to the customers and customers could choose alternative software vendors if the software was excessively priced and (paragraph B37(c) of IFRS 15), and,

d) the right to use the software arose only at the time when it was granted to the customer (by the Software Agreement); thus, the issuer did not have the ability to direct its use or to obtain substantially all of its remaining benefits (Example 48 in paragraph IE247B of IFRS 15 Illustrated Examples).

59. According to a comparable IFRS IC agenda decision[3], at the time of entering the contract with the customer (after the reseller has provided the advice), there was no valid expectation of the customer that the reseller would transfer a good or service to the customer other than the standard software licences. Therefore, IFRS IC observed that, in the submitted fact pattern, the promised goods in the reseller's contract with the customer were the standard software licences. Because the standard software licences were the

[3] IFRS IFRIC Update April 2022.

only promised goods in the contract with the customer, they were distinct goods to be provided to the customer.

60. Regarding the assessment of whether the reseller controls the standard software licences before they are transferred to the customer, the IFRS IC observed that while the software developer was responsible for fulfilling the promise to provide the licences to the customer in respect to software's functionality, as well as for issuing and activating the licences, the reseller was responsible for unaccepted licences. The IFRS IC also noted that the reseller had no inventory risk before the licences were provided to the customer but then had inventory risk until the customer accepted the licences. Lastly, it was mentioned that pricing discretion, depending on the specificities of the market, may be less relevant to the assessment of control.

61. Based on the arguments presented in paragraphs 56-58 above and taking into consideration the observations included in the IFRS IC's agenda decision, the enforcer concluded that the issuer acted as an agent for the sale of software licences.

VII. Decision ref EECS/0124-07 – Own-use exemption

Financial year end: 31 December 2022
Category of issue: Power purchase agreements, own-use exemption
Standards or requirements involved: IFRS 9 *Financial Instruments;* IFRS 16 *Leases*

Description of the issuer's accounting treatment

62. In its 2022 financial statements, the issuer, a supplier of natural gas, technologies and services in the Industry and Health industry, disclosed that it had signed up several renewable energy (wind and solar) supply contracts (power purchase agreements, or PPAs) in order to support its production and activities in several countries where it operates. As of 31 December 2022, the PPA commitments were material.

63. The issuer referred to these contracts not only in its financial statements, but also in its management report when providing information regarding its strategy and actions to reduce Scope 2 carbon dioxide (CO_2) emissions and to limit environmental transition risk.

64. In its financial statements the issuer disclosed:

a) the accounting treatment of the contracts, stating that the 'own-use' exemption set out in paragraph 2.4 of IFRS 9 was applied to these contracts, and

b) the main characteristics of the contracts, such as:

i. the number of PPAs signed, country of application and year of start,

ii. whether the contracted prices are fixed or indexed, and

iii. the volume of purchase commitments. In this respect the issuer disclosed that the energy volume contracted was fixed (i.e., the issuer could not purchase more or less energy from the supplier than the volume specified in the contracts).

The enforcement decision

65. The enforcer accepted the accounting treatment followed by the issuer. In light of the characteristics of the contract, the enforcer concurred that the issuer should account for these contracts applying the 'own-use' scope exemption under paragraph 2.4 of IFRS 9.

Rationale for the enforcement decision

66. When assessing the issuer's accounting treatment of the PPAs, the enforcer took into account the following:

a) The issuer did not control the energy supplier or did not have joint control of it with other parties because:

i. none of the PPAs were included under structured entities or corporate wrappers,

ii. the issuer was not a shareholder of any of the suppliers, it did not have any rights to variable returns, and it did not have the ability to affect the returns of the suppliers as set out by paragraph 6 of IFRS 10,

iii. there were no contractual arrangements between the issuer and suppliers as set out in paragraphs 5(b) and B2-B4 of IFRS 11.

b) The PPAs were not linked to specific assets and the issuer only purchased a small portion of the electricity produced by the supplier. Therefore, the PPAs did not fall within the definition of a lease as set out in paragraphs 9 and B20 of IFRS 16.

c) The volume of electricity contracted and provided to the issuer through the PPAs was significantly lower than the issuer's energy consumption. As such, the issuer always consumed all the energy provided through the PPAs (i.e., the issuer never resold any portion of the energy not used and did not plan to do so in the future). Moreover, the contractual terms of PPAs did not allow net settlement, nor did a past practice of net settlement exist.

67. On the basis of the above, enforcer concurred with the issuer that the PPAs analysed were not within the scope of IFRS 9 in light of paragraph 2.4 of IFRS 9 as they were entered into and continued to be held for the purpose of the receipt or delivery of non-financial items in accordance with the issuer's expected usage requirements.

68. Finally, the enforcer noted that issuer's PPA commitments differed significantly from the contracts capable of being settled net in cash that were analysed by the IFRS IC and

referred to in its June 2023 agenda decision on “Application of the ‘Own Use’ Exception in the Light of Current Market and Geopolitical Questions”.[4]

VIII. Decision ref EECS/0124-08 – Hedge accounting disclosures

Financial year end: 31 December 2021
Category of issue: Hedge accounting disclosures, cash flow hedges
Standards or requirements involved: IFRS 7 *Financial Instruments: Disclosures*

Description of the issuer’s accounting treatment

69. The issuer, a travel and transportation company, hedged a highly probable future issuance of a fixed interest rate bond (expected within six months after the annual reporting date) with forward-start interest rate swap derivatives. The nominal amount of the derivative contracts designated under the cash flow hedge accounting relationship according to paragraph 6.5.2(b) of IFRS 9 comprised approximately 80% of the nominal amount of all the issuer’s interest rate derivatives.

70. In its financial statements, the issuer disclosed that its loans were floating-rate loans with reference rates of 3–6 months Euribor rates. The issuer further disclosed that it used interest rate swaps to reduce the interest rate risk related to payments on floating-rate loan agreements by changing floating interest rates into fixed interest rates. For some of these contracts, the issuer applied hedge accounting.

71. In addition, the issuer briefly mentioned that, to hedge the interest rate risk arising from the highly probable future loan arrangements it had entered into, forward-start interest rate swap contracts for which hedge accounting were applied. No further quantitative or qualitative information was specifically disclosed for these hedge relationships.

72. The issuer also included in the notes a general statement noting that, in cash flow hedges used, the most significant terms and conditions of the hedged items and hedging instruments coincided and the hedge ratio 1:1 was applied for hedged items.

The enforcement decision

73. The enforcer required the issuer to improve its disclosures regarding cash flow hedges to enable users of its financial statements to understand the nature and extent of risks arising from financial instruments.

Rationale for the enforcement decision

74. According to paragraph 21A(a) of IFRS 7, an entity must provide information about an entity’s risk management strategy and how it is applied to manage risk. Under paragraph

[4] IFRS IC June Update

22A of IFRS 7, an entity shall explain its risk management strategy for each risk category of risk exposures that it decides to hedge, and for which hedge accounting is applied.

75. According to the information received by the enforcer, the issuer's hedging strategy was to enter into forward-start interest rate derivatives, where the issuer would pay fixed interest and receive variable interest from the date of the bond issuance onwards. The purpose was to hedge the change of the fixed interest rate between the trade date of the derivative contracts and the issuance of the bond. The derivatives were planned to be voluntarily terminated at the issuance of the bond and the market value of the terminated hedging derivative was to be amortised over the expected life of the bond.

76. However, when looking at the disclosures provided in the notes, the enforcer noted that:

   a) the issuer had not explained the nature of the hedged risk (the change of a fixed interest rate between the trade date of the derivatives and the issuance of the bond) as it had not specified that the hedged bond issuance had a fixed interest rate (in contrast to all other hedged liabilities of the issuer and differently to the hedging strategy explained in the notes), and,

   b) the issuer had disclosed that it had used a hedge ratio of 100%, whereas according to the issuer's hedge documentation only 50% of the highly probable future bond issuance were hedged.

77. With regards to paragraph 21A(b) of IFRS 7, the enforcer was of the view that the issuer had not given sufficient information to understand the effect that the entity's hedging activities may have on the amount, timing, and uncertainty of its future cash flows. Furthermore, according to the paragraph 22B(a) of IFRS 7, an entity should describe the hedging instruments that are used (and how they are used) to hedge risk exposures. In accordance with paragraph 22A(c) of IFRS 7, an entity should provide information that enables users of financial statements to evaluate the extent of risk exposures that the entity manages. The enforcer considered that users of the issuer's financial statements would be unable to evaluate the extent of risk exposures that the issuer manages, because the all hedge accounting derivatives were aggregated in the maturity analysis and the nominal amounts of the hedged items and the hedging derivatives regarding the future bond issuance were not disclosed.

78. Finally, according to the requirements in paragraph 22B of IFRS 7, an entity should describe, *inter alia*, how the entity determines the economic relationship between the hedged item and the hedging instrument for the purpose of assessing hedge effectiveness, and how the entity establishes the hedge ratio and what the sources of hedge ineffectiveness are. Although the issuer had documented this information with regards to its hedge of the future bond issuance internally, no disclosures were provided. For example, the issuer had documented but not included the following sources of ineffectiveness:

a) the nominal amount of the derivatives could exceed the nominal amount of the future bond issuance,

b) the average duration of the derivatives could exceed the duration of the future bond issuance, and,

c) the issuance of the bond may not realise in the nominal amount or in the time frame as planned.

IX. Decision ref EECS/0124-09 – Disclosures related to leases

Financial year end: 31 December 2021
Category of issue: Lessees' disclosures, right-of-use asset, total cash outflow for leases
Standards or requirements involved: IFRS 16 *Leases*

Description of the issuer's accounting treatment

79. As of 31 December 2021, the issuer, an IT and management consulting company, recognised in its statement of financial position right-of-use assets related to office premises and vehicles which representing more than 10% of the total assets.

80. In 2021, the issuer signed a new lease agreement related to the new office premises and sold the former headquarters. The new lease agreement represented more than 90% of the right-of-use assets recognised in the statement of financial position.

81. The issuer's 2021 financial statements did not include any information regarding the additions to right-of-use assets (as required by paragraph 53(h) of IFRS 16) or the total cash outflow for leases (as required by paragraph 53(g) of IFRS 16) because the issuer did not consider this information to be material to users of the financial statements.

82. In particular, the issuer was of the view that the specific disclosure required by paragraphs 53 (g) and (h) of IFRS 16 were not necessary because users of financial statements had information regarding:

a) the depreciation charge for right-of-use assets in the reporting period (the amount was disclosed in the cash flow statement)[5],

b) the interest expense on lease liability,

c) low value leases.

[5] Using the indirect method in accordance with paragraph 18 (b) of IAS 7.

83. The issuer was of the view that the information above indirectly provided the user with a reasonable picture of the cash outflow for the leases as well as the additions to right-of-use assets of the year.

The enforcement decision

84. Given that both the additions to right-of-use assets and the total cash outflow for the lease agreements were material amounts, the enforcer requested the issuer to provide the disclosures required by paragraphs 53(h) and (g) of IFRS 16.

Rationale for the enforcement decision

85. Paragraph 51 of IFRS 16 states that the objective of the disclosures for lessees is to provide information in the notes that, together with the information provided in the statement of financial position, statement of profit or loss and statement of cash flows, gives a basis for users of financial statements to assess the effect that leases have on the financial position, financial performance and cash flows of the lessee.

86. According to paragraphs 53(g) and (h) of IFRS 16, a lessee shall disclose the total cash outflow for leases and additions to right-of-use assets for the reporting period to meet this objective.

87. The enforcer did not agree with the issuer that this information could be understood from the information already provided in the financial statements, either directly or indirectly. By not disclosing both amounts, the issuer did not provide any information that would enable users to compare investments in leased and owned assets (paragraph BC217(e) of IFRS 16 Basis for Conclusions (BC)) nor useful information about lease cash outflows that users of financial statements would need in order to forecast future lease payments (paragraph BC217(d) of IFRS 16 BC).