



European Securities and
Markets Authority

Report

19th Extract from the EECS's Database of Enforcement



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

List of abbreviations and acronyms used in this report

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

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

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

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

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

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

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

- The decision refers to a complex accounting issue or an issue that could lead to different applications of IFRS;
 - The decision relates to a relatively widespread issue among issuers or within a certain type of business and, thereby, may be of interest to other enforcers or third parties;
 - The decision addresses an issue on which there is no experience or on which enforcers have inconsistent experiences;
 - The decision has been taken on the basis of a provision not covered by an accounting standard.
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I. Decision ref EECS/0116-01 – Inflation-related index derivative embedded in a host lease contract

Financial year end: 31 December 2014

Category of issue: Embedded derivative in a host lease contract; inflation-related index; leveraged lease

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

Description of the issuer's accounting treatment

1. The entity has entered into several multi-year operating leases of buildings in a Member State of the Eurozone, with rental payments denominated in Euro. The contract contained the following specifications regarding the adjustment of the rent:
 - During the first 8 years, the increase in rents is determined by multiplying the change in the Harmonized Index of Consumer Prices (HIPC - a measure of consumer price inflation in the Eurozone) by a factor of 1.85. However, there was a floor to the increase of rents for the first three years of 2.5% (the estimated HIPC at inception of the lease, which was known to the parties, was -0.3%). This floor expired in 2012.
 - From year 9 until the end of the lease term, the increase in rent will be determined by multiplying the HIPC with a factor of 1.5.
2. The issuer considered that the rent adjustment represented an embedded derivative, however, in the issuer's opinion, it was closely related to the host contract and therefore no separation of the embedded derivative was required. According to paragraph AG33(f) of IAS 39, an embedded derivative in a host lease contract is closely related to the host contract if the embedded derivative is an inflation-related index, provided that the index relates to the inflation in the entity's own economic environment and the lease is not leveraged.
3. As the buildings are located in a Eurozone country with an inflation rate that highly correlates with the development of the Eurozone's overall inflation rate and as all payments are made in Euro, the issuer was of the opinion that the index relates to the inflation in the entity's own economic environment.
4. Regarding lease leverage, the issuer noted that although the term "leverage" appears in several examples in paragraph AG33 of IAS 39, the standard does not define this term. The issuer further considered that no guidance is given in IFRS as to whether there is a threshold by which the changes in the rent can exceed the change in the underlying without the lease contract being considered leveraged. The issuer believed that paragraph AG33(a) of IAS 39 could be applied by analogy to determine whether there is such a threshold. Paragraph AG33(a) of IAS 39 explains that an embedded derivative, in which the underlying is an interest rate, would be closely related to the host contract unless the embedded derivative's holders' initial rate of return could at least double the holder's initial rate of return on the host contract and could result in a rate of return that is at least twice what the market return would be for a contract with the same terms as the host contract. From this the issuer concluded that as long as the HIPC's multipliers used for the adjustment of the rent

would be below two (and thus the adjustment of the rent would not be doubled by the variation in the HIPC) the lease contract would not be leveraged. As the HIPC multipliers were 1.85 for the first period and 1.5 for the second the issuer concluded that the lease would not be leveraged. Regarding the 2.5% floor, the issuer believed that this would be a fixed adjustment to the rent and, as such, non-dependent on the underlying and therefore could be disregarded when assessing whether the lease would be leveraged.

The enforcement decision

5. The enforcer disagreed with the issuer's accounting treatment and determined that the embedded derivative had to be separated from the host lease contract.

Rationale for the enforcement decision

6. In the enforcer's view a hybrid instrument has leverage features if the contractual cash flows that are determined by changes in an underlying item are modified in a manner that increases the effect of those changes. In this case the adjustments to the rents are higher than the actual inflation rate therefore the hybrid instrument contains leverage features.
7. Paragraph AG33 of IAS39 analyses different situations whereby the entity does not have to separate the embedded derivative from the host contract. The conclusion in each example is specific to the facts and circumstances described. Each is subject to different requirements and conditions because so are the facts and circumstances of each of the different situations addressed by the respective subparagraphs. Therefore, analogous application of the conclusion from one subparagraph to a different situation addressed by another subparagraph is not appropriate. Paragraph AG33(a) of IAS 39 only deals with situations in which the underlying item is an interest rate or an interest rate index and requires separation of the embedded derivative only if a multiplier of two is exceeded. However, paragraph AG33(f) of IAS 39, which deals with inflation-related indices embedded in a host lease contract, does not contain such a threshold.
8. The enforcer therefore concluded that an embedded derivative in a host lease contract with an inflation-related index as underlying item should always be separated whenever it is leveraged, which generally occurs when there is a multiplier above 1 that has more than an insignificant effect, as in the present case.

II. Decision ref EECS/0116-02 – Classification of a separate vehicle as joint operation based on 'other facts and circumstances'

Financial period end: 31 December 2014

Category of issue: Joint operations

Standards or requirements involved: IFRS 11 *Joint Arrangements*

Description of the issuer's accounting treatment

9. The issuer and a partner jointly owned a legally separate vehicle. The issuer held a 56% stake and the partner a 44% stake in this arrangement. All strategic decisions, the appointment of members to

the Management Committee, approval of the budget and validation of any decision relating to the operational activities of the arrangement required unanimous consent of both partners. The arrangement had no access to external markets and all its production was exclusively bought by the partners at cost plus a 15% margin. The determination of the volume of the arrangement's output was based on an annual budget approved by the partners, who were contractually committed to acquire the output. If they would not purchase the arrangement's whole output, the parties must indemnify the arrangement for its entire uncompensated costs plus a 15% margin. Finally, the arrangement was financed by the parties, as almost all its liabilities were to them.

10. Based on the fact pattern above, the issuer concluded in accordance with paragraphs B5 and B6 of IFRS 11 that both parties jointly controlled the arrangement, as decisions about the entity's relevant activities required the unanimous consent of both parties.
11. Regarding the classification of the joint arrangement, the issuer determined in accordance with paragraph 17 of IFRS 11 that the arrangement was a joint operation.

The enforcement decision

12. The enforcer agreed with the issuer's assessment that the arrangement was a joint operation.

Rationale for the enforcement decision

13. In the case of a joint arrangement structured through a separate vehicle, the qualification as a joint operation depends, according to paragraph B20 of IFRS 11, on the party's rights to the assets and obligations for the liabilities. IFRS 11 does not clearly define the form those rights and obligations should have in order to qualify the arrangement as a joint operation, but provides guidance.
14. According to paragraph B21 of IFRS 11, when analysing these rights and obligations, the parties need to assess whether the legal form of the separate vehicle, the terms of the contractual arrangement and, when relevant, any other facts and circumstances give them rights to the assets, and obligations for the liabilities, relating to the arrangement. The enforcer noted that the joint arrangement is structured through a legally separate vehicle and the contractual arrangements do not specify that the parties have rights to the assets and obligations for the liabilities. However, following paragraph B30 of IFRS 11, the consideration of other facts and circumstances can lead to such an arrangement being classified as a joint operation.
15. As the arrangement has no access to external markets and the whole output is sold to the parties, they have, in accordance with paragraph B31 of IFRS 11, rights to substantially all the economic benefits of the assets of the arrangement. In addition, the arrangement is designed in a way that the liabilities incurred by the arrangement are, in substance, satisfied by the cash flows received from the parties through the purchase of the arrangement's entire output. Moreover, the arrangement is financed by the parties. As such, the parties are substantially the only source of cash flows contributing to the continuity of the operations of the arrangement. According to paragraph B32 of IFRS 11, this indicates that the parties have an obligation for the liabilities relating to the arrangement.

16. The enforcer also ensured that the discussions by the IFRS IC in 2014 and 2015 regarding the topic did not contradict the position of the issuer.
17. In conclusion, as the parties have rights to substantially all the assets and obligations for substantially all the liabilities of the joint arrangement through “other facts and circumstances”, the arrangement is a joint operation.

III. Decision ref EECS/0116-03 – Selection of the appropriate exchange rate when multiple exchange rates are available

Financial year end: 31 December 2015

Category of issue: Currency translation; multiple exchange rates

Standards or requirements involved: IAS 21 *The Effects of Changes in Foreign Exchange Rates*

Description of the issuer’s accounting treatment

18. The issuer is a manufacturer with operations in more than 30 territories, including Venezuela. The Venezuelan Bolivar Fuerte (‘VEF’) is subject to strict currency restrictions and is not freely exchangeable. As at 31 December 2014 there were three legal exchange rates in Venezuela that could be used for valuation and translation under IAS 21: CENCOEX, SICAD-I and SICAD-II. Currency exchange legislation in Venezuela was then amended in the first quarter of 2015 to create a new mechanism (known as SIMADI), which permitted both individuals and entities to buy and sell foreign currency with fewer restrictions than other mechanisms in Venezuela (CENCOEX and SICAD). In addition, SICAD-I and SICAD-II were merged. Therefore, as at 30 June 2015 the following three official rates of exchange of VEF to US dollars (US\$) existed:

- the variable SICAD rate, which was US\$1 = VEF 12.8;
- the newly created SIMADI rate, which allowed individuals and businesses to buy and sell foreign currency more easily and to offset the parallel market rate. The SIMADI rate was US\$1 = VEF 197; and
- the existing ‘official rate’ (CENCOEX) available to certain specific sectors considered to be priority was fixed at US\$1 = VEF 6.3.

19. The disparity between the different rates was significant. Consequently, the determination of the appropriate rate of exchange at which to consolidate the issuer’s Venezuelan operations had a material impact on the financial statements.

20. The issuer changed the rate at which it consolidated its Venezuelan operations from the SICAD rate to the SIMADI rate during the first half-year period of 2015. The issuer argued that the SIMADI rate was the most appropriate rate for accounting and consolidation, as it believed that this was the rate at which it would extract economic benefit. The change from the SICAD rate to the SIMADI rate reduced the issuer’s cash by approximately CU100M and its net assets by approximately CU 600M. Following this change, the issuer’s operations in Venezuela accounted for less than 1% of consolidated EBITDA.

21. In the narrative and in the notes in its half-yearly report, the issuer disclosed:

- the accounting treatment applied in the six-month period in respect of the exchange rate used by the issuer to consolidate the results, assets and liabilities of its operations in Venezuela. Such disclosure included information about the foreign exchange rate used;
- the impact of changes to the rates of exchange used compared to the previous full year rates; and
- the rationale and judgement made by management for applying the SIMADI rate during the half-year period.

The enforcement decision

22. The enforcer agreed with the issuer's accounting treatment and disclosures.

Rationale for the enforcement decision

23. Paragraph 26 of IAS 21 states that when several exchange rates are available, the rate used is that at which the future cash flows represented by the transaction or balance could have been settled if those cash flows had occurred at the measurement date.

24. Recognising that paragraph 26 of IAS 21 requires the exercise of management judgement, the enforcer did not disagree with the issuer's assertion that the SIMADI rate is the most appropriate rate for accounting and consolidation, as the issuer believes that this is the rate at which it extracts economic benefit.

IV. Decision ref EECS/0116-04 – Presentation of gains arising from the sale of an intangible asset

Financial year end: 31 December 2012

Category of issue: Intangible Assets

Standards or requirements involved: IAS 38 *Intangible Assets*

Description of the issuer's accounting treatment

25. The issuer is a biotech company that undertakes research and development projects but does not produce the products itself. It received milestone payments during the research and development process based on contracts signed with other pharmaceutical companies, which, if the projects were completed, would produce and distribute the pharmaceutical products. If the products were approved by the authorities and sold to consumers, the issuer would receive royalties.

26. In 2011, the issuer acquired a development project as part of a business combination and recognised the project as an intangible asset in accordance with paragraph 33 of IAS 38. Its value amounted to more than 50% of the issuer's total assets. At the beginning of 2012, the issuer judged that it could not complete the project on its own due to insufficient funds and attempted to form partnerships with other companies or to find external investors to be able to continue working on the project. After

these initiatives failed, the issuer tried to sell the project, including all rights to future development. In the 2012 half-year report the issuer recognised an impairment loss for the full value of the intangible asset.

27. After the publication of the half-year financial report, the issuer succeeded in selling the project. The gain from the sale was classified as revenue in the 2012 annual financial statements. The issuer argued that their business was medical research and development and that the sale of rights arising from the project should therefore be classified as revenue in accordance with paragraph 7 of IAS 18 since the sale of rights was part of the issuer's ordinary business.

The enforcement decision

28. The enforcer disagreed with the issuer. Gains arising from derecognition of an intangible asset cannot be presented as revenue as paragraph 113 of IAS 38 explicitly forbids this.

Rationale for the enforcement decision

29. The issuer transferred development projects to other companies on two previous occasions. These took place before 2001, when the issuer used national GAAP. They were both to companies where the issuer had significant influence. Payment of the purchase price was made in shares. No projects were sold from 2001 to 2012.
30. The enforcer noted that, based on historic transactions, there was no indication that the issuer's business model is to sell development projects. Rather, the issuer starts developing new products, and at a certain point invites partners to participate in them. These partners are normally pharmaceutical companies with production facilities and marketing infrastructure. Therefore, the issuer's business model is to develop a product then leave the production and marketing of the product to partners. The issuer obtains milestone payments during the development phase and royalties after the product is brought to the market.
31. Regarding the issuer's argument that the sale of rights was part of the issuer's ordinary business, the enforcer noted that, according to paragraph 3(a) of IAS 38, the scope of the standard does not include intangible assets held by an entity for sale in the ordinary course of business. As the issuer has recognised an intangible asset in accordance with IAS 38, it cannot argue that it was held for sale in the ordinary course of business. Therefore, according to paragraph 113 of IAS 38, the gains from derecognition of this intangible asset cannot be classified as revenue.

V. Decision ref EECS/0116-05 – Identification of unobservable inputs

Financial year end: 31 December 2014

Category of issue: Disclosures related to unobservable inputs

Standards or requirements involved: IFRS 13 *Fair Value Measurement*

Description of the issuer's accounting treatment

32. The issuer is a Real Estate Investment Trust and owns approximately 1,500 multi-unit residential rental apartment properties in and near urban centres. In its 2014 annual financial statements, the issuer disclosed that the 'capitalisation rate' and 'stabilised net rental income' were the key unobservable inputs/assumptions. 'Stabilised net rental income' represents the net rental income from a stabilised portfolio, defined as all properties owned continuously during an accounting period.

33. Regarding the capitalisation rate, the issuer disclosed all information required by paragraph 93 of IFRS 13. However, with regard to the stabilised net rental income, the issuer's fair value notes did not disclose the information required by paragraphs 93(d) and (h)(i) of IFRS 13:

- a description of the valuation technique and the inputs used in the fair value measurement of the investment property;
- quantitative information about the significant unobservable inputs used in the fair value measurement of investment property; and
- a narrative description of the sensitivity of the fair value measurement to changes in unobservable inputs if a change in those inputs to a different amount might result in a significantly higher or lower fair value measurement.

34. Contradicting its disclosures regarding the key unobservable inputs/assumptions, the issuer argued that the disclosures required by paragraphs 93 of IFRS 13 were not provided for the stabilised net rental income, because it was not a significant unobservable input. In the issuer's view, whereas the capitalisation rate is determined by the use of market data and the application of professional judgement, the stabilised net rental income was built up unit-by-unit based on most recent rents knowledge and therefore there would be no single 'input' applied to determine the stabilised net rental income. The issuer argued that a variation in the net rental income for an individual unit (even a significant variation) would not have a significant impact on the fair value measurement of the property portfolio. Therefore, the issuer considered that the stabilised net rental income was not a significant unobservable input.

The enforcement decision

35. The enforcer did not accept the issuer's rationale for considering that the 'stabilised net rental income' was not a significant unobservable input and considered that the capitalisation rate was not the only unobservable input to determine the fair value of the investment properties.

Rationale for the enforcement decision

36. The issuer utilises the Direct Income Capitalisation Method as a valuation technique to measure the fair value of its investment property portfolio. The capitalisation rates and the stabilised net rental income are the relevant unobservable inputs. The enforcer noted that the stabilised net rental income is influenced by how the issuer defines it and calculates 'stabilised net rental income' (i.e. all properties owned continuously during an accounting period). It is apparent that this calculation is based on rental income from properties on an aggregate basis rather than at an individual unit level, which was the issuer's argument. As a result, if there are significant variations in the stabilised net rental income for all units within the issuer's property portfolio taken as a whole, then this factor could have an impact on the fair value measurement of the issuer's property portfolio. Given that the stabilised net rental income was an unobservable input used for the valuation technique and stabilised net rental income is based on the rental income from all the properties in the issuer's investment property portfolio, the enforcer concluded that the stabilised net rental income was a significant unobservable input and the relevant disclosures should have been given.

VI. Decision ref EECS/0116-06 – Reverse acquisition of a listed shell company

Financial year end: 31 December 2015

Category of issue: Reverse acquisition

Standards or requirements involved: IFRS 3 *Business Combinations*; IAS 8 *Accounting Policies, Changes in Accounting Estimates and Errors*, IFRS 2 *Share-based Payment*

Description of the issuer's accounting treatment

37. A non-listed operating company (Company A) paid cash for 97.5% of the shares of a listed company (Company B). On the same day, Company B's activities, including all its assets and liabilities except for its cash and cash equivalents, were sold to its former shareholders. Company A planned to merge with the empty shell Company B in order to list. The consideration for the shares was significantly higher than the cash remaining in Company B after the sale of its activities. In the subsequent merger Company B paid for Company A's shares by issuing new shares to Company A's owners and therefore became the legal acquirer of Company A. Thereby the merged group kept Company B's legal characteristics, including the shares' listing.

38. As, at the date of its acquisition, Company B was a shell company and thus not a business as defined in IFRS 3, the transaction was not in the scope of IFRS 3. Management therefore referred to paragraph 10 of IAS 8 and used judgement to develop an appropriate accounting policy on how to account for the transaction. It concluded that even though IFRS 3 was not applicable, the transaction would in substance be a reverse acquisition of Company B by Company A. Therefore, the consolidated financial statements would be issued under Company B's name as the legal acquirer but as a continuation of Company A's financial statements and as such would present Company A's prior year consolidated figures as comparative information.

39. Management further considered that the merger was a mere internal restructuring with no accounting impact, except the reorganisation of equity. Therefore, the difference between the consideration transferred for Company B's shares and its remaining cash and cash equivalents should be considered to be the cost of listing existing shares and therefore charged to the income statement.

The enforcement decision

40. The enforcer accepted the issuer's accounting treatment. As IFRS 2 and 3 are not applicable, management has to use judgement to develop an accounting treatment.

Rationale for the enforcement decision

41. The enforcer concurs with management's analysis that the transaction is, in substance, a reverse acquisition. The following facts and circumstances mentioned in paragraph B15 of IFRS 3 that indicate the existence of a reverse acquisition, were present:

- The merged company's board members were appointed by Company A's shareholders and replaced Company B's board members.
- Company A's management replaced Company B's former management.
- Company A's relative size is significantly greater than Company B's.
- Company A's owners will hold the majority of the voting rights in the combined entity.
- Company A paid a premium over the fair value of Company B's shares.

42. Therefore, the enforcer concluded that the transaction cannot be accounted for as an acquisition of the legal acquiree by the legal acquirer as the legal acquirer cannot be identified as the accounting acquirer based on the guidance in the standard. The enforcer further agreed that IFRS 3 was not applicable, as the acquiree was not a business.

43. The IFRSs do not provide guidance on how to account for such a transaction. Therefore, the relevant accounting treatment has to be determined according to paragraphs 10-12 of IAS 8.

44. Recognising the difference between the consideration paid and the fair value of the cash left in Company B by analogy with IFRS 3 as goodwill would not be appropriate as no future economic benefits can be expected from Company B, as it was an empty shell company.

45. The enforcer noted that the IFRS Interpretations Committee discussed in March 2013¹ a similar case. Yet, unlike in the case at hand, in which Company A acquired Company B's shares by a cash payment, in the case discussed by the IFRS Interpretations Committee, the shareholders of a non-listed operating entity became the majority shareholders of the combined entity by exchanging their shares for new shares of a listed non-operating entity. The IFRS Interpretations Committee concluded that in this case IFRS 2 should be applied. Based on the guidance provided in paragraph 13A of IFRS 2 any difference in the fair value of the shares deemed to have been issued by the

¹ IFRIC Update March 2013, Agenda decision: IFRS 3 Business Combinations and IFRS 2 Share-based Payment—Accounting for reverse acquisitions that do not constitute a business

accounting acquirer and the fair value of the accounting acquiree's identifiable net assets represents a payment for a service received by the accounting acquirer, in this case the listing of Company A's shares. This leads, in substance, to the same result as the issuer's accounting treatment.

46. Therefore, the enforcer concluded that the issuer's accounting treatment to expense the difference between the consideration paid and the fair value of the cash left in Company B as costs incurred for the listing on the stock exchange properly reflects the substance of the transaction (i.e. the acquisition of a listing vehicle).

VII. Decision ref EECS/0116-07 – Disclosure of the amounts of significant categories of revenue

Financial year end: 31 December 2014

Category of issue: Revenue; Entity-wide disclosures

Standards or requirements involved: IAS 18 *Revenue*; IFRS 8 *Operating Segments*

Description of the issuer's accounting treatment

47. The issuer is a company that supplies products for 3D-printing. The description of the accounting policies in the financial statements referred to various components of revenue, such as sale of: machinery, spare parts, disposables and services. Also, the management report contained explanations and amounts for these revenue generating activities. However, despite the fact that the issuer generated several categories of revenue, it disaggregated the revenue in the financial statement notes into only two components, namely 'revenue' and 'freight', the latter being immaterial (less than 1% of revenue).

The enforcement decision

48. The enforcer disagreed with the issuer's accounting treatment. The issuer should have disclosed in its financial statements more granular information regarding its revenue.

Rationale for the enforcement decision

49. Paragraph 35b of IAS 18 requires disclosure of the amount of each significant category of revenue recognised during the period. Furthermore, paragraph 32 of IFRS 8 requires an entity to report the revenues from external customers for each product or service, or each group of similar products and services. The fact that the issuer describes the various accounting policies by category of revenue and in the management report discloses disaggregated amounts of several revenue generating activities confirms that more significant revenue components than disclosed in the financial statements exist and thus disaggregated information on revenue should have been provided in the financial statements.

VIII. Decision ref EECS/0116-08 – Determination of whether a dealer network acquired in a business combination is an intangible asset with indefinite useful life

Financial year end: 31 December 2013

Category of issue: Intangible assets with indefinite useful lives

Standards or requirements involved: IAS 38 *Intangible Assets*

Description of the issuer's accounting treatment

50. The issuer, a producer of transport equipment, acquired Entity A in 2008. Its intention was to enter a new geographical market by acquiring a widespread dealer network. The dealers sell the goods to retail customers and provide them with maintenance. The relationships between the acquired entity and the dealers were not based on contracts establishing exclusive relationships between Entity A and the dealers but on ongoing business. In the course of the purchase price allocation, the issuer identified the dealer network as a separate intangible asset. It considered that the period over which the dealer network would generate net cash inflows would have no foreseeable limit. The issuer recognised an intangible asset with an indefinite useful life, which according to paragraph 107 of IAS 38 shall not be amortised. In the issuer's view the dealer network was one self-renewing asset rather than separate relationships with the individual dealers.

The enforcement decision

51. The enforcer disagreed with the issuer's accounting treatment. The dealer network does not have an indefinite useful life and the intangible asset should have been amortised since its acquisition.

Rationale for the enforcement decision

52. According to paragraph B31 of IFRS 3, an acquirer in a business combination shall recognise intangible assets if they are identifiable. According to paragraph 12 of IAS 38 (which is consistent with paragraphs B32 and B33 of IFRS 3) an intangible asset is identifiable if it is either:

- separable, i.e. capable of being separated or divided from the entity and sold, transferred, licensed, rented or exchanged, either individually or together with a related contract, identifiable asset or liability, regardless of whether the entity intends to do so; or
- arises from contractual or other legal rights, regardless of whether those rights are transferable or separable from the entity or from other rights and obligations.

53. The dealer network was not separable from Entity A but according to paragraph IE28 of IFRS 3 customer relationships meet the contractual-legal criterion if an entity has a practice of establishing contracts with its customers, regardless of whether a contract exists at the acquisition date. Like the example in IFRS 3, the relationships between the dealers and Entity A were based on ongoing business which in turn is established through contracts. Therefore, the contractual-legal criterion was fulfilled.

54. However, the contractual-legal criterion was met for the individual relationships with the single dealers within the dealer network, not the network itself. Even if the issuer intended to acquire a dealer network in its entirety, the identifiable intangible asset only refers to the relationships with the individual dealers.
55. The useful life of the relationships with the individual dealers is finite because they continuously cease. Therefore, the intangible asset has to be amortised over its useful life in accordance with paragraph 97 of IAS 38. The fact that dealers with whom the relationship ends could be replaced does not alter this assessment. The acquired asset relates only to those dealers with which Entity A had established relationships at the acquisition date.

IX. Decision ref EECS/0116-09 – Exchange of a business for an interest in a subsidiary and subsequent distribution of the acquired subsidiary to owners

Financial year end: 31 December 2014

Category of issue: Measurement of the consideration transferred in a business combination; Distribution of non-cash assets to owners

Standards or requirements involved: IFRS 3 *Business Combinations*; IFRIC 17 *Distribution of Non-cash Assets to Owners*

Description of the issuer's accounting treatment

56. The issuer owned Business E whose net assets amounted to CU 1.3M and had a fair value of CU 30.0M. On 1 July 2014, the issuer contributed Business E to Entity P and in return received 80% of Entity P's shares. Entity P, which met the definition of a business, held net assets with a carrying amount and fair value of CU 7.2M. Since the issuer controlled Entity P after the transaction and Entity P met the definition of a business, the transaction was accounted for as a business combination and the issuer was identified as the acquirer. The issuer elected to measure the non-controlling interest in Entity P after the transaction at its fair value, as permitted by paragraph 19 of IFRS 3.
57. The issuer argued that it acquired the 80% of Entity P for a consideration of zero, since it retained control over Business E after the transaction. It considered that the former shareholders of Entity P are still the owners of the former net assets of Entity P, which have a fair value of CU 7.2M. Therefore, the issuer recognised the transaction as an increase of the net assets for an amount of CU 7.2M and of non-controlling interests in the same amount. No goodwill or negative goodwill was recognised.
58. In August 2014, the issuer was authorised to distribute its interest in Entity P to its own shareholders. The distribution was accounted for in accordance with IFRIC 17. The issuer recognised a decrease in its share capital and recognised a liability for the fair value of the interest in Entity P at the

authorization date. The change in this fair value between the authorization date and the time the shares were distributed in November 2014 was recorded as an adjustment to the liability via equity. Profit on the transaction was calculated based on the derecognition of the liability, the non-controlling interest and entity P's net assets. The issuer also reclassified to profit or loss the accumulated remeasurements of a net defined benefit liability of Entity P that were previously recognised in other comprehensive income.

The enforcement decision

- 59. The enforcer disagreed with the issuer's accounting treatment.
- 60. Firstly, the issuer transferred 20% of its interests in Business E to acquire 80% of the original interests in Entity P. Therefore, the issuer's measurement of non-controlling interest, goodwill and the profit upon settlement of the dividend payable was not correct.
- 61. Secondly, the accumulated remeasurements relating to the net defined benefit liability of Entity B should not have been reclassified to profit or loss upon distribution of entity P.

Rationale for the enforcement decision

- 62. In accordance with paragraph 37 of IFRS 3, the consideration transferred shall be calculated as the sum of the acquisition-date fair values of the assets transferred by the acquirer. As the fair value of Business E at acquisition date was CU 30M, the fair value of the 20% effectively transferred for the acquisition of Entity P is CU 6M, which represents the consideration transferred. The fair value of the identifiable net assets of Entity P is CU 7.2M and the non-controlling interest in the acquiree is CU 1.44M (20% of CU 7.2M). The issuer should have recognised goodwill of CU 0.24M as, in accordance with paragraph 32 of IFRS 3, goodwill is measured as the excess of the consideration transferred (CU 6.0M) and the amount of non-controlling interests in the acquiree (CU 1.44M) over the fair value of the identifiable net assets acquired (CU 7.2M).
- 63. The change in the issuer's ownership interest in Business E shall not be recognised in profit or loss as, according to paragraph 38 of IFRS 3, if an acquirer retains control of the assets and liabilities transferred as part of the consideration then it shall measure those assets and liabilities at their carrying amounts immediately before the acquisition date. As such, the non-controlling interest due to the change in ownership interest of 20% in Business E amounts to 20% of Business E's pre-acquisition carrying amount of CU 1.3M or CU 0.26M.
- 64. The following journal entries illustrate the appropriate accounting treatment:

DT	Net assets of Entity P	7.20	
DT	Goodwill	0.24	
CT	Non-controlling interest in Entity P		1.44
CT	Non-controlling interest in Business E		0.26
CT	Retained Earnings		5.74

65. Since entity P is not controlled by the same parties before and after the distribution, IFRIC 17 is applicable to the distribution of the shares of P to the shareholders of the issuer. The enforcer therefore agrees with the accounting treatment of the issuer. According to paragraph 13 of IFRIC 17, the adjustment of the carrying amount of the liability that reflects the changes in the fair value of the assets, has to be recognised in equity. The enforcer further agrees that at the settlement date the difference between the carrying amount of the assets distributed and the carrying amount of the dividend payable has to be recognised in profit or loss in accordance with paragraph 14 of IFRIC 17. However, due to the fact that the issuer measured the non-controlling interests incorrectly and has not identified goodwill, the profit was not determined correctly. Furthermore, the accumulated remeasurements of the net defined benefit liability which were in the past recognised in other comprehensive income should, according to paragraph 122 of IAS 19, not have been reclassified to profit and loss.

X. Decision ref EECS/0116-10 – The determination of the maximum economic benefits available from a pension plan and the measurement of the defined benefit asset

Financial year end: 31 December 2014

Category of issue: Asset ceiling; defined benefit asset

Standards or requirements involved: IAS 19 *Employee Benefits*; IFRIC 14 *IAS 19-The Limit on a Defined Benefit Asset, Minimum Funding Requirements and their Interaction*

Description of the issuer's accounting treatment

66. In one of the issuer's pension plans, the fair value of the plan assets exceeded the present value of the defined benefit obligation by CU 17.8M and the issuer was entitled to receive this surplus upon the pension plan's termination. The pension plan was closed and no additional premiums needed to be paid by the issuer apart from additional solvency payments to which the issuer had committed. The issuer explained that its standard practice was to not realise such a surplus over time but through a buy-out, i.e. by transferring the defined benefit obligation and the plan assets to an insurance company in return for a payment. The issuer explained that it would be willing to agree to a buy-out if an insurer would offer a payment which corresponds to the issuer's past cumulated solvency payments to the pension plan of CU 2.0M. The issuer therefore concluded that the expected economic benefit available as a refund would be CU 2.0M and that therefore CU 2.0M would represent the asset ceiling and thus measured the net defined benefit asset in this amount.

The enforcement decision

67. The enforcer determined that the issuer measured the defined benefit asset incorrectly, as the determination of the asset ceiling should take into account the maximum economic benefit that is available from refunds, reductions in future contributions or a combination of both, even if the issuer intends to settle its pension obligations in the future through a less favourable approach. The issuer should have measured the net defined benefit asset as the amount of the surplus at the end of the period that the entity has a right to receive as a refund, less associated costs.

Rationale for the enforcement decision

68. According to paragraph 8 of IAS 19, the net defined benefit asset is defined as the surplus, adjusted for any effect of limiting a net defined benefit asset to the asset ceiling. The asset ceiling is the present value of any economic benefits available in the form of refunds from the plan or reductions in future contributions to the plan. Paragraph 13 of IFRIC 14 clarifies that the entity shall measure the economic benefit available as a refund as the amount of the surplus at the end of the reporting period that the entity has a right to receive as a refund, less associated costs. In addition, paragraph 9 of IFRIC 14 clarifies that the entity's intended use of the surplus is not relevant when measuring the economic benefits available.
69. Thus, if the expected benefit from realising the surplus over time is higher than from a buy-out, the economic benefit should be measured based on the assumption that the surplus is realised over time even though the issuer intends to opt for the buy-out. As the issuer did not base its calculation of the asset ceiling on the settlement method that provided the maximum economic benefit, the issuer determined the asset ceiling incorrectly.

XI. Decision ref EECS/0116-11 – Measurement of a deferred tax liability relating to biological assets when income tax rates are changing over the assets' useful lives

Financial year end: 31 December 2014

Category of issue: Measurement of deferred tax liabilities; changing tax rates on income

Standards or requirements involved: IAS 12 *Income Taxes*, IAS 41 *Agriculture*

Description of the issuer's accounting treatment

70. The issuer specialised in planting cacao trees, operating a cacao plantation and harvesting cacao in Africa. After planting the young cacao trees, the first harvests were expected after 18 months and the lifetime of the trees was expected to be 30-35 years. The issuer started planting trees in 2013 and expected the first harvest in October 2015. At the end of 2014, the trees still had to grow about four more years before they would reach their maturity. Afterwards their fair value would decrease after each harvest.
71. In accordance with paragraph 12 of IAS 41 the cacao trees were measured on initial recognition and at the end of each reporting period at fair value less costs to sell. As the tax base of the trees was nil, a taxable temporary difference existed. Between 2014 and 2026, the issuer is exempt from all income taxes in the country where the cacao plantation is located. In 2027 the normal tax rate would be reduced by 50% and in 2028 by 25%. Afterwards the normal tax rate of 25% would apply.
72. The issuer did not recognise a deferred tax liability as it believed that the temporary difference existing at 31 December 2014 would reverse entirely during the tax holiday period. The issuer believed that the temporary difference would be recovered by the harvests in the first four to six years

and that the temporary differences that reverse after the end of the tax holiday period would only arise in the future due to the future growth of the trees until they reach maturity.

The enforcement decision

73. The enforcer disagreed with the issuer's accounting treatment to not recognise a deferred tax liability.

Rationale for the enforcement decision

74. According to paragraph 16 of IAS 12, the amount by which the carrying amount of an asset exceeds its tax base is a taxable temporary difference and the obligation to pay the resulting income taxes in future periods is a deferred tax liability. As the entity recovers the carrying amount of the asset, the taxable temporary difference will reverse and the entity will have taxable profit. According to paragraph 47 of IAS 12, a deferred tax liability shall be measured at the tax rates that are expected to apply to the periods when the asset is realised. The issuer should have determined which part of the asset is realised during the tax holiday period and which part is realised afterwards.
75. It is not appropriate to estimate that the temporary difference as of 31 December 2014 relating to young cacao trees with a lifetime of 30-35 years will be recovered in full during the next four to six years and that the temporary differences that will reverse after the tax holiday period will entirely be generated after 2014. The growth of the young cacao trees that occurred until 31 December 2014 is the basis for all benefits that will flow to the issuer during the entire lifetime of the trees. Therefore, the period over which the asset is realised is the entire lifetime of the trees.
76. Subsequently, the following approach to measure the deferred tax liability was used in this specific case. For the determination of the fair value of the biological assets, the Discounted Cash-Flow-method (DCF) was used by the issuer. The issuer determined at which point in time (according to its DCF calculations) the trees would hold the maximum fair value and thus the temporary differences would be highest. Then it determined in which periods the temporary differences would reverse, the amount of the reversal in each period (equal to the decrease in fair value based on the DCF calculations) and which tax rates would be applicable in each of these periods. Then the fair value of the trees at the reporting date (end of 2014) was compared with the trees' fair value upon maturity (which is the moment when the trees have the highest fair value) to determine which percentage of future reversions of temporary differences should be recognised as a deferred tax liability at the reporting date. As the fair value and thus the carrying amount of the trees on 31 December 2014 represented about 60% of the maximum fair value the trees would reach upon their maturity, it was considered appropriate to measure the deferred tax liability at 60% of the temporary differences which will be reversed multiplied with the respective tax rate upon their reversal. The same principle was applied for 2013 where the fair value reached 37% of the maximum fair value that the trees will reach.

XII. Decision ref EECS/0116-12 – Accounting for contributions to a deposit guarantee fund in the interim financial report

Period end: 30 June 2015

Category of issue: Levies; deposit guarantee scheme; interim financial reporting

Standards or requirements involved: IFRIC 21 *Levies*

Description of the issuer's accounting treatment

77. The issuer is a credit institution which is subject to a deposit guarantee scheme. The local legislation in force at the time predates the transposition of the Directive 2014/49/EU of the European Parliament and the Council on deposit guarantee schemes. The credit institutions whose deposits are (partially) guaranteed by a deposit guarantee fund have to make a non-refundable cash contribution of 2-tenths of a percent of the deposits existing at the end of the year, to the deposit guarantee fund, irrespective of the amount of deposits maintained during the rest of the year.

78. The issuer's accounting policy was to recognise in each interim period a provision for these contributions proportional to the estimated amount at year end to be paid within the next 2 months of the following year. Therefore, as of 30 June 2015, the issuer recognised a provision measured at 50% of the expected total annual levy for the year 2015.

The enforcement decision

79. The enforcer disagreed with the issuer's accounting treatment. No provision should have been recognised for the contributions to the deposit guarantee fund as of 30 June 2015, as the obligating event had not yet occurred.

Rationale for the enforcement decision

80. According to paragraph 13 of IFRIC 21, in the interim financial report, an entity shall not recognise a liability to pay a levy if there is no present obligation to pay the levy at the end of the interim reporting period. As the contribution to the deposit guarantee fund depends exclusively on the amount of deposits maintained at the end of the year, there is no legal obligation to pay contributions as of 30 June 2015. Even though the issuer might be economically compelled to hold deposits at year-end in order to be able to continue to operate in the future, as of 30 June 2015 there is no constructive obligation to make any contributions. This is supported by paragraph 9 of IFRIC 21 which sets out that an entity does not have a constructive obligation to pay a levy that will be triggered by operating in a future period as a result of the entity being economically compelled to continue to operate in that future period.

81. The obligation to contribute to the deposit guarantee fund only occurs if the issuer holds deposits on 31 December. Therefore, the obligating event is holding deposits at year-end irrespective of the level of deposits maintained the previous 364 days of the year. This point is also illustrated by Example 3 in paragraph IE1 of IFRIC 21 which is broadly similar to this situation. In this example, a levy on a bank is triggered in full only if the entity operates as a bank at the end of the annual reporting period.

The amount of the levy is calculated by reference to the amounts in the statement of financial position at the end of the annual reporting period. The obligating event is that the bank operates at the end of the annual reporting period. The example further illustrates that before the obligating event occurs, the entity has no present obligation to pay the levy, even if it is economically compelled to operate as a bank in the future and as such no liability shall be recognised before the obligating event occurs.