European Securities and Markets Authority

Report

25th Extract from the EECS's Database of Enforcement

15 July 2021 | ESMA32-63-1192

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The decisions included in this report were taken by national enforcers in the period from November 2019 to July 2020. 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
BoD	Board of Directors
CEO	Chief Executive Officer
CFO	Chief Financial Officer
DTA	Deferred Tax Asset
ECL	Expected Credit Loss
EEA	European Economic Area
EECS	European Enforcers Coordination Sessions
ESMA	European Securities and Markets Authority
IAS	International Accounting Standards
IASB	International Accounting Standards Board
IFRIC	International Financial Reporting Interpretations Committee Interpretation
IFRS	International Financial Reporting Standards
IFRS IC	International Financial Reporting Standards Interpretations Committee
OEM	Original Equipment Manufacturer

The European Securities and Markets Authority (ESMA) publishes extracts from its confidential database of enforcement decisions on financial statements, with the aim of strengthening supervisory convergence and providing issuers and users of financial statements with relevant information on the appropriate application of the International Financial Reporting Standards (IFRS). According to its founding regulation, ESMA shall act in the field of financial reporting to ensure the effective and consistent application of European legislation.

In order to fulfil these responsibilities, ESMA organises the European Enforcers Coordination Sessions (EECS), a forum of 38 European enforcers from all European Economic Area (EEA) countries with responsibilities in the area of supervision and enforcement of financial information.[1]

With responsibility for the coordination of supervision of almost 4,500 issuers listed on the regulated markets in the EEA preparing IFRS financial statements, EECS constitutes the largest regional enforcers' network with supervision responsibilities for IFRS.

Through EECS, European enforcers discuss and share their experience on the application and enforcement of IFRS. In particular, they discuss significant enforcement cases before and/or after decisions are taken in order to promote a consistent approach to the application of IFRS. In addition, EECS produces technical advice on ESMA Statements and Opinions on accounting matters and reviews accounting practices applied by European issuers to enable ESMA to monitor market developments and practices.

In taking enforcement decisions, European enforcers apply their judgement, knowledge and experience to the facts and circumstances of the individual cases they consider. Relevant factors may also include other areas of national law beyond the accounting requirements. Interested parties should, therefore, carefully consider the circumstances when reading the cases. As IFRS are principles-based, there can be no one single way of dealing with numerous situations which may seem similar but in substance are different.

Decisions taken by enforcers do not provide generally applicable interpretations of IFRS; this remains the role of the IFRS Interpretations Committee (IFRS IC). The decisions published in each extract are based on the IFRS requirements valid at the time of the IFRS financial statements and may be superseded by subsequent developments in IFRS.

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

[1] Following the exit of the United Kingdom from the European Union as of 31 January 2020, the number of enforcers does not include national authorities representing the United Kingdom and the number of issuers does not include the issuers listed on regulated markets in the United Kingdom

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

- 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 was taken on the basis of a provision not covered by an accounting standard.

I. Decision ref EECS/0121-01 – Measurement of expected credit losses

Financial year end: 31 December 2018
Category of issue: Measurement of the expected credit losses (ECLs) on overdue trade receivables.
Standards or requirements involved: IFRS 9 *Financial Instruments*

Description of the issuer's accounting treatment

1. The issuer is a producing, upstream oil and gas company. It operates with the national licence holder for all oil and gas operations in the country in which the issuer operates. Operators must sign production-sharing agreements (PSAs) with the licence holder to carry out agreed work. The licence holder is the only customer for gas production by the issuer. The licence holder is both a debtor and creditor of the issuer.
2. When the issuer considered whether the trade receivables due from the licence holder for invoiced gas sales were credit impaired, the issuer took into account the licence holder's intention to offset other amounts due by the issuer to the license holder, which were in dispute between the parties, against the issuer's trade receivables. The licence holder is rated non-investment grade by rating agencies.
3. Although the amount of the trade receivable and interest for late payment were past due for between 8 and 18 months, the issuer expected trade receivables to be fully recovered from the licence holder within six months' delay from the reporting date. Therefore, the issuer did not recognise an ECL charge in its financial statements. In this respect, the issuer also noted that all its trade receivables are due from a unique debtor which is at the same time a creditor.

The enforcement decision

4. The enforcer concluded that the issuer did not comply with the recognition and measurement requirements of paragraph 5.5.17 of IFRS 9 in relation to the trade receivables past due from the licence holder and should measure ECLs of a financial instrument in a manner that reflects an unbiased and probability weighted amount that is determined by evaluating a range of possible outcomes. The enforcer concluded that, in measuring ECLs on trade receivables, the issuer did not consider the risk or probability that a credit loss occurred.
5. Therefore, the enforcer requested the issuer to provide a probability-weighted calculation of the trade receivables' ECL as at the reporting date that reflects a range of possible outcomes as required under paragraph 5.5.17 of IFRS 9.

Rationale for the enforcement decision

6. Paragraph 5.5.17(c) of IFRS 9 states that an entity shall measure ECLs of a financial instrument in a way that reflects reasonable and supportable information that is available without undue cost or effort at the reporting date about past events, current conditions and forecasts of future economic conditions. According to paragraph B5.5.52 of IFRS 9, an entity shall adjust historical data, such as credit loss experience, on the basis of current observable data to reflect the effects of the current conditions and its forecasts of future conditions that did not affect the period on which the historic data is based.

7. The enforcer disagreed with the issuer's assumption that there would be a 100% recovery rate of the trade receivables notwithstanding that trade receivables are overdue for an extended period and the rating of the debtor. In addition, there were no contractual terms or legal agreements that permit a right to offset trade receivables against other liabilities and which may need to be considered as collateral, in measuring the ECLs on trade receivables as per paragraph B 5.5.55 of IFRS 9.

8. Therefore, the enforcer concluded that the issuer's ECL calculation did not comply with the requirements of paragraph 5.5.18 of IFRS 9 which states that an entity shall consider the risk or probability that a credit loss occurs by reflecting the possibility that a credit loss occurs and the possibility that no credit loss occurs, even if the possibility of a credit loss occurring is very low.

9. The enforcer noted that in accordance with paragraph 5.5.17(c) of IFRS 9, the ECL measurement must reflect reasonable and supportable information that is available without undue cost or effort at the reporting date about past events, current conditions and forecasts of future economic conditions including, in this instance, the fact that there were no contractual rights to offset receivables and liabilities, the rating of the debtor and the delay in settling trade receivables.

II. Decision ref EECS/0121-02 – Recognition of lease on the first application of IFRS 16

Financial year end: 30 June 2019
Category of issue: Lease component, right to obtain substantially all the economic benefits and direct the use of identified assets.
Standards or requirements involved: IFRS 16 *Leases*

Description of the issuer's accounting treatment

10. The issuer has several projects on the development, construction, and operation of wind farms. For this purpose, the issuer leases for 30 years plots of land where the wind farms are located. The lease contracts include general features of the land area (such as location, boundaries, plant) and, in some cases, information regarding the location where the wind turbines are installed.

11. Once the wind turbines are installed, the probability of their substitution or relocation throughout the duration of the contract is very remote. In addition, most contracts include clauses allowing the owners of the land to use the parts of the land not constructed by the issuer for other activities to the extent that such use does not interfere with the operations of the lessee.

12. The issuer considered that the existence of clauses that allow the landowner to use parts of the land to carry out other activities such as agriculture or ranching, significantly limited its ability (i) to obtain the economic benefits related to the land and (ii) to control the asset. Therefore, the issuer concluded the contracts did not contain a lease and thus did not comply with the requirements set out in IFRS 16.

The enforcement decision

13. The enforcer did not agree with the issuer's assessment of whether the contracts contained a lease component under the scope of IFRS 16. Accordingly, the enforcer requested that the issuer apply IFRS 16 to these transactions.

Rationale for the enforcement decision

14. According to paragraph B9 of IFRS 16, in order to meet the definition of a lease, the customer must have both (i) the right to obtain substantially all the economic benefits from the use of an identified asset; and (ii) the right to direct the use of the identified asset throughout the period of use. In addition, paragraph B13 of IFRS 16 states that an asset is typically identified by being explicitly specified in a contract, or by being implicitly specified at the time that the asset is made available for use by the customer. Furthermore, paragraph B20 allows for a capacity portion of an asset to be identified as a leased asset if it is physically distinct.
15. The enforcer noted that there is an identified portion of an asset, which is physically distinct, consisting of the part of the land occupied exclusively by the wind turbine (including the air space occupied by the blades). In this respect, the enforcer observed that it is the issuer (the lessee) that decides the exact location of the windmill turbines either by including such information in the contract or by defining it when the construction phase begins.
16. Furthermore, the enforcer noted that whilst the contract allowed the landowner (the lessor) to carry out other economic activities on the part of the land that is not occupied by the wind generator (e.g. for agricultural purposes), the portion of the land occupied by the wind turbines could not be used for any other purposes, so it is under the lessee's control.
17. As regards the right to obtain economic benefit from an identified asset and the right to direct the use of the asset, the enforcer noted that the portion of land on which the wind turbine is located is exclusively used with the objective of generating wind energy. Therefore, in respect of this part of the land, the issuer has the right to obtain all the economic benefits during the period in which the wind turbines maintain their location.
18. Finally, it is the issuer who takes all the important decisions related to the use of the asset during the contract period such as determining the exact location of the windmills and the day-to-day operation of the windmills. The issuer has unlimited access to the leased land in order to repair, ensure maintenance or carry out any other activities that the issuer considers necessary to uphold or to increase the efficiency of the equipment. The issuer has the right to operate the assets without the landowner's prior consent. In addition, the landowner does not have the right to object or to change the issuer's operating instructions.

III. Decision ref EECS/0121-03 – Depreciation of leased assets and dismantling costs

Financial year end: 31 December 2018
Category of issue: Recognition of costs for asset retirement obligations and the period to be used for the depreciation of such costs.
Standards or requirements involved: IFRS 16

Description of the issuer's accounting treatment

19. The issuer operates in the mobile telecommunications sector. It entered into a lease agreement to rent land, which includes obligations at the end of the lease to remove the property, plant and equipment ("PPE") that the issuer installs on the leased space (e.g. telecommunications equipment).

20. The issuer decided to recognise the costs for asset removal obligations ("ARO"), in accordance with paragraph 24 (d) of IFRS 16 and as such capitalise the costs within the Right of Use ("RoU") assets, instead of accounting for them in accordance with paragraph 16 (c) of IAS 16 and capitalise the costs with the item of PPE that is to be dismantled. This has an impact on the presentation of the statement of financial position.

21. The issuer used the useful life of the telecommunications licenses as the depreciation period for ARO and not the estimated terms of the leased lands or the useful life of the telecommunications equipment as it is unable to foresee the dates when each individual telecommunications site would have to be dismantled.

The enforcement decision

22. The enforcer accepted the accounting treatment applied by the issuer in the recognition of the costs of removing the telecommunications equipment and restoring the leased land as part of the RoU assets in accordance with paragraph 24 (d) of IFRS 16.

23. However, the enforcer did not agree with the issuer's determination of the useful life regarding the costs of ARO (i.e. depreciation over the telecommunications licenses' useful life). The enforcer required the issuer to amend the accounting treatment used for the depreciation of the asset representing the costs for ARO and to use the lease term of its RoU assets instead. The enforcer also pointed out that a consistent period should be applied to both, the depreciation period for the costs for ARO and the discount period for the ARO provision in its future consolidated financial statements, being the lease term of the underlying asset.

Rationale for the enforcement decision

24. According to paragraph 24 (d) of IFRS 16, the costs of the RoU asset shall comprise an estimate of costs to be incurred by the lessee in dismantling and removing the asset, restoring the underlying asset to the condition required by the terms and conditions of the lease [..]. The obligation to restore the land to its original condition stemmed from the lease agreement and the accompanying terms and conditions.

25. With respect to the depreciation period to be used for ARO, the enforcer concluded that the issuer should use the lease term, determined in accordance with paragraph 18 of IFRS 16, as the depreciation period. The rationale was substantiated by the following elements:

   a) the dismantling obligation is foreseen by the terms and conditions of the lease agreement;

   b) the costs for ARO are incurred in relation to the leased land and not in relation to other specific telecommunication equipment, i.e. the issuer could replace the telecommunications equipment without the obligation to dismantle being triggered;

   c) the issuer is obliged to restore the land to its original condition when the lease is over; and

   d) the depreciation period of the costs for ARO should be aligned with the lease term of the land which is the underlying asset and would also coincide with the reasonably certain period of the lease (determined following paragraph 19 of IFRS 16).

IV. Decision ref EECS/0121-04 – Impairment of finance lease receivables

Financial year end: 31 December 2018
Category of issue: Finance lease, Expected credit losses, Credit risk exposure disclosures.
Standards or requirements involved: IFRS 9, IFRS 7 *Financial Instruments: Disclosures*

Description of the issuer's accounting treatment

26. The issuer is a credit institution. One of its operating segments related to international financial leasing services ("International Leasing") accounts for significant shares of the issuer's total assets and pre-tax income, just as finance lease receivables represent a material portion of the total loans and advances at amortised cost and of the 2018 total assets.

27. In its accounting principles, the issuer states that a "simplified model, which is based on a historic default rate for the portfolio in question is used to determine the expected credit loss (ECL) for exposures at Leasing International level". Based on this information, it could be understood that the issuer has made the accounting policy choice to measure the ECL allowance for its lease finance receivables at an amount equal to lifetime ECLs, as permitted by paragraph 5.5.15(b) of IFRS 9.

28. However, a table showing a breakdown of loans and receivables due from customers subject to impairment by stage in the notes to the financial statements, indicated that the ECL allowance for receivables related to finance leases was measured based on the general approach (as they were all categorised by stage) and not based on the simplified model.

29. Upon request, the issuer confirmed that it uses both simplified and general approaches to measure the ECL allowance of its finance lease receivables. In practice, certain entities (direct or indirect subsidiaries active in the "International Leasing" segment) use the general approach to calculate provisions, while others, which do not benefit from all the necessary risk parameters and for which the related operational burden for the development and maintenance of such model would be disproportionate in relation to their size and credit risk, use the

simplified approach. As of 31 December 2018, 87% of the issuer's finance lease receivables were subject to the general approach while 13% are subject to the simplified approach.

The enforcement decision

30. The enforcer disagreed with the accounting treatment followed by the issuer when measuring the ECL allowance in relation to finance lease receivables based on two different approaches (the simplified approach and the general approach). The enforcer required the issuer to choose a method to measure ECLs and apply it consistently to all its finance lease receivables.
31. Taking into account the importance of these transactions, the enforcer considered the general approach to be the most appropriate.
32. Finally, the enforcer requested the issuer to improve the disclosures in accounting policies related to the application of the simplified approach and its analysis of the credit risk exposure to lease receivables.

Rationale for the enforcement decision

33. According to paragraph 5.5.15(b) of IFRS 9, an entity shall always measure the loss allowance at an amount equal to lifetime ECLs for lease receivables that result from transactions that are within the scope of IFRS 16, if the entity chooses as its accounting policy to measure the loss allowance at an amount equal to lifetime ECLs. That accounting policy shall be applied to all lease receivables but may be applied separately to finance and operating lease receivables.

V. Decision ref EECS/0121-05 – Presentation of expenses related to COVID-19

Financial year end: 30 June 2020
Category of issue: Presentation of the non-recurring expenses, Interim financial statements.
Standards or requirements involved: IAS 1 *Presentation of financial statements*

Description of the issuer's accounting treatment

34. In its interim financial statements, the issuer presented some costs and expenses related to COVID-19 as non-recurring items. The issuer classified expenses such as exceptional bonuses of employees, logistic costs including cleaning, sanitising and other protective measures for employees, representing around a quarter of its recurring operating profit, as non-recurring items. Therefore, the issuer excluded these costs and expenses from its recurring operating results.
35. According to the issuer, COVID-19 related costs and bonuses meet its definition of non-recurring income or expense because they result from events or transactions that do not relate to the issuer's ordinary activities in view of their nature, frequency or materiality.

The enforcement decision

36. The enforcer disagreed with the presentation of COVID-19 related costs specified by the issuer as non-recurring items, as this did not provide a fair, consistent and relevant presentation as

required by paragraphs 17, 45 and 46 of IAS 1. Therefore, the enforcer required the issuer to present these costs and expenses in its primary financial statements within the costs of goods sold, selling expenses and overhead expenses depending on their nature.

Rationale for the enforcement decision

37. According to paragraph 17(b) of IAS 1, a fair presentation requires an entity to present information, including accounting policies, in a manner that provides relevant, reliable, comparable and understandable information.

38. Furthermore, paragraph 46 of IAS 1 states that an entity changes the presentation of its financial statements only if the changed presentation provides information that is reliable and more relevant to users of the financial statements and the revised structure is likely to continue, so that comparability is not impaired.

39. The enforcer considered that the issuer's presentation of COVID-19-related items did not comply with the presentation requirements of IAS 1 for the following reasons:

    a) it was not clear if the COVID-19 effects in the financial statements of the issuer had been determined reliably. The COVID-19 pandemic impacted more than one line item of the profit and loss statement and thus it was not appropriate to isolate some of the costs and expenses in a single line and exclude them from the recurring operating income when other effects, which were positive, were presented in aggregate;

    b) the explanation provided by the issuer to classify some costs and expenses as linked to COVID-19 was not convincing. For instance, certain employee bonuses were classified by the issuer as COVID-19 related. However, these costs were also linked to an increase of the activity and efficiency of the issuer;

    c) it was not certain whether the effects of the COVID-19 pandemic would be limited to one period and not affect the performance of the issuer in future reporting periods. Therefore, classifying these costs and expenses as non-recurring was not appropriate.

VI. Decision ref EECS/0121-06 – Presentation current/ non-current liabilities in the balance sheet

Financial year end: 31 December 2019
Category of issue: *Classification of a debt issued by the issuer, as non-current liability*
Standards or requirements involved: IAS 1, IAS 34 *Interim Financial Reporting*

Description of the issuer’s accounting treatment

40. The issuer is a biotechnology company. In October 2017, the issuer issued debt fully subscribed by company B, for an amount representing around 30% of the total liabilities of the issuer. According to the initial terms of the loan, the repayment was due in October 2020. Concurrently, the issuer signed another contract with company B with similar maturity, to develop activities in the area of biotechnology. The issuer considered the two contracts linked as the loan was used to finance the activities and operations foreseen in the second contract.

41. In the end of 2019, the issuer requested the extension of the term of both contracts (the loan and the development contract) by one year. While the development contract was extended without further ado, in December 2019, company B signed a letter notifying the issuer that the extension of the debt maturity to October 2021 was upon condition that the issuer formally demonstrated its ability to reimburse the loan at the new maturity date. As of 31 December 2019, company B had not formally validated that the condition set in the letter was met.

42. In April 2020, an amendment to the debt agreement was signed between the issuer and company B deferring the repayment of the debt liability to October 2021.

43. In its financial statements as of 31 December 2019, the issuer classified the financial liability as a non-current liability. The issuer considered that the condition set by the letter signed by company B in December 2019 was met at the closing date because:

    a) in December 2019, the issuer signed a preliminary financing term agreement with company C (a new investor) for an amount that the issuer considered sufficient to finance its current operations for two years and the reimbursement of the debt with company B by October 2021;

    b) company B, who was represented on the issuer's board of directors, was informed of the financial situation, the liquidity, the financial projections of the issuer and the new financing term signed with company C.

The enforcement decision

44. The enforcer disagreed with the issuer's classification of the financial liability as non-current because, as of 30 December 2019, the issuer did not have the unconditional right to defer the repayment of the liability for at least twelve months after the reporting date. The enforcer noted that, as of 31 December 2019, there was no legal and formal amendment of the debt agreement, or a formal and legally binding acknowledgement of company B that the conditions for extension of the debt maturity were met. Therefore, the enforcer required the issuer to reclassify the debt as current.

Rationale for the enforcement decision

45. The enforcer considered that the classification is not compliant with paragraphs 69 (d) and 73 of IAS 1. According to paragraph 73 of IAS 1, if an entity has the right, at the end of the reporting period, to roll over an obligation for a least twelve months after the reporting period under an existing loan facility, it classifies the obligation as non-current even if it would otherwise be due within a shorter period. However, when refinancing or rolling over the obligation is not at the discretion of the entity (for example there is no arrangement for refinancing), the entity does not consider the potential to refinance the obligation and classifies the obligation as current.

46. The enforcer concluded that the letter from company B and the new financing term agreement with investor C were not sufficient to consider that the issuer had an irrevocable right at the balance sheet date to defer the settlement of the liability for at least twelve months after the reporting period. When taking this decision, the enforcer noted that at the reporting date:

    a) the issuer had not signed a definitive, formal and irrevocable contract with company C but only a preliminary financing term agreement;

b) company B had never formally confirmed that the conditions set out in its letter were met as of 31 December 2019. The participation of company B in the issuer's board meetings and its knowledge of the issuer's financial situation did not demonstrate that the liability was no longer due to be settled within twelve months after the end of the reporting period;

c) refinancing was not at the discretion of the issuer as a third-party investor was involved.

VII. Decision ref EECS/0121-07 – Reconciliation of net-debt

Financial year end: 31 December 2018
Category of issue: Presentation of changes in liabilities arising from financial activities.
Standards or requirements involved: IAS 7 *Statement of Cash Flows*

Description of the issuer's accounting treatment

47. The issuer presented in the notes to the financial statements a reconciliation of a net financial debt for the period (1/1/2018 to 31/12/2018). The issuer defined its net financial debt as the sum of its financial debts, the fair value of its hedging instruments, less the amounts of its cash and cash equivalents and other financial assets used for treasury purposes.

48. The reconciliation of net financial debt included:

    a) Net financial debt as of 1/1/2018;

    b) Total net cash flows movements of the period stemming from operating, investing and financing operations, respectively, excluding changes in financial debts and financial assets;

    c) Other non-cash movements in net financial debt;

    d) Net financial debt as of 31/12/2018.

49. Narrative and quantitative information regarding the nature and amount of the main cash flows arising from financing activities was also disclosed in the notes to the financial statements. This included, for example, dividends paid to the issuer's shareholders, acquisitions and disposals of treasury financial assets, cash payments on acquisitions of non-controlling interests and capital increase, and the nature and amount of the main movements on borrowings and financial debt.

The enforcement decision

50. The enforcer considered that the information disclosed did not fully enable users of financial statements to evaluate changes in liabilities arising from financing activities, in accordance with paragraph 44A of IAS 7.

Rationale for the enforcement decision

51. The enforcer noted that when an entity discloses a reconciliation in accordance with paragraph 44D of IAS 7, it should ensure that the reconciliation enables investors to link items included in the reconciliation to other items/ amounts included in the financial statements. In doing this, an entity should apply, amongst others, the following paragraphs of IAS 7:

    a) Paragraph 44C to identify liabilities arising from financing activities and use them as the basis of the reconciliation.

    b) Paragraph 44E to disclose changes in liabilities arising from financing activities separately from changes in any other assets and liabilities.

    c) Paragraph 44D to provide sufficient information to enable investors to link the items included in the reconciliation to amounts reported in the statement of financial position and the statement of cash flows, or related notes.

52. The enforcer considered that the IFRS IC observed in its September 2019 meeting that an entity applies judgement in determining the extent to which it disaggregates and explains the changes in liabilities arising from financing activities included in the reconciliation to meet the objective in paragraph 44A of IAS 7.

53. The enforcer considered that the changes in liabilities arising from financing activities should have been disclosed separately and with sufficient details. In the opinion of the enforcer, since the issuer did not disclose the main changes arising from non-cash movements on financial liabilities, the reconciliation prepared by the issuer under paragraph 44D of IAS 7 was not sufficiently detailed and did not meet the objective set out in paragraph 44A of IAS 7.

54. The enforcer required the issuer to add a narrative or tabular disclosure detailing the non-cash changes in liabilities arising from financing activities separately from non-cash changes in other assets and liabilities from operating and investing activities.

VIII. Decision ref EECS/0121-08 –Disclosures of financial risk

Financial year end: 31 December 2018
Category of issue: Disclosure of forward-looking information and further risk factors.
Standards or requirements involved: IAS 1 and IFRS 7

Description of the issuer's accounting treatment

55. The issuer is a large bank. Income from savings and loans constitutes a significant part of the issuer's total income and is therefore of significant importance to users of the issuer's financial statements. In its consolidated financial statements, the issuer offset negative interest paid on financial assets against "interest income" and positive interest income received from financial liabilities against "interest expense". The offset amounts were neither presented separately in the income statement nor disclosed in the notes.

56. Moreover, the issuer disclosed, amongst others, limited information on:

a) the use of forward-looking information when determining ECLs. The issuer explained that the forward-looking information included management's current macroeconomic expectations and referred to the preparation of three macroeconomic scenarios;

b) its write-off policy, including information on the expectation of recovery and on financial assets that were written off. The issuer merely replicated provisions and terminology included in IFRS;

c) how it determines whether the financial asset is credit impaired; and

d) its definition of default. The issuer referred to the definition of default in EU regulation no 575/2013, whereas, according to its definition of credit-impaired financial assets, stage 3 facilities are facilities where the financial asset is non-performing or otherwise credit-impaired.

The enforcement decision

57. The enforcer disagreed with the issuer's presentation regarding offsetting interest income and expenses. Furthermore, the enforcer considered the disclosures provided by the issuer referred to above were neither complete nor sufficiently entity-specific. Therefore, the enforcer required that the issuer improve its disclosures and change the presentation of interest expense on financial assets and interest income from financial liabilities.

Rationale for the enforcement decision

58. The enforcer noted that paragraphs 32 and 33 of IAS 1 generally do not permit offsetting income and expenses. The enforcer considered the IFRS IC Agenda Decision on January 2015 that concluded that interest resulting from a negative effective interest rate on a financial asset does not meet the definition of interest revenue, because it reflects a gross outflow, instead of a gross inflow, of economic benefits. Consequently, the expense arising on a financial asset because of a negative effective interest rate should not be presented as interest revenue, but in an appropriate expense classification. Therefore, the enforcer required the issuer to change the presentation of the effects of negative interest rates in the income statement and to provide further information regarding the amounts of interest expense on financial assets and interest income from financial liabilities in order to comply with the requirements of paragraphs 85 and 112(c) of IAS 1.

59. Following paragraph 35G(b) of IFRS 7, the enforcer concluded that disclosures on the use of forward-looking information when determining ECLs needed to be more specific. Disclosures on how the issuer considered macroeconomic variables such as expected GDP growth, number of bankruptcies, unemployment and inflation were deemed relevant to enable users to understand the issuer's assessment of ECLs.

60. In order to enable users to assess the recoverability of claims, the issuer should have provided a company-specific description of its write-off policy, including the indicators that there is no reasonable expectation of recovery and information about the policy for financial assets that are written-off but are still subject to enforcement activity in accordance with paragraph 35F(e) of IFRS 7.

61. The enforcer considered the issuer's disclosure on determining whether the financial assets were impaired to be too generic to comply with paragraph 35G(a)(iii) of IFRS 7. Therefore, the enforcer asked the issuer to improve its disclosures on the inputs to the assessment of impairment, the underlying assumptions as well as the estimation techniques used.

62. The definition of default was deemed too generic. The enforcer required the issuer to improve its definitions of default in order to allow users to understand the effects of credit risk on the amount, timing and uncertainty of future cash flows as required by paragraphs 35B and 35F(b) of IFRS 7. In particular, the enforcer required the issuer to disclose how it applies the different default definitions in relation to the various types of financial instruments and the reasons for selecting those definitions.

63. Finally, in the case of the definition of credit-impaired financial assets, the enforcer was of the view that users were not able to discern how the issuer determined that financial assets are credit-impaired as per paragraph 35F(d) of IFRS 7.

IX. Decision ref EECS/0121-09 – Measurement of purchased credit impaired assets (POCI)

Financial year end: 31 December 2018
Category of issue: Measurement of financial assets; Purchased or originated credit impaired assets (POCI)
Standards or requirements involved: IFRS 9

Description of the issuer's accounting treatment

64. The issuer is a company whose core business is credit management. The company purchases portfolios of credit impaired loans for a small portion of the nominal value of the assets in order to collect payments on these debts. Each portfolio usually consists of a large number of homogeneous loans. When purchasing a loan portfolio, the issuer prepares a projection of the portfolio's estimated future cash flows, which also takes into account estimates of ECLs and forecasted collection costs. Based on the estimated portfolio cash flows, an initial effective interest rate is calculated for each portfolio (credit-adjusted effective interest rate).

65. The issuer measures the acquired loans at amortised cost. According to the issuer's accounting policy, the effective interest rate used to calculate amortised cost at the end of each reporting period may be adjusted if this interest rate remains within a range between 5 and 25 percent.

66. The issuer argued that IFRS 9 does not preclude changes of the initial credit-adjusted effective interest rate within a predetermined interval. The issuer also argued that according to IAS 8, many accounting measurements are based on estimates and assumptions that may change in future periods.

67. In line with the issuer's accounting policy, the original effective rate may be adjusted when calculating the new amortised costs of the portfolio assets after revising the cash-flow estimates. For a portfolio of credit impaired loans acquired in March 2016, the issuer determined at initial recognition a credit-adjusted effective interest rate of around 12%. In the

second half of 2017, a new estimation resulted in significantly lower estimated future portfolio cash flows. Discounting these cash flows at the portfolio's original effective interest rate would have led to a significant loss due to the lower amortised cost of the portfolio assets. However, in calculating the new amortised cost, the issuer reduced the effective interest rate from 12% to 5% (the lowest mark of the internal range). The loss from the reduced estimated cash-flows was offset by the gain resulting from the adjusted effective interest rate.

68. The issuer argued that IFRS 9 does not provide a precise definition of a variable interest rate with regard to purchased credit impaired assets. In the issuer's view, the cash flows resulting from purchased credit impaired loans are variable in nature because they often differ significantly from contractual cash flows and their estimates are subject to variability. The issuer consequently concluded that the application of paragraph B5.4.5 of IFRS 9 justifies an adjustment of the effective interest rate in the event of a re-assessment of the assets' future cash flows.

The enforcement decision

69. The enforcer did not agree with the issuer's accounting treatment. The enforcer concluded that the issuer shall continue to use credit-adjusted effective interest rate determined at initial recognition to calculate the amortised cost of the purchased credit-impaired assets.

Rationale for the enforcement decision

70. According to paragraph 5.4.1 of IFRS 9, interest revenue for purchased or originated credit-impaired financials assets (POCI assets) shall be calculated using the effective interest method, with the credit-adjusted effective interest rate applied to the amortised cost of the financial asset from initial recognition. The ECLs for these assets shall be discounted in accordance with paragraph B5.5.45 of IFRS 9 using the credit-adjusted effective interest rate determined at initial recognition.

71. Paragraph B5.4.5 of IFRS 9, to which the issuer referred, is not applicable because the re-estimation of cashflows for loans in the portfolios of credit impaired losses purchased by the issuer did not reflect movements in market rates.

X. Decision ref EECS/0121-10 – Disclosure of the effects of changes in the credit risk related to financial liabilities designated as at fair value through profit and loss

Financial year end: 31 December 2018
Category of issue: Disclosures on financial liabilities at fair value through profit and loss; Change in fair value of a financial liability attributable to changes in its credit risks
Standards or requirements involved: IFRS 9

Description of the issuer's accounting treatment

72. The issuer is a bank that finances a specified group of loans by issuing bonds whose changes in fair value tend to offset each other. The contractual terms of these instruments demonstrate a contractual link between the effects of changes in the credit risk of the bonds and changes in the fair value of the loans.

73. The issuer issues and buys-back the bonds regularly, whereas the loans are not traded with very few exceptions. To reduce accounting mismatches, the entity designated both the bonds and the loans as at fair value through profit or loss in order to eliminate the inconsistency in the timing of the recognition of the gains and losses that would otherwise result from measuring them both at amortised cost and recognising a gain or loss each time a bond is repurchased.

74. Since presenting changes in the fair value of the bonds attributable to changes in their credit risk in other comprehensive income would have enlarged an accounting mismatch in profit or loss, the entity presented all gains and losses on the liabilities (including the effects of changes in the credit risk) in profit or loss in accordance with paragraph 5.7.8 of IFRS 9.

75. When an issuer designates financial liabilities as at fair value through profit or loss, paragraph 10A of IFRS 7 requires the issuer to disclose the amount of change, during the period and cumulatively, in the fair value of the financial liability that is attributable to changes in the credit risk of that liability. In addition, in accordance with paragraph 11 of IFRS 7, the issuer is required to disclose a detailed description of the methods used to comply with the requirements in paragraph 10A. The issuer did not disclose the information required by the referred paragraphs.

The enforcement decision

76. The enforcer concluded that the issuer shall provide the disclosures required by paragraphs 10A and 11 of IFRS 7 in relation to liabilities arising from the issued bonds.

Rationale for the enforcement decision

77. The enforcer assessed that disclosure of the impact of changes in the credit risk of liabilities designated as at fair value through profit and loss and of the methods applied is material information. In this assessment, the enforcer emphasised that designated financial liabilities amounted to more than half of the issuer's balance sheet and, therefore, disclosure of this information is necessary to assess whether and how changes in the credit risk of the liabilities affect the financial statements.