



European Securities and
Markets Authority

Report

21st 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 June 2015 to February 2017. ESMA will continue publishing further extracts from the database on a regular basis.

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
ERV	Estimated Rental Value
IAS	International Accounting Standards
IFRS	International Financial Reporting Standards
IFRS IC	International Financial Reporting Standards Interpretation Committee
REIT	Real Estate Investment Trust
UCITS	Undertaking for Collective Investment in Transferable Securities
VIU	Value In Use

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

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

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

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

The publication of selected enforcement decisions 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, 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/0117-01 – Country risk premium in impairment test

Financial year end: 31 Dec 2015

Category of issue: Country risk premium in the impairment test of oil and gas assets;
Determination of pre-tax discount rate.

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

Description of the issuer's accounting treatment

1. The issuer holds oil and gas assets in a third country subject to significant political turmoil and increasing political uncertainty. These assets were tested for impairment by calculating their Value in Use (VIU). For this purpose, the pre-tax discount rate applied was calculated based on the issuer's Weighted Average Cost of Capital (WACC) at year-end 2015. The issuer decided to reflect the country risk premium as part of the discount rate rather than in the cash flows.
2. In the financial years between 2012 to 2015, the discount rate adopted by the issuer for the VIU calculation had significantly decreased. According to the issuer, in 2015 the discount rate was in line with the rate used by peers (as disclosed in their annual reports), as well as with those indicated by external analysts and valuation reports. However, the issuer had not taken into account updated available external sources that provide explicit estimates of country risk premium and had not provided a rationale as to why the discount rate adopted had decreased over time.

The enforcement decision

3. The enforcer did not agree with the issuer's determination of the discount rate used for the impairment test of the oil and gas assets located in the third country as the rate and the country risk premium reflected therein were not based on the assessment of all available sources of information.

Rationale for the enforcement decision

4. The enforcer noted that the decline in the discount rates adopted by the issuer between 2012 and 2015 was not supported by any improvements in observed risk factors in the third country where the assets were located. Rather, the enforcer highlighted that market prices of traded bonds for that area indicated that the current cost of debt was higher than the discount rate used by peers and analysts and adopted by the issuer. As the WACC takes into account both the cost of debt and the costs of equity and the cost of equity cannot be lower than the cost of debt, the enforcer concluded that the discount rate used by the issuer that was lower than the observed cost of debt could not be accepted.
5. Furthermore, the enforcer noted that according to paragraph 32 and A18 of IAS 36, the risks specific to the asset, including country risk, should be reflected either in the cash flows or in the

discount rate. According to paragraph 55 of IAS 36, the discount rate shall reflect current market assessments of the time value of money and the risks specific to the asset. While the enforcer acknowledged that estimating the country risk is a widely debated topic with different approaches available on how to calculate, it noted that it is necessary to take into account all available market information, including estimates of country risk premium from external sources.

6. Finally, the enforcer indicated that it would be inappropriate to analogize to the discount rates used by peers, external analysts and valuation reports without having specific information on how and if these analyses and valuations take into account country risk in the cash flows or use other risk adjustment on the discounted values. The enforcer noted that according to paragraph 56 of IAS 36, the rate shall reflect the return investors would require if they were to choose an investment that would generate cash flows of amounts, timing and risk profile equivalent to those that the entity expects to derive from the asset.

II. Decision ref EECS/0117-02 – Assessment of joint control

Financial year end: 31 December 2014

Category of issue: Joint Control; Control

Standards or requirements involved: IFRS 11 *Joint Arrangements*; IFRS 10 Consolidated Financial Statements

Description of the issuer's accounting treatment

7. Issuer A, a retail group, has a 42% shareholding interest in entity B, which it created together with eight other investors. These other partners are either financial institutions or venture capitalists that own between 1.6% and 14.5% of entity B's shares. Entity B owns and manages commercial centres. In each commercial centre managed by entity B, issuer A owns a supermarket; whereas the rest of the commercial centre is owned by entity B. Entity B earns revenue through rental of the owned premises and management fees but also through acquisition and disposal of assets. Therefore, entity B's relevant activities are property development, the management of commercial centres, and the acquisition and disposal of assets.
8. All significant decisions of entity B are taken by its board of directors. According to the bylaws of entity B, issuer A nominates a maximum of 5 of the 12 board members. One board member should be independent and each of the six shareholders that hold more than 5% of the shares nominates one board member. Some decisions, such as the approval of the budget, annual review of the business plan, significant investments or divestments, financial debt issuance or merger or transfer of assets require a 2/3 majority and can thus not be taken against the will of entity A. No shareholder has any specific right and no shareholder agreement was signed.
9. Issuer A considered it had joint control over entity B because it held 42% of entity B's shares and therefore had a veto right on some decisions, which means that an agreement had to be found between issuer A and some other shareholders for a decision to be taken.

The enforcement decision

10. The enforcer did not agree with this assessment. Issuer A did not have joint control over entity B which instead was regarded as an associate of issuer A.

Rationale for the enforcement decision

11. Paragraph 7 of IFRS 11 defines joint control as “the contractually agreed sharing of control of an arrangement, which exists only when decisions about the relevant activities require the unanimous consent of the parties sharing control.” As illustrated in the application examples 2 and 3 in paragraph B8 of IFRS 11, to be a joint arrangement, it must be clear which combination of parties is required to agree unanimously to decisions about the relevant activities of the arrangement. However, in the case at hand there is more than one combination of parties possible to reach the required majority. Therefore, issuer A does not have joint control.
12. Furthermore, the enforcer assessed whether issuer A controlled entity B. However, the enforcer concluded that issuer A did not control entity B. Paragraph B14 of IFRS 10 clarifies that in order to have power over an investee, an investor must have existing rights that give it the ability to direct the relevant activities. In the case at hand, entity A did not have the ability to direct the relevant activities as it could only block decisions, but could not unilaterally make decisions. There were no contractual arrangements that gave the issuer additional powers beyond its voting rights. Furthermore, as there were only eight other investors, these could have acted together to outvote the issuer.

III. Decision ref EECS/0117-03 – Valuation and equity method for participation with restrictions

Financial year end: 31 December 2015

Category of issue: Accounting for Associates; Fair value measurement

Standards or requirements involved: IFRS 13 *Fair Value Measurement*; IAS 28 *Investments in Associates and Joint Ventures*

Description of the issuer’s accounting treatment

13. The issuer holds 90% of the share capital of entity B, a public welfare housing company, and the other 10% is held by the issuer’s parent, a holding company. According to local law, public welfare housing companies must provide affordable housing to the public. In return, all profits are tax exempt and housing companies can receive various subsidies. To be granted the status of a public welfare housing company, the local government has to accept the application for this status. Public welfare housing companies are subject to several restrictions, which include:
 - a) The total annual profit distributable to the shareholders shall not exceed 3.5% of the total paid-in capital;
 - b) The profits that cannot be distributed to the shareholders accrue in a special equity account which can be used to cover future losses. They represent the remaining

claim in the net assets of the housing company after repaying the paid-in capital and the capped profits to shareholders;

- c) Upon liquidation or revocation of the public welfare status, the non-distributable profits accrued in the special equity account are payable to the local government. The government may nominate another public welfare housing company as the recipient;
- d) There is no legally permissible way for shareholders to extract profits beyond the 3.5% profit limit. The law explicitly prevents any means of extracting any capital beyond capped profits and the paid-in capital (e.g. through mergers into non-welfare companies, capital adjustments, redemptions, etc.);
- e) A unilateral termination of the status as a public welfare housing company requires the approval of the local government, which would then extract the non-distributable accumulated profits in the special equity account.

14. In 2013, the issuer transferred all voting rights in entity B to its parent company while retaining the 90% capital share and a minority representation in the managing bodies of the housing company. As the transfer of voting rights led to the loss of control over entity B, the issuer deconsolidated the public welfare housing company from its accounts. Upon deconsolidation, the issuer measured the fair value of the retained investment in the former subsidiary disregarding the above-mentioned restrictions.

15. After deconsolidation, the issuer considered entity B to be an associate and applied the equity method. When applying the equity method, it recognised 90% of the public welfare housing company's profits without considering the limits on distribution and the government's claims on the non-distributable profits. The issuer recognised in the years 2013, 2014 and 2015 a share of profits of more than 100 million CU, while the maximum distributable dividends to the issuer amounted to only about 4 million CU. The issuer argued that according to paragraph BC18 of IAS 28, the equity method would also be applicable when severe long term-restrictions impair an associate's ability to transfer funds to the investor.

The enforcement decision

16. The enforcer did not agree with the issuer's accounting treatment. When measuring the fair value of the retained investment in the former subsidiary, the issuer should have taken into account the restrictions to extract profits. Furthermore, the enforcer concluded that when applying the equity method, the issuer should account for its actual share in the profits and net assets of the investee, which due to the restrictions is lower than its nominal shareholding.

Rationale for the enforcement decision

17. According to paragraph 11 of IFRS 13, when determining fair value, an entity shall take into account the characteristics of the asset if market participants would take those characteristics into account, including restrictions on the sale or use of the asset. As the restrictions on the business of the public welfare housing companies would also be transferred to potential buyers, other market participants would take them into account in the valuation.

18. Paragraph 3 of IAS 28 sets out that an investor should include in its profit or loss its share of the investee's profit or loss and in its other comprehensive income the share of the investee's other comprehensive income. Therefore, when the economic interest of an investor does not correspond to its nominal shareholding, the investor should account for the amount of its interest in the profits and net assets of the investee. In the case at hand, issuer A's share of entity B's profits is limited to 3.5% of the paid-in capital. The issuer has no claim on the non-distributable accumulated profits and therefore, should exclude them when determining its share of profit or loss and net assets. The issuer is correct that according to paragraph BC18 of IAS 28 the equity method is applicable where there are restrictions impairing the ability to transfer funds. However, when applying the equity method, only the share of the investee's profit or loss and other comprehensive income that the investor is entitled to should be recognised by the investor.

IV. Decision ref EECS/0117-04 – Assessment of joint control

Financial year end: 31 January 2016

Category of issue: Joint control; control

Standards or requirements involved: IFRS 11 *Joint Arrangements*; IFRS 10 *Consolidated Financial Statements*

Description of the issuer's accounting treatment

19. The issuer acquired 49.5% of the shares in Entity X from Entity Y and accounted for it as an associate in accordance with IAS 28 *Investments in Associates and Joint Ventures*. The following are the key terms and conditions of the share purchase agreement (hereinafter 'the agreement') on the basis of which the issuer concluded that the treatment of Entity X as an associate was appropriate:

- a) the Board of Directors of Entity X will comprise five members, three of which will be appointed by Entity Y and two by the issuer;
- b) the right to designate the Chairman of Entity X is reserved to Entity Y;
- c) certain 'restricted matters' require in addition to a majority vote of the Board of Directors also a 'qualified consent' (positive vote) from the issuer. The restricted matters require the agreement of both the Entity Y and the issuer. The 'restricted matters' include: altering constitutional documents; changing or varying the share capital; modifying, varying or abrogating any rights attaching to any shares; material changes in the nature or scope of the business; acquisitions and disposals or partnerships and joint ventures other than as contemplated by business plan; appointing or removing the Chief Executive or Chief Financial Officer; adopting or amending the business plan or annual budget; borrowing other than as contemplated by business plan, annual budget or investor approved financing arrangements; capital expenditure, other than as contemplated by business plan or annual budget; entering into any contract outside the ordinary course of business; appointing or removing the auditors; approving the statutory accounts and/or any change in the accounting principles or tax policies and/or any change in the end of

the financial year; declaring or paying any dividend or distribution dividends other than as contemplated by business plan or annual budget; and entering into, renewing or amending any transaction, contract or arrangement with any investor or a member of its investor group.

- d) Call option granted to the issuer: Entity Y irrevocably undertakes to transfer all its shareholding in Entity X to the issuer if the issuer exercises its call option. The call option could be exercised during specified periods in 2018, 2019 and 2020.
- e) 'Drag-along' provision: in the event that the issuer does not exercise the call option, Entity Y has the right to require the issuer to sell its 49.5% interest as part of a joint exit.

20. In addition the issuer believed that accounting for Entity X as an associate was appropriate on the basis of the following elements:

- a) the issuer holds a minority shareholding in Entity X;
- b) the issuer holds only two out of the five seats on Entity X's Board of Directors;
- c) while the 'restricted matters' require the issuer's positive approval, all other decisions require only a majority vote of Entity X's Board of Directors;
- d) the 'restricted matters' provide the issuer with protective rights and allow it to have the ability to influence the relevant activities, but these rights do not allow it to direct the relevant activities of Entity X;
- e) the 'restricted matters' allow the issuer an increased level of participation in the critical operating decisions of Entity X, but Entity Y continues to control the primary decisions and resolution of such matters. Entity Y continues to substantially control all major decisions in connection with management of the business of Entity X; and
- f) Entity Y has the initial decisions on the selection of the recruiting firms and the lists of individuals proposed for any key roles.

The enforcement decision

21. The enforcer did not agree with the issuer's accounting treatment. When assessing whether an issuer has control or joint control over an entity, it shall take into account any veto power or qualified consent that the issuer has in relation to the strategic decisions over the relevant activities of the investee. As both the issuer and Entity Y have to agree on the restricted matters which involve decisions on Entity X's relevant activities, the enforcer concluded that the issuer has joint control over Entity X.

Rationale for the enforcement decision

22. According to Appendix A of IFRS 11 "joint control" is defined as: "*the contractually agreed sharing of control of an arrangement which exists only when decisions about the relevant activities require the unanimous consent of the parties sharing control*".

23. Appendix A of IFRS 10 defines relevant activities as “*activities of the investee that significantly affect the investee’s returns*”. As the issuer’s qualified consent is required for the ‘restricted matters’ which relate to strategic decisions over the operation and governance of Entity X, the enforcer believes that these matters relate to activities which are capable of significantly affecting the investee’s returns and therefore would meet the definition of ‘relevant activities’ in IFRS 10.
24. The enforcer also believes that the qualified consent on the restricted matters does not provide the issuer with mere protective rights but rather with substantive rights. Paragraph B27 of IFRS 10 states that: “*Because protective rights are designed to protect the interests of their holder without giving that party power over the investee to which those rights relate, an investor that holds only protective rights cannot have power or prevent another party from having power over the investee.*” The issuer’s veto power and qualified consent on the restricted matters require the issuer to take decisions over the relevant activities that are necessary to govern Entity X. The issuer’s veto power/qualified consent prevents Entity Y from having power over Entity X and therefore the issuer’s veto power/qualified consent are not protective rights.
25. Finally, the fact that the issuer does not participate in the day-to-day management of Entity X does not necessarily mean that it cannot be involved in directing the relevant activities. In assessing whether the issuer has power over Entity X, only substantive rights can be considered. For a right to be substantive, according to paragraph B22 of IFRS 10, the issuer must have the practical ability to exercise that right. The issuer has the right and power to use its veto on any decision relating to the restricted matters. The issuer’s veto power/qualified consent does amount to joint control as the issuer’s consent is required for the strategic decisions (relevant activities) in order to govern Entity X.

V. Decision ref EECS/0117-05 – Restatement of comparative amounts

Financial year end: 31 December 2014

Category of issue: Restatement, Interim Financial Statements

Standards or requirements involved: IAS 8 *Accounting Policies, Changes in Accounting Estimates and Errors*; IAS 34 *Interim Financial Statements*

Description of the issuer’s accounting treatment

26. The issuer is a financial institution which presented, in its 2014 consolidated annual financial statements, a maturity analysis of financial liabilities on an undiscounted basis and by remaining contractual maturity as at 31 December 2014 together with comparative information as at 31 December 2013.
27. In the maturity analysis table, selected comparative data (for year-end 2013) had been restated as compared with that presented in the issuer’s 2013 annual financial statements. These included deposits by banks that were restated by more than EUR 3bn, derivative liabilities restated by more than EUR 90m and the total column restated by more than EUR 250m.
28. In the notes to the issuer’s 2014 annual financial statements, the issuer indicated that it had made some reclassifications for the amounts in the maturity analysis of the financial liabilities in order

to enhance comparability, but did not provide any further disclosure as to the nature of the reclassifications.

29. The 2013 comparative amounts contained in the 2014 half-yearly consolidated financial statements, had also been restated and the issuer indicated in the notes that the restatements were made to improve comparability with the period presented.

The enforcement decision

30. The enforcer assessed that the restatement of comparatives, both in the annual and interim financial statements, related to the correction of a prior period error and that the disclosure requirements have not been complied with, in full, and therefore requested additional disclosure in future financial statements.

Rationale for the enforcement decision

31. The enforcer noted that paragraph 42 of IAS 8 requires an entity to correct material prior period errors retrospectively in the first set of financial statements authorised for issue after their discovery, by either restating the comparative amounts for the prior period(s) presented in which the error occurred; or, if the error occurred before the earliest prior period presented, by restating the opening balances of assets, liabilities and equity for the earliest prior period presented. Furthermore, paragraph 49 of IAS 8 requires an entity to disclose, amongst other things, the nature of the prior period error. Finally, the enforcer also noted that paragraph 15B(g) of IAS 34 requires disclosure of prior period errors, if significant.
32. In the enforcer's view, irrespective of the fact that the restatements did not relate to amounts presented on the primary financial statements, they related to material prior period errors as due to their nature and magnitude they could have influenced the decisions of users. The enforcer regarded disclosures related to the maturity of "deposits by banks" and funding as key information for users of the financial statements.
33. Finally, the enforcer also noted that the disclosures of the comparative data in both the consolidated annual and half-yearly accounts were insufficient for the following reasons:
- a) the data had not been explicitly identified as "restated" and did not explicitly identify the amount of the restatement nor the individual line items affected; and
 - b) no description of the nature of the prior period error was provided.

VI. Decision ref EECS/0117-06 – Disclosures on a reverse factoring transaction

Financial year end: 31 December 2015

Category of issue: Disclosures on reverse factoring

Standards or requirements involved: IAS 1 Presentation of Financial Statements; IAS 39: Financial Instruments: Recognition and Measurement

Description of the issuer's accounting treatment

34. The issuer, a telecommunication company, entered into a reverse factoring agreement whereby the financial institution becomes obligated for the payables towards the issuer's suppliers which have agreed to become a party to the reverse factoring. According to the agreement, the issuer repays the financial institution within a maximum period of 360 days after the date of the issuance of the invoice by the supplier. The remuneration is equal to Euribor plus a margin for the extension of the original maturity.
35. Given that the maturity of the liability to the financial institution was significantly longer than the initial maturity of the liability to the supplier, and that the financial institution receives compensation for that extension, the issuer decided to classify the liability resulting from the payables towards the suppliers that participate into the reverse factoring agreement as a financial liability under paragraph 54 of IAS 1 and not as a trade payable.
36. In addition, the issuer provided specific disclosures regarding the reverse factoring transaction describing its characteristics, including information on the changes in the characteristics of the liability (i.e. extension of maturity and interest paid) and the classification in the financial statements and amounts concerned.

The enforcement decision

37. The enforcer agreed with the issuer's assessment that the liability towards the financial institution arising from the reverse factoring agreement should be classified as a financial liability under paragraph 54 of IAS 1 rather than as a trade payable. The enforcer also agreed with the disclosures presented by the issuer on the agreement and its impact on the financial statements.

Rationale for the enforcement decision

38. The enforcer considered that once a supplier agrees to become a party into the reverse factoring agreement, a number of substantial modifications are made to the original payable, namely:
- a) the extension of maturity is significant with regard to customary terms of payment in the specific jurisdiction;
 - b) once a supplier enters into the agreement, all its invoices are automatically processed as part of the factoring scheme;
 - c) compensation is paid to extend the maturity of the original payable; and

d) the creditor is no longer the supplier, but a financial institution.

39. According to the enforcer these modifications indicate that the original liability has substantially changed and that in order to faithfully represent the effects of the reverse factoring agreement, the transaction should be depicted as a transaction giving rise to a new financial liability. In the enforcer's view this is consistent with paragraph 15 of IAS 1 requiring that financial statements present fairly the financial position, financial performance and cash flows of an entity and to do so financial statements need to provide a faithful representation of the effects of the underlying transactions.
40. The enforcer also considered that this is consistent with paragraph 40 of IAS 39 requiring that an exchange of debt instruments with substantially different terms is accounted for as an extinguishment of the original liability and the recognition of a new financial liability.
41. In addition, the enforcer believes that the disclosures provided by the issuer were appropriate to meet the information needs of users of financial information in line with the requirements of paragraphs 125 to 129 of IAS 1.

VII. Decision ref EECS/0117-07 – Assessment of control over investment funds

Financial year end: 31 Dec 2014

Category of issue: Control; delegated power; control of specified assets

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

Description of the issuer's accounting treatment

42. The issuer is an insurance company, which has holdings in sub-funds of an umbrella UCITS (undertaking for collective investment in transferable securities) fund. Although its holdings in the umbrella fund are very small, its holdings in some of the sub-funds are significant, in one case being a majority holding. The issuer determined that the sub-funds fulfil the conditions set out in paragraph B77 of IFRS 10 and can thus be treated as deemed separate entities (silos). The UCITS was designed by the sponsoring group, which includes the UCITS' board of directors and the investment manager of the sub-funds. The board of directors of the umbrella UCITS fund has extensive decision-making power over the sub-funds. It determines the investment objectives and policies and the investment manager has discretion to make investments within the investment policies. In most cases, the investors have a right to object to material changes to investment policies; however, these rights are protective in nature. The investors do not have substantive removal rights or other substantive rights that restrict the decision maker's discretion. The investment manager and the directors of the UCITS do not have any holdings in the sub-funds and receive a management fee based on a percentage of the funds' net asset values, plus in some cases a performance fee of up to 20% of the outperformance of a benchmark.

43. The issuer considered that it does not control the sub-funds as the power over the relevant activities of the sub-funds rests with the sponsoring group including the directors of the umbrella fund and the investment manager.

The enforcement decision

44. The enforcer agrees with the conclusions reached by the issuer that the issuer does not control the sub-funds because facts and circumstances indicate that the sub-funds are controlled by the UCITS' board of directors.

Rationale for the enforcement decision

45. The enforcer agrees with the issuer's assessment that the sub-funds are separate silos. The enforcer then assessed whether the issuer has control over the silos and determined that the directors of the UCITS umbrella fund have extensive decision-making authority. They determine the investment objectives and policies of the sub-funds. Paragraphs 17 and 18 of IFRS 10 require analysis whether that power is held by the UCITS' board of directors in their own right, as principals, or as agents for the investors in the fund. The enforcer considered the factors set out in paragraph B60 of IFRS 10 in order to assess whether UCITS' board of directors is acting as agent or as principal.

46. The enforcer noted that the management fee seems to be commensurate with the services provided and that there is no indication that the terms, conditions or amounts of the remuneration were not negotiated on an arm's length basis. The remuneration exposes the sponsoring group to variability of returns from the activities of the funds but does not create exposure that is of such significance that it indicates that the fund manager is the principal. Furthermore, proprietary interests of decision-makers in the sub-funds are forbidden, and there are no evidence of such holdings. The enforcer noted that the examples 13-16 in paragraph B72 of IFRS 10 indicate that in such cases the decision maker would act as an agent.

47. Based on the analysis above, the enforcer concluded that the board of directors of the UCITS, which is the decision maker for the sub-funds, is acting as agents for the investors in the UCITS umbrella fund. As the holdings in the UCITS umbrella fund are widely dispersed, the issuer does not control the sub-funds.

VIII. Decision ref EECS/0117-08 – Fair value measurement disclosures of unobservable inputs

Financial year end: 31 Mar 2016

Category of issue: Fair value measurement disclosures

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

Description of the issuer's accounting treatment

48. The issuer is a real estate investment trust (REIT) and is engaged in property investment with a view to maximising shareholders' returns through income and capital appreciation. The issuer has four classes of investment properties: commercial/office assets, industrial assets, residential assets and development assets.
49. The financial statements disclosed, in tabular format, the unobservable inputs used for the determination of the fair value of each class of investment property. All classes of investment properties were classified as Level 3 in the fair value hierarchy. Except for development assets, the unobservable inputs were disclosed for all other asset classes, as follows: annual rent per square metre [lowest and highest in range], estimated rental value (ERV) per square metre and the equivalent yield (%).
50. The disclosures of unobservable inputs for development assets were limited to a quantification of the equivalent yield. ERV data for development assets were disclosed only outside the audited financial statements in the management commentary.

The enforcement decision

51. The enforcer concluded that ERV is also a significant unobservable input for development assets and therefore the issuer had failed to disclose the related quantitative information. In addition, disclosures of the sensitivity of the fair value measurement to changes in these inputs was required if such changes might result in significantly higher or lower fair value. The enforcer required the issuer to provide this information in future financial statements.

Rationale for the enforcement decision

52. According to paragraph 93(d) of IFRS 13 an entity is required to disclose for Level 3 fair value measurements quantitative information about all significant unobservable inputs. Paragraph 93(h)(i) also requires an entity to disclose a narrative description of the sensitivity of Level 3 fair value measurements 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.
53. The enforcer noted that, based on the information provided by the issuer, the fair value of development assets was measured by means of a residual value method which utilises as key input the yield and the ERV. The enforcer also took into account that rents under existing leases were lower than market rents. In addition, the enforcer noted that the increase in the fair value of development assets during the year amounted to almost 50% of the total increase in the fair value

of all investment properties of the issuer for the year. For these reasons, the enforcer concluded that ERVs were a significant unobservable input for the fair value measurement of development assets.

54. All significant unobservable assumptions used in the fair value measurement are required to be disclosed by IFRS 13.93(d). In the enforcer's view, disclosing only the yield and sensitivity of yield was not sufficient to meet the disclosure requirements in IFRS 13. This was on the basis that the disclosure of the ERV assumptions (together with any other unobservable inputs e.g. yields) was necessary to gain an understanding of the judgements relating to the fair valuation of Level 3 development assets in accordance with IFRS 13. The enforcer regarded this information as important information for REITs.
55. Finally, the enforcer also acknowledged that ERV data for development assets were disclosed in the narrative accompanying the financial statements however, the narrative was itself insufficient to comply in full with IFRS 13.93(d). It was noted that the narrative accompanying the financial statements falls outside the audited financial statements and, therefore, was not audited.

IX. Decision ref EECS/0117-09 – Recognition and measurement of the proceeds from an arbitration agreement

Financial year end: 30 Jun 2015

Category of issue: Interim financial statements; recognition and measurement of provisions and contingent assets.

Standards or requirements involved: IAS 39 Financial Instruments: Recognition and Measurement; IAS 37 Provisions, Contingent Liabilities and Contingent Assets; IAS 18 Revenue

Description of the issuer's accounting treatment

56. The issuer is an IT company which pursued in court another company, Entity X, for the infringement of the issuer's patents. Following an arbitration procedure in front of a third country court, Entity X agreed to pay damages to the issuer. There is no ability to appeal this ruling and the issuer expected to receive the full payment by the end of the year. The issuer provided disclosure about the successful arbitration procedure in the interim financial statements, but did not recognise any income. Shortly after the end of the interim period the issuer received a first tranche of the payment by Entity X which is disclosed but not recognised, in its interim financial statements. In the notes to the interim financial statements, the issuer also disclosed that it expected the remaining receivable to be settled within the following 12 months.
57. Despite the fact that Entity X had agreed to pay the damages for the patent infringement, the issuer argued that, at the end of the reporting period, there were still be uncertainties as to whether the amount agreed would be received, because the court decision was taken in a third country that was neither the country of the issuer, nor the country of Entity X. The issuer argued that Entity

X may not comply with the decision taken by the third country court and that the decision may not be enforced by the authorities in the issuer's home country.

58. In addition, the issuer had doubts whether Entity X had the financial means to pay this amount.
59. Finally, the issuer argued that according to IAS 18 the conditions for the recognition of income associated with the winning case were not met.
60. Consequently the issuer considered the proceeds from winning the court case against Entity X to be a contingent asset in accordance with IAS 37.

The enforcement decision

61. The enforcer disagreed with the issuer that the awarded damages should be considered a contingent asset. According to the enforcer the receivable that the issuer was entitled to, as a result of the successful arbitration procedure, qualified as an asset and the related gain should have been recognised in the period during which the court decision was taken.

Rationale for the enforcement decision

62. The enforcer noted that, according to paragraphs 14 and AG35(a) of IAS 39, as the issuer had won the case before the end of the reporting period, the issuer had a financial asset that should have been recognised in the financial statements of the period in which the court case was confirmed to be successful.
63. The enforcers noted that, as set out in paragraph 46 of IAS 39, this financial asset should have been initially recognised at its fair value and subsequently classified as a receivable and measured at amortised cost.
64. If the issuer revised its estimate of receipts, it would adjust the carrying amount of the financial asset to reflect actual and revised estimated cash flows. This adjustment would be recognised in Statement of Profit and Losses.
65. The enforcer also noted that IAS 18 does not apply in this case. However, the enforcer noted that, should the recognition criteria in IAS 18 be applied by analogy, these would also have led to the recognition of income as it was probable that the issuer would receive economic benefits from the agreement. The enforcer highlighted that the assessment of uncertainty should be made on the basis of the evidence available when the financial statements were prepared. Since, at the reporting date, the issuer had already received the first payment from Entity X, there was no indication that it would not be able to obtain the full amount. Finally, the issuer had not demonstrated that there was any objective evidence of impairment of the receivable.

X. Decision ref EECS/0117-10 – Impairment test of trademarks

Financial year end: 31 Dec 2015

Category of issue: Testing trademarks for impairment

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

Description of the issuer's accounting treatment

66. The issuer is an industrial company with operations in several countries around the world. The issuer recognises trademarks as part of its intangible assets and provided disclosure on the following individual trademarks or groups of trademarks:

- a) trademark X (individual trademark)
- b) group of trademarks relating to entity Y
- c) group of trademarks relating to multiple geographical areas
- d) group of trademarks relating to geographical area 1
- e) group of trademarks relating to geographical area 2

67. All trademarks are tested for impairment individually and the issuer does not allocate them to Cash Generating Units (CGUs). The value in use (VIU) of each trademark is calculated by applying the 'relief from royalty' method.

68. The issuer disclosed specific assumptions relating to the impairment test only for trademark (a), and trademark groups (b) and (c) which together comprised 80% of the total carrying amount of trademarks. For these, the issuer disclosed the carrying amount, the expected growth in the forecast period, the expected growth in the terminal period and the discount rate calculated as weighted average cost of capital (WACC). For the other trademarks, the issuer only disclosed that the remaining part of the total carrying amount of the trademarks related to geographical areas 1 and 2. No additional disclosures had been provided on the assumptions applied in the impairment test because, according to the issuer, each trademark was individually immaterial.

The enforcement decision

69. The enforcer considered whether trademarks could be tested individually instead as part of a CGU. The enforcer agreed that they could test trademarks individually, unless the recoverable amount of the individual trademark could not be measured reliably.

Rationale for the enforcement decision

70. The enforcer considered the requirements in paragraph 66 of IAS 36, which explains that the recoverable amount shall be estimated for an individual asset. If it is not possible to estimate the recoverable amount of an individual asset, an entity shall determine the recoverable amount of the CGU to which the asset belongs.

71. According to paragraph 67 of IAS 36, the recoverable amount of an individual asset cannot be determined if the asset's VIU cannot be estimated to be close to its fair value less costs of

disposal, and the asset does not generate cash inflows that are largely independent of those from other assets.

72. The enforcer notes that the “relief from royalty” method is also widely used to estimate the fair value of the trademarks and therefore the asset’s value in use is close to, or in this case the same as, its fair value less costs of disposal and the assets can be tested individually.

XI. Decision ref EECS/0117-11 – Recognition of deferred tax assets for carry forward of unused tax losses

Financial year end: 31 Dec 2015

Category of issue: Deferred tax assets; carryforward of unused tax losses; evidence for future taxable profits

Standards or requirements involved: IAS 12 *Income Taxes*

Description of the issuer's accounting treatment

73. In 2015, the issuer recognised deferred tax assets of 1.1 million CU arising from the carry-forward of unused tax losses. Overall, the issuer's deferred tax assets at year-end 2015 amounted to 9.8 million CU of which 4.1 million CU arose from the carry-forward of unused tax losses. The deferred tax assets were recognised even though the issuer had losses in that year and the two previous years and thus a history of recent losses. Furthermore, the economic situation of the issuer had significantly worsened over the previous few years and there were significant doubts about the existence of future taxable profits and over whether the entity could continue as a going concern. Before the authorisation of the issuer's financial statements, the strained economic situation eventually manifested itself in the non-payment of a semi-annual coupon on a 200 million CU bond issuance, which constituted an event of default under the terms of the bond.

74. The issuer argued that it was appropriate to recognise the deferred tax assets from carry-forward of unused tax losses based on its expectation that the bondholders would agree to forgive a portion of the debt. Furthermore, the issuer pointed to its business plan, which forecast a significant improvement of its financial situation over the following periods.

The enforcement decision

75. The enforcer did not agree with the recognition of deferred taxes from the carry-forward of unused tax losses.

Rationale for the enforcement decision

76. According to paragraph 34 of IAS 12, a deferred tax asset shall be recognised for carry-forward of unused tax losses to the extent that it is probable that future taxable profits will be available against which the unused tax losses can be utilised. Furthermore, paragraph 35 of IAS 12 sets out that the existence of unused tax losses is strong evidence that future taxable profit may not be available. Therefore, when an entity has a history of recent losses, it recognises a deferred tax asset arising from unused tax losses only to the extent that there is convincing evidence that sufficient taxable profit will be available.

77. The enforcer determined that the issuer's expectation to successfully complete a renegotiation with the bondholders could not be considered convincing evidence, as it depended on the future decision of a third party, which outcome was uncertain. Moreover, the enforcer deemed that the

significant uncertainty over whether the issuer was a going concern cast doubt on the ability of the issuer to fulfil its business plan. In fact, at the balance sheet date, the issuer was still negotiating the main features of future restructuring with local authorities, the realisation of which was highly uncertain. Therefore, the enforcer concluded that the issuer could not provide sufficient convincing evidence that sufficient taxable profit would be available against which the unused tax losses could be utilised by the company.

XII. Decision ref EECS/0117-12 – Definition of ‘economic environment’ and separation of foreign-currency embedded derivatives in a power contract

Financial year-end: 31 Dec 2014

Category of issue: Separation of embedded derivatives

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

Description of the issuer’s accounting treatment

78. The issuer is a power producing company that enters into long-term power contracts with power intensive industrial companies. These contracts are usually denominated in Euro, even if both parties have a functional currency of their national non-Euro currency, which is a stable and liquid currency.
79. According to the issuer, paragraph 11 of IAS 39 requires that any embedded derivative included in a contract for the sale or purchase of a non-financial item that is denominated in a foreign currency shall be separated when its economic characteristics and risks are not closely related to those of the host contract. However, the issuer also noted that according to paragraph AG33(d)iii of IAS 39, an embedded derivative in a host contract that is not a financial instrument is closely related, and therefore should not be separated, if it is not leveraged, does not contain an option feature, and requires payments denominated in a currency that is commonly used in contracts to purchase or sell non-financial items in the economic environment in which the transaction takes place (eg a relatively stable and liquid currency that is commonly used in local business transactions or external trade).
80. In the issuer’s view, the applicability of the requirements in paragraph AG33(d)iii depend on the notion of “economic environment” where the currency in which the derivative is denominated is commonly used. The issuer argued that the concept of “economic environment” in IAS 39 is not necessarily limited to the national economy and that the references in the standard to a currency commonly used in local business transactions or external trade is not exhaustive. Rather, in the issuer’s view, economic environment refers to the set of factors and circumstances that influence the transaction and therefore it may refer to a broader geographical entity, such as the “regional power market” as a whole, in which the Euro is a widely spread currency for regional power transactions.
81. Furthermore, the issuer argues that the rationale of the requirements in AG33(d)(iii), as presented in paragraph BC37 of IAS 39, is to avoid the possibility for an entity to circumvent the recognition and measurement requirements for derivatives merely by embedding a derivative in a non-derivative financial instrument. The issuer argued that the contracts are denominated in Euro not to achieve a desirable accounting result, but because Euro is a commonly used currency in the regional power market as a whole. The issuer compares its contracts denominated in Euro with transactions denominated in USD in hyperinflationary economies. In both cases, the environment

in which transactions takes place result in denomination in another currency than the local currency, and the foreign currency is commonly used in the relevant environment.

82. As the issuer believes that the regional power market is the relevant economic environment for power transactions, the embedded foreign currency derivative did not need to be separated from the host power contracts.

The enforcement decision

83. The enforcer disagreed with the issuer and noted that the relevant economic environment of the embedded derivatives is the country, i.e. an area where transactions with non-financial items in general take place and where usually only one currency is commonly used. In the relevant country it is only power contracts that are routinely denominated in Euros. Other industries routinely use the national non-Euro currency, which is a stable and liquid currency. Therefore, the enforcer did not believe that the criteria in paragraph AG33 of IAS 39 (d) (iii) were met. Furthermore, as none of the other exceptions in AG33(d)(i) and (ii) applied in the case at hand, the embedded foreign currency derivatives had to be separated.

Rationale for the enforcement decision

84. The enforcer noted that IAS 39 does not provide a definition of “economic environment”. However, in the light of the guidance and of the examples accompanying the Standard, the enforcer believed that the economic environment cannot be defined based only on one specific good or service (in this case, power).
85. The criteria in paragraph AG33(d) of IAS 39 set out limited exceptions for not accounting the host and embedded derivative separately. These criteria to elect these exceptions should be analysed separately as they relate to different situations.
86. While paragraph AG33 d) ii) of IAS 39 deals with a situation related to currency applied in a specific industry worldwide; paragraph AG33 d) iii) of IAS 39 deals with a situation where the contracts are related to an “economic environment” which shall be transversal to different industries. According to paragraphs BC39 and BC40 of IAS 39, this exception is meant to apply to transactions in a specific country which are denominated in a different currency than the official currency in this country, because that currency is not accepted at international level or because internal (national) transactions are usually denominated in a different currency than the official currency due to stability or inflation issues.
87. Since the regional power market deals only with one specific good, it cannot be seen as the economic environment of reference. On this basis, the enforcer concluded that the economic environment is the country of the issuer.