



European Securities and
Markets Authority

Report

18th Extract from the EECS's Database of Enforcement



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The decisions included in this extract were taken by national enforcers in the period from February 2014 to May 2015. ESMA will continue publishing further extracts from the database on a regular basis, with the next extract expected to be published in the first half of 2016.

List of abbreviations and acronyms used in this report

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

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

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

With responsibility for coordination of supervision of approximately 6 400 issuers listed on European regulated markets preparing IFRS financial statements, EECS currently constitutes the largest regional enforcers' network with supervision responsibilities for IFRS. Through EECS, European enforcers discuss and share their experience on the application and enforcement of IFRS. In particular, they discuss significant enforcement cases before or after decisions are taken in order to promote a consistent approach to the application of IFRS. In addition, EECS produces technical advice on the issuance of ESMA Statements and opinions on accounting matters which deserve specific focus. It also reviews accounting practices applied by European issuers to enable ESMA to monitor market developments and changes in those practices.

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

The publication of selected enforcement decisions will inform market participants about which accounting treatments European enforcers may consider as complying with IFRS; i.e. whether the treatments are considered as being 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 Guidelines on the enforcement of financial information, cases submitted to the enforcement database are considered as 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/0215-01 – Presentation of licensed activities as discontinued operations

Financial year end: 31 December 2014

Category of issue: Discontinued operations

Standards or requirements involved: IFRS 5 *Non-current Assets Held for Sale and Discontinued Operations*

Description of the issuer's accounting treatment

1. The issuer is a biotech company that had several products in its research/development pipeline and one single commercialised product (product A) that has been marketed for several years. The issuer was directly involved in manufacturing, marketing and selling this product.
2. In 2013, a decision was taken to withdraw from the product A business and focus on the development of other products. The issuer developed a single, co-ordinated plan under which discussions were entered into with one potential purchaser for the manufacturing facility (a newly built production facility intended to produce other products in addition to product A) and with another party for the marketing and distribution activities.
3. At the beginning of 2014, the issuer signed an agreement for the sale of the production facility/activities to company X. Later in the first half of 2014, the issuer licensed the marketing and distribution rights in all existing markets to company Z and also granted company Z the exclusive rights to expand the distribution to other territories. The marketing and distribution staff was transferred to company Z and the issuer had no further involvement with product A.
4. As a result of the license agreement, the issuer has a right to royalty income based on the sales of product A generated by company Z. The licence agreement has a duration of 10 years, to be extended automatically unless one of the parties objects. According to the issuer it would abandon the product A if the agreement with company Z were not renewed.
5. In its 2014 half-yearly financial statements, the issuer presented sales and expenses for product A net, as 'discontinued operations'. As product A was the issuer's only commercialised product, the issuer considered it to be a component of an entity representing a separate major line of business. Thus it would fulfil the definition of a discontinued operation provided in paragraph 32 of IFRS 5.

The enforcement decision

6. The enforcer considered whether the fact that the issuer would retain an interest in the ongoing sales performance of product A as a result of the royalty income precludes its classification as a discontinued operation and decided to accept the issuer's accounting treatment.

Rationale for the enforcement decision

7. Paragraph 8A of IFRS 5 requires an entity that is committed to a sale plan involving loss of control of a subsidiary to classify all the assets and liabilities of that subsidiary as held for sale when the criteria set out in paragraphs 6–8 of IFRS 5 are met, regardless of whether the entity will retain a non-controlling interest in its former subsidiary after the sale. Paragraph BC24C of IFRS 5 refers to the fact that loss of control is a significant economic event that changes the nature of an investment. Therefore, it can be assumed that a certain continuing involvement (in this case the receipt of licence fees and the fact that the marketing authorisation is still the issuer's property and that it holds the intellectual property of product A) does not preclude the presentation as discontinued operations according to IFRS 5.
8. The production facility was sold. The issuer has no involvement in activities relating to product A anymore. The license period is longer than product A's residual useful life, which was estimated by the issuer to be only 6 years when estimating the amortisation period of the development cost of the product. The issuer does not have the intention to restart the commercialisation of product A if, after 10 years, the license will not be extended. Furthermore, the issuer indicated that it would no longer possess the know-how to restart the commercialisation of product A. This means that the operations and cash flows generated by this component of the entity were disposed of and that the issuer will receive a licence fee instead.
9. The enforcer concluded that the issuer's loss of control over the production, marketing and distribution activities represented a significant economic event that changed the nature of the issuer's investment and that, in substance, the issuer had discontinued those operations.

II. Decision ref EECS/0215-02 – Disclosures in interim financial statements

Financial period end: 30 June 2014

Category of issue: Disclosures; Interim financial reporting

Standards or requirements involved: IAS 34 *Interim Financial Reporting*

Description of the issuer's accounting treatment

10. The issuer recognised, in its first quarter 2014 interim financial statements, an impairment loss approximately equal to half of the entity's equity and provided the relevant disclosures. The impairment loss event had been covered in depth in the media. However, in its first half 2014 interim financial statements, the issuer stated only that an impairment loss had been recognised in its interim financial statements for the first quarter but no further details were provided.

The enforcement decision

11. The enforcer disagreed with the issuer's approach. The enforcer concluded that further disclosures on the impairment loss should have been included in the first half-year interim financial statements even though they were already included in the first quarter accounts.

Rationale for the enforcement decision

12. According to paragraph 15 of IAS 34, an entity shall include in its interim financial report an explanation of events and transactions that are significant to an understanding of the changes in financial position and performance of the entity since the end of the last annual reporting period. In addition, paragraph 15B(b) of IAS 34 requires an entity to provide disclosures on impairment losses if they are significant. As the impairment loss represents approximately 75% of the first half-year's net loss and about 50% of the equity at the beginning of the year the impairment loss is significant.
13. The fact that the information was disclosed in the interim financial statements for the first quarter does not relieve the issuer from disclosing it in the interim financial statements for the first half-year as, according to paragraph 6 of IAS 34, the interim financial report is intended to provide an update on the latest complete set of annual financial statements. It is a principle of IAS 34 that information is reported on a year-to-date basis.
14. It is the enforcer's view; information that, according to IAS 34, must be disclosed in the interim financial statements cannot be omitted even if the information was already communicated to the market in other ways.

III. Decision ref EECS/0215-03 – Disclosures on post-employment benefit plans

Financial year end: 31 December 2013

Category of issue: Post-employment benefits: defined benefit plans

Standards or requirements involved: IAS 19 *Employee Benefits*

Description of the issuer's accounting treatment

15. The issuer operates a number of defined benefit pension schemes for its employees in several jurisdictions. The notes to the issuer's annual financial statements disclosed the principal assumptions used to calculate the defined benefit obligation at 31 December 2013. These assumptions were presented in ranges for groups of plans in a table similar to the one presented below:

Assumption	Range disclosed in issuer's annual financial statements	Range	Range variation
Inflation	1.4% - 2.6%	1.2%	86%
Salary increases	1.8% - 4.2%	2.4%	133%
Increase in pensions in payment	1.4% - 2.8%	1.4%	100%
Discount rate	3.5% - 4.5%	1.0%	29%

The enforcement decision

16. The enforcer considered the disclosures on the significant actuarial assumptions used to determine the present value of the defined benefit obligation to be inadequate because in combination they were not presented in sufficiently narrow bands.

Rationale for the enforcement decision

17. According to paragraph 144 of IAS 19, an entity shall disclose the significant actuarial assumptions used to determine the present value of the defined benefit obligation. Such disclosure shall be in absolute terms (e.g. as an absolute percentage, and not just the margin between different percentages and other variables). When an entity provides disclosures in total for a grouping of plans, it shall provide such disclosures in the form of weighted averages or relatively narrow ranges.
18. It was the enforcer's view that, due to the wide range between the highest and lowest assumptions, the existing disclosure did not fully meet the requirements of paragraph 144 of IAS 19 to provide such disclosures in the form of relatively narrow ranges.

IV. Decision ref EECS/0215-04 – Going Concern disclosures

Financial periods end: 31 March 2014, 30 June 2014 and 30 September 2014

Category of issue: Disclosures; interim financial statements

Standards or requirements involved: IAS 34 *Interim Financial Reporting*, IAS 1 *Presentation of Financial Statements*

Description of the issuer's accounting treatment

19. Significant doubts were cast upon an issuer's ability to continue operating as a going concern due to weak profitability in combination with a high debt-to-asset ratio. The issuer was in breach of several loan covenants, and its liquidity situation was challenging. The uncertainties regarding the issuer's ability to operate as a going concern were disclosed in the notes to the 2013 annual financial statements.
20. However, in its interim financial statements as of 31 March and 30 June 2014 the issuer did not include a sufficient and complete assessment of the going concern assumption or associated issues, inter alia, breach of covenants and an updated liquidity risk assessment.
21. In the interim financial statements as of 30 September 2014 the issuer included disclosures regarding the material uncertainties related to its ability to continue as a going concern, as required by paragraph 25 of IAS 1, and a maturity analysis according to paragraph 39 of IFRS 7, where the time bands had been narrowed down to quarterly periods rather than annual. It also disclosed information on the breach of a loan agreement as required by paragraph 15B(i) of IAS 34. Available liquidity was disclosed, but no further assessment of the situation was presented. The issuer also reported that a significant receivable from the sale of a subsidiary was past due. The

receivable was of a magnitude that it was important both for the ongoing discussions with the issuer's debt holders and for short term liquidity.

The enforcement decision

22. The enforcer concluded that the disclosures regarding the uncertainty whether the issuer could operate as a going concern and its liquidity risk in the interim financial statements for the first two quarters of 2014 were not sufficient. Furthermore, it determined that the disclosures given by the issuer in the interim financial statements as of 30 September 2014 were not sufficient to evaluate the significance of financial instruments on the issuer's financial position and performance.

Rationale for the enforcement decision

23. According to paragraph 15 of IAS 34, an entity shall include in its interim financial report an explanation of events and transactions that are significant to an understanding of the changes in financial position and performance of the entity since the end of the last annual reporting period. Considering the demanding financial situation of the issuer, sufficient information about the issuer's uncertainty to operate as a going concern and judgments made by management in assuming this ability as required by paragraph 25 of IAS 1, about its liquidity risk as required by paragraph 39 of IFRS 7 and about the breach of loan covenants as required by paragraph 15B(i) of IAS 34 should have been provided in the interim financial statements for the first two quarters of 2014 as this information was significant to an understanding of the issuer's situation.

24. The information provided in the interim financial statements as of 30 September 2014 was an improvement when compared to the interim financial statements for the first two quarters. However, the disclosures related to the liquidity assessment still did not include detailed qualitative information on how the company would meet its liquidity needs within each period to enable users of the financial statements to evaluate the significance of financial instruments on the issuer's financial position and performance, as required by paragraph 39(c) of IFRS 7 and the general requirements in paragraph 7 of IFRS 7. Furthermore, the issuer did not include sufficient information on the past due receivable despite the fact that this receivable was significant in the sense of paragraph 15 of IAS 34.

V. Decision ref EECS/0215-05 – Control of an entity without holding any equity interest

Financial year end: 31 December 2013

Category of issue: Control

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

Description of the issuer's accounting treatment

25. The case refers to the issuer's assessment of control over entity B following the purchase of entity B's bonds.

26. Entity B held and operated wind farms. It was structured as a limited partnership with two partners. Under this limited partnership, all business decisions, amongst them the approval of budgets, were taken by one of the partners, called the General Partner. The only decisions that needed the approval of both partners were “extraordinary decisions” such as a merger or liquidation. The second partner (Limited Partner) owned entire the share capital but the share capital was insignificant in relation to the total financing of the entity. The Limited Partner could not dismiss the General Partner.
27. Entity B’s wind farms were financed through bonds issued in 2006 in three tranches: senior, junior and subordinated bonds. Entity B had not yet paid any interest to the holders of the junior and the subordinated bonds, whereas the senior bondholders have received their interest in full. Entity B was not allowed to pay any dividends to the partners before all bonds are reimbursed, which would be in about 10 years.
28. In January 2013, the issuer, an integrated industrial operator involved in each stage of the development of wind farms, purchased 70% of the subordinated bonds and obtained various rights, amongst them the right to appoint entity B’s General Partner. Hence, the CEO of the issuer was appointed General Partner of entity B. The transaction price was significantly lower than the residual nominal amount of the subordinated bonds with a fixed price of less than 2% of the nominal amount and a contingent consideration of between 0% and 40% of the nominal amount. In addition, the issuer acquired call options that could be exercised in about 10 years to purchase the shares of the Limited Partner for a fixed price of CU 1¹.
29. The issuer concluded that as it had the right to appoint entity B’s General Partner it controls entity B even though it did not hold any equity interest in entity B. Therefore, the issuer consolidated entity B in its financial statements as of 31 January 2013.

The enforcement decision

30. The enforcer agreed with the issuer’s conclusion on the assessment of control over entity B.

Rationale for the enforcement decision

31. According to paragraph 7 of IFRS 10, an investor controls an investee if and only if the investor has power over the investee; exposure, or rights, to variable returns from its involvement with the investee; and the ability to use its power over the investee to affect the amount of the investor’s return.
32. The Limited Partner only holds a veto right for very few and extraordinary decisions such as the dissolution of the company or the sale of the wind farms. As these rights relate only to fundamental changes to the activities of an investee or apply in exceptional circumstances they are according to paragraph B26 of IFRS 10 protective rights only. According to paragraph B27 of IFRS 10 protective rights do not prevent another party from having power over the investee. As the General

¹ In this decision, and in other decisions in this report, monetary amounts are denominated in ‘currency units (CU)’

Partner takes all business decisions and the issuer has the right to appoint the General Partner, the issuer has power over entity B.

33. Paragraph 15 of IFRS 10 provides that an investor is exposed to variable returns from its involvement with the investee when the investor's returns from its involvement have the potential to vary as a result of the investee's performance, whereby the returns can be either positive, negative or both. Paragraph B57 of IFRS 10 explains that the concept of returns is broad and includes, amongst others, changes in the value of the investor's investment in the investee and fees and exposure to loss from providing credit or liquidity support. The issuer purchased 70% of the subordinated bonds for a small fixed price of less than 2% of the bonds' nominal amount and a variable consideration between 0% and about 40% of the nominal amount depending on the performance of entity B. In addition to that the issuer also holds call options to acquire the Limited Partner's shares for a fixed price and the issuer has concluded service contracts for the maintenance of the wind farms. Hence, the issuer has a very significant exposure to positive returns and an exposure (but more limited) to negative returns.
34. The senior bondholders have a very limited exposure to variable returns because their claims are secured by a pledge of the tangible assets of entity B (the fair value of the tangible assets being higher than the senior bonds nominal value). The amount of junior bonds is much lower compared to the amounts of senior and subordinated bonds.
35. The enforcer considered, therefore, that the issuer is exposed to variable returns from its involvement with entity B. The enforcer furthermore concluded that the issuer's power over entity B can be used to affect the amount of the investor's return. The three conditions of paragraph 7 of IFRS 10 being fulfilled, it was concluded that the issuer controls entity B.

VI. Decision ref EECS/0215-06 – De facto control

Financial year end: 31 December 2013

Category of issue: Control

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

Description of the issuer's accounting treatment

36. The issuer is a listed holding company that holds 49.99% of entity A's shares and accounted for entity A as an associate. The fact pattern was as follows:
- Including the issuer, entity A had 15 shareholders. The largest shareholders of entity A, apart from the issuer, were entity C which held about 3.4% of entity A's shares and entity D that held about 28.3% of entity A's shares. Entity C was controlled by the founder of the issuer, who had a significant shareholding in the ultimate parent of the issuer. Entity D was controlled by a number of the initial founders of entity A.
 - The rest of about 18.3% of the shares were held by 12 shareholders that were either entity A's founders or their descendants. Entity D and the 12 shareholders that were either entity A's founders or their descendants were bound by a shareholding

agreement. However this agreement did not encompass voting rules but only a mutual right of first refusal if one of them wished to sell its shareholding in entity A.

- The Board of Directors of entity A consisted of 5 members. Entity A disclosed in its financial reports that 3 of these 5 board members were representatives of the issuer. One of them was at the same time the founder of the issuer, a major shareholder of the issuer's parent company and a board member of the issuer. This founder of the issuer was also the general manager of entity A and all its subsidiaries. The second board member of entity A that was considered to be a representative of the issuer is the CEO of the issuer and the third one was a family member of the founder of the issuer and a major shareholder in the issuer's parent company without any own direct shareholding in entity A.
- There had not been complete owner representation, either personally or by proxy, at the last two annual general meetings of entity A.

37. The issuer deemed that it did not control entity A as it did not hold the majority of voting rights. Furthermore it claimed that it did not have the power to instruct two of the three board members of entity A which were classified as representatives of the issuer in the financial reporting of entity A. These two board members were the issuer's founder and the family member of the founder who both were major shareholders of the issuer's parent company.

The enforcement decision

38. The enforcer disagreed with the issuer's assessment and concluded that the issuer had the practical ability to direct the relevant activities unilaterally and therefore had de facto control over entity A. Thus the issuer should have consolidated entity A.

Rationale for the enforcement decision

39. No special rules for the nomination or election of board members in entity A existed, so the board members were elected by the shareholders of entity A. In assessing whether the issuer had power over entity A without holding a majority of voting rights, the enforcer considered all facts and circumstances. In the first step it considered those facts mentioned in paragraph B42 of IFRS 10. With a shareholding of 49.99% the issuer had as many voting rights as possible, without having a majority. With its shareholding of about 28.3%, entity D, as second largest investor was presumed to have significant influence over entity A. However, according to paragraph 14 of IFRS 10, the latter does not preclude the issuer from having power over entity A. The enforcer considered that the issuer only needed the support or the absence of one of the other shareholders in the shareholder's meeting to represent a majority of the voting rights. However, the enforcer found this fact pattern not to be conclusive so that additional facts and circumstances, such as the secondary factors described in paragraph B45 of IFRS 10, needed to be considered.

40. 13 of the 15 investors in entity A representing about 46.6% of the voting rights were either the founders of entity A or their descendants. However, the enforcer assumed that the fact that they were not all relatives and mostly second generation investors with a more remote relationship to

issuer A would affect the likelihood that they would vote as a block. Furthermore the issuer and entity C which held about 3.4% of entity A's shares, and was controlled by the founder of the issuer, together held about 53.4% of entity A's shares. Although the issuer did not have control over entity C, if evaluating potential voting patterns, entity C would normally be expected to have more interests in common with the issuer than with the other 13 investors.

41. Although there were few issues of a controversial nature at the annual general meeting, the decisions were all unanimous. This was also the case for an annual proxy given to the board of directors of entity A to acquire own shares, unrestricted by the right of first refusal existing in the shareholders agreement. Although not constituting a potential voting right, this introduced a mechanism whereby the board of entity A (with 3 out of 5 members of entity A's board being related parties to the issuer) could initiate a transaction that effectively would give the issuer a majority of the voting rights. The enforcer concluded that this indicated a low degree of shareholder activism.
42. Furthermore, when considering the facts and circumstances whether the issuer had control over entity A, the enforcer noted that paragraph B45 of IFRS 10 provides that the factors set out in paragraph B18 and the indicators in paragraphs B19 and B20 of IFRS 10 have to be considered, with greater weight being given to the factors set out in paragraph B18 of IFRS 10. Although the issuer did not have a contractual right to appoint the general manager or a majority of the board of directors of entity A, the enforcer considered the fact that the general manager of entity A was the founder, board member and a large shareholder of the issuer, showed the issuer's ability to appoint the key management personnel. In addition to that, the fact that the issuer has been able to sustain a majority representation in the board of directors through several changes in the composition of the board from 2010 onwards showed that it could dominate the election process. Besides, all the representatives of the issuer, constituting the majority of entity A's board of directors were related parties to the issuer according to paragraph 9 of IAS 24, *Related Party Disclosures*.
43. After considering the secondary factors, the enforcer concluded that the issuer had de facto power over the entity. Further, there was found to be a link between power and returns. The issuer was exposed to variable returns from entity A and had the ability to affect those returns through its power, and thus had control over entity A. According to paragraph B80 of IFRS 10 an investor shall reassess control when facts and circumstances appear to have changed. Therefore, any future changes to the fact pattern would trigger re-evaluation of whether the issuer still controls entity A.

VII. Decision ref EECS/0215-07 – Impairment of goodwill

Financial year end: 31 December 2013

Category of issue: Impairment

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

Description of the issuer's accounting treatment

44. The issuer is a bank operating in several European markets. At the end of 2013 goodwill represented more than 10% of the issuer's total equity and about 1% of total assets. Goodwill related to multiple cash generating units (CGUs), amongst them CGUs A, B and C.

45. In its impairment tests, which were based on value in use models, the bank assumed that the reference interest rates for CGUs A and B would increase from 0.2% in 2013 to 3.6% in 2017 and for CGU C from 0.5% to 3.7%. According to the bank's value in use model, this would lead to an increase in the bank's deposit margin (the spread between the interest rate paid to the depositors and the reference interest rate) in CGU A from 0.7% to 2.6%, in CGU B from 0.7% to 1.7% and in CGU C from 1.0% to 2.5%. On the other hand, the bank expected the lending margin (the spread in basis points that borrowers agree to pay above an agreed reference interest rate) to remain unchanged. Furthermore the bank assumed that there would be a significant amount of deposits available where the interest rate would be either zero or close to zero regardless of the level of the reference interest rate. Given these expected developments, the net interest income would almost double from 2013 to 2017. The loan impairment levels per year were assumed to be between 0.1% and 0.2% of the loans outstanding in CGUs A, B and C.
46. The CGUs were acquired in the years 2004 to 2007. CGU A's and B's profitability was rather weak in the years from 2007 to 2012 with a pre-tax Return on Equity (ROE) ranging from -5% to 11%. CGU C exhibited negative earnings for all but two years of the period from 2007 to 2012 with pre-tax ROE ranging from -75% to 1%.
47. The impairment test carried out by the issuer in 2013 did not result in any impairment loss.

The enforcement decision

48. The enforcer disagreed with the issuer's assessment and concluded that the issuer's assumptions were not in line with the requirements of paragraphs 33(a) and 37 of IAS 36.

Rationale for the enforcement decision

49. According to paragraph 33(a) of IAS 36, in measuring value in use, management shall base its cash flow projections on reasonable and supportable assumptions that represent management's best estimate of the range of economic conditions that will exist over the remaining useful life of an asset. However greater weight shall be given to external evidence.
50. The enforcer considered the expected development of the reference interest rate to be overly optimistic. It considered that the issuer should take into consideration the forward rates of the reference interest rate used when determining the expected future level of the reference interest rate, as the forward rates represent the market expectations and constitutes external evidence. The forward rates available at the time of the impairment test for the reference interest rate for CGUs A and B indicate an increase of the reference interest rate until 2017 to only 1.1% and not to 3.6% as assumed by the issuer. For CGU C the forward rate for the reference interest rate indicated an increase in the reference interest rate to only 2.9% in 2018 instead of the 3.7% as expected by the issuer in its value in use model.
51. The budgets used in the value in use model showed that their earnings were expected to increase between four and eight times over ten years which would eventually result in a very high return on equity of up to 70%. Furthermore, for two of the CGUs the earnings in the terminal period reached levels that the CGUs had never reached in their history. Paragraph 37 of IAS 36 provides that

when conditions are favourable, competitors are likely to enter the market and restrict growth. Therefore, entities will have difficulty in exceeding the average historical growth rate over the long term for the products, industries, or countries in which the entity operates, or for the market in which the asset is used. The enforcer furthermore concluded that, given the CGU's historical earnings, the overall level of earnings was overly optimistic.

52. In addition to that, the enforcer believed that the assumed receivable impairment levels were too low as the historical impairment levels of the three CGUs were significantly above the issuer's estimates. Whereas the issuer expected loan impairment levels of between 0.1% and 0.2%, the historical loan impairment levels over the prior 15 years for the three CGUs averaged between 0.5% and 1.5% per year.

VIII. Decision ref EECS/0215-08 – Fair value measurement for fixed-rate loans

Financial year end: 31 December 2013

Category of issue: Fair Value Measurement of financial instruments

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

Description of the issuer's accounting treatment

53. The issuer is a bank that makes use of the fair value option to measure fixed-rate loans. As it operates in a country where no secondary market for fixed-rate loans exists, it tried to simulate such a market. It identified potential market participants as other financial institutions, both in the country and abroad.
54. When measuring the fair value of the loans the issuer discounted the contractual cash flows with a discount rate consisting of the swap rate plus a margin that was intended to cover a potential investor's costs and rate of return on equity beyond the swap rate. The calculation of this margin took into account the funding/liquidity mark-up, the rate of return on equity and assumptions regarding normalised losses and operating costs of a potential market participant. The calculated margin used for the measurement of the fair value of the fixed-rate loans is the same for all fixed-rate loans, regardless of their maturity. The swap rate and the funding/liquidity mark-up are observable inputs to the model. The other inputs used are based on the issuer's own economic situation or presumptions, as it considers itself to be a potential buyer of fixed-rate loans in a hypothetical secondary market and thus a typical market participant.
55. There is significant competition amongst providers of fixed-rate loans to private customers in the country. A public register exists that publishes the lending rates of all types of loans, sorted by the level of collateral provided and maturities. From the first quarter 2013 until the first quarter 2014 the discount rate used to measure the fair value of the fixed-rate loans was significantly below the issuer's and other banks' lending rates on new fixed-rate loans at the measuring date. The difference between the discount rate used for the fair value measurement and the lending rate observable in the retail market that could be derived from the public register had been up to 100 basis points. Therefore, at initial recognition the loans have been measured with a higher value

than the transaction price and day-1 profits have frequently appeared. According to paragraph AG76(b) of IAS 39 the issuer would have to defer any differences between the transaction price and the fair value, as the fair value was not evidenced by a quoted price in an active market for an identical asset.

The enforcement decision

56. The enforcer disagreed with the issuer's accounting treatment and concluded that the discount rate used to determine the fair values of the fixed-rate loans should be calibrated to the market interest rates observable in the retail market (the market for issuing new fixed-rate loans).

Rationale for the enforcement decision

57. According to paragraph 9 of IFRS 13, fair value is the price that would be received to sell an asset in an orderly transaction between market participants at the measurement date. In the respective jurisdiction, no secondary market for selling or buying fixed-rate loans exists, so the fair value cannot be directly derived from such a market. When determining fair value, according to paragraph 23 of IFRS 13, the entity shall identify characteristics and factors specific to market participants with whom the entity would enter into a transaction in that market. The enforcer considered that other financial institutions in the respective jurisdiction would be potential market participants. These financial institutions would have the choice to either buy existing loans or to issue new loans directly to customers.
58. Paragraph 22 of IFRS 13 requires an entity to measure the fair value of an asset using the assumptions that market participants would use when pricing the asset, assuming that market participants act in their economic best interest. The enforcer was of the view that it does not seem reasonable to assume that the market participants would be willing to buy an existing fixed-rate loan for a significant premium when they could obtain the same cash flows by issuing the same loan directly. The enforcer therefore concluded that a fixed-rate loan in the retail market and a fixed-rate loan in a hypothetical secondary market are similar products, because the cash flows are identical, the risk is similar and it could be assumed that there would be the same participants in both markets.
59. Thus, the enforcer determined that there would be a close connection between the price a market participant would be willing to pay to acquire an existing fixed-rate loan handed out to a customer from a bank (exit price/discount rate) and the price the same market participant would ask when issuing a new fixed-rate loan to the same customer (entry price/lending rate). The enforcer concluded that prices in a hypothetical secondary market for fixed-rate loans should not significantly diverge from the observable prices in the retail market.
60. Paragraph 61 of IFRS 13 requires an issuer to maximise the use of relevant observable inputs and minimise the use of unobservable inputs when using valuation techniques. As market lending rates in the retail market can be observed and as the fixed-rate loans in the retail market and the fixed-rate loans in the hypothetical secondary market are similar in nature, the observable inputs derived from the retail markets should be taken into account in the valuation of the fixed-rate loans.

61. Furthermore, according to paragraph AG76 of IAS 39, the best evidence of the fair value of a financial instrument at initial recognition would normally be the transaction price.

IX. Decision ref EECS/0215-9 – Carrying amounts of a cash-generating unit to be tested for impairment

Financial year end: 31 December 2013

Category of issue: Impairment

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

Description of the issuer's accounting treatment

62. The issuer is a salmon farming company holding farming licenses which at the end of the year 2013 corresponded to 9% of the issuer's total assets. The farming licenses were considered to have an indefinite useful life. The issuer performed an annual impairment test of the farming licenses for 2013 as required by IAS 36. For the purpose of testing, the farming licenses were allocated to CGUs.

63. The recoverable amount was based on the value in use. In its impairment tests, the issuer compared only the carrying amounts of the farming licenses with the CGU's recoverable amounts. None of the other assets that represented a material part of the total assets used to generate cash inflows were included in the carrying amount of the CGU.

The enforcement decision

64. The enforcer disagreed with the issuer's accounting treatment as the carrying amount of the CGU tested for impairment should include all assets that generate or are used to generate the CGU's relevant stream of cash inflows. This includes fixed assets, normalised working capital consisting of inventory, accounts receivable and accounts payable, in addition to licenses and goodwill.

Rationale for the enforcement decision

65. The farming licenses do not generate cash inflows that are independent of those from other assets. Therefore, according to paragraph 67 of IAS 36, the farming licenses have to be grouped in CGUs together with the other assets necessary to generate the CGU's cash flows.

66. The carrying amount of a CGU shall be determined on a basis consistent with the way the recoverable amount of the CGU is determined according to paragraphs 75-79 of IAS 36. According to paragraph 77 of IAS 36 all assets that generate or are used to generate the CGU's relevant stream of cash flows have to be included in the carrying amount to be tested for impairment. Furthermore, paragraph 102 of IAS 36 provides also that the carrying amounts of corporate assets that can on a reasonable basis be allocated to the CGUs under review shall be allocated to the relevant CGUs.

X. Decision ref EECS/0215-10 – Presentation and disclosure of discontinued operations in separate financial statements

Financial year end: 31 December 2013

Category of issue: Discontinued operations in separate financial statements

Standards or requirements involved: IFRS 5 *Non-current Assets Held for Sale and Discontinued Operations* and IAS 27 *Separate Financial Statements*

Description of the issuer's accounting treatment

67. The issuer is a manufacturing company. Until 2012 the issuer's operations consisted of three separate divisions integrated into the legal entity of the parent company. The issuer prepared its separate financial statements in accordance with IFRS. In 2012 the issuer established three new subsidiaries and transferred each division into one of the newly established subsidiaries in exchange for the subsidiaries' equity instruments.

68. In the comparative financial information presented in the separate financial statements of the parent company as of the end of 2012, the issuer did not apply IFRS 5 to the operations that were transferred to the new subsidiaries and thus did neither classify nor present separately the results of the discontinued operations in the statement of comprehensive income.

The enforcement decision

69. The enforcer disagreed with the issuer and determined that the issuer should have applied IFRS 5 for the transfer of the three divisions to the subsidiaries. The issuer therefore should have presented the results of the discontinued operations separately in the statement of comprehensive income of the 2012 separate IFRS financial statements.

Rationale for the enforcement decision

70. As each component of the entity that has been disposed of represented a separate major line of business and was part of a single co-ordinated plan to dispose of it, the enforcer considered each division to be a discontinued operation according to paragraph 32 of IFRS 5.

71. The issuer, therefore, has to apply the rules regarding presentation and disclosure of discontinued operations set out in paragraphs 33 to 35 of IFRS 5. The entity has to disclose in the statement of comprehensive income a single amount for the post-tax profit or loss of the discontinued operations, as required by paragraph 33 of IFRS 5.

72. Paragraph 9 of IAS 27 requires separate financial statements to be prepared in accordance with all applicable IFRSs, except as provided in paragraph 10 of IAS 27. There is no exception in IFRS regarding the sale, disposal or transferral of a component of an entity to a subsidiary of the entity. Therefore, in its separate financial statements, the issuer has to treat the disposals to its subsidiaries in the same way as disposals to third parties.