European Securities and Markets Authority

Report

11th Extract from the EECS's Database of Enforcement

16 August 2011 | ESMA/2011/265

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Introduction

European National Enforcers of financial information monitor and review financial statements and consider whether they comply with IFRS and other applicable reporting requirements, including relevant national law.

Operating under the operational ESMA group charged with accounting issues, the Corporate Reporting Standing Committee, the European Enforcers Coordination Sessions (EECS) is a forum in which all EU National Enforcers of financial information meet to exchange views and discuss experiences of enforcement of IFRS. A key function of EECS is the analysis and discussion of decisions taken by independent EU National Enforcers in respect of financial statements published by issuers with securities traded on a regulated market and who prepare their financial statements in accordance with IFRS.

EECS is not a decision-making forum. It neither approves nor rejects decisions taken by EU National Enforcers who apply their judgement, knowledge and experience to the particular 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 individual 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. Consistent application of IFRS means consistent with the principles and treatments permitted by the standards.

Decisions taken by Enforcers do not provide generally applicable interpretations of IFRS, which remains the role of the IFRS Interpretation Committee (IFRS IC).

As proposed in CESR Standard No 2 on Financial Information, "Co-Ordination of Enforcement Activities", ESMA has developed a confidential database of enforcement decisions taken by individual EECS members as a source of information to foster appropriate application of IFRS. In response to public comment to the Standard, ESMA committed to publish extracts of the database to provide issuers and users of financial statements with similar assistance.

Publication of enforcement decisions will inform market participants about which accounting treatments EU National Enforcers may consider as complying with IFRS; that is, whether the treatments are considered as being within the accepted range of those permitted by the standards or IFRIC interpretations. Such publication, together with the rationale behind these decisions, will contribute to a consistent application of IFRS in the European Union.

Decisions that deal with simple or obvious accounting matters will not normally be published, even if they were material breaches leading to sanctions. The selection criteria are based on the above stated objectives, and accordingly, only decisions providing market participants with useful guidance will be published.

On this basis, all cases submitted to the enforcement database are considered as appropriate for publication, unless:
- similar decisions have already been published by ESMA, and publication of a new one would not add any substantial value to the fostering of consistent application;
- the decision deals with a simple accounting issue that, even having been considered a material infringement, does not in itself have any accounting merit;
- there is no consensus in the EECS to support the submitted decision.
- a particular EU National Enforcer, on a grounded and justified basis, believes that the decision should not be published;

ESMA will continue publishing further extracts from the database on a regular basis.

I Decision ref EECS/0211-01 – Determination of fair value less costs to sell

Financial year end: 31 December 2009
Category of issue: Determination of fair value less costs to sell
Standards or requirements involved: IFRS 5 – Non-current assets Held for Sale and Discontinued Operations
Date decision taken: 12 August 2010

Description of the issuer's accounting treatment

1. In December 2009 the issuer's Board decided to sell one of its business divisions through a mixed asset and share deal. The decision to sell was based on the fact that closing down the division would give rise to significant social liabilities and to subsidiaries defaulting on their debt obligations towards the parent company. Restructuring the division was not an option because of the lack of available finance to fund the restructuring and the lack of certainty that it would return the division to profitability.

2. The decision to sell the division, together with the sales price of m.u. 2 million was made public in December 2009 and gained the necessary shareholder approval at an Extraordinary General meeting of the company in the first quarter of 2010.

3. In accordance with IFRS 5, paragraph 6, the business division was presented as a disposal group in the issuer's 2009 statement of financial position. The issuer specified in its accounts that depreciation and amortization charges relating to the non-current assets of the disposal group had been recognised and that the carrying amounts of the current assets of the disposal group had been adjusted to take into account doubtful receivables and obsolete stock.

4. The business division was sold for a fixed amount of m.u. 2 million and, under an earn-out, a variable amount equal to 50 % of the accumulated profits of the division until 31 December 2012. The parties involved agreed to defer the payment of the lump sum of m.u. 2 million until 31 December 2013. As it was expected that the division would remain loss-making in the following two years, the issuer was of the view that the fair value of the division was m.u. 2 million and that it should not be increased for the earn-out.

5. At the initial classification of the division as held for sale, its net carrying amount amounted to m.u. 18 million. In writing down the disposal group's carrying amount to its fair value less cost to sell, the issuer accounted for an impairment loss of m.u. 16 million.

6. The issuer accounted for three expense items closely related to the sale of the business division as follows:
   a. A possible loss relating to a receivable due to the business to be sold; the item related to the agreement between the seller and the buyer according to which the seller would refund the buyer in the event that the receivable was not collected by the buyer from a customer which was involved in an insolvency procedure under its national legislation;
   b. An expense relating to the discounting of the long term receivable on the fixed amount of the sale price of the disposal group;
   c. A provision relating to the expected transaction costs (legal advice, lawyer fees, etc.).

7. The issuer recognised these three expense items as part of the result of the discontinued operations. In its 2009 statement of financial position however, the issuer presented these costs as provisions of the continuing operations.

The enforcement decision

8. The enforcer was of the opinion that the three items mentioned above did not qualify as provisions of the continuing operations of the issuer and, for that reason, could not be presented as such in the issuer's statement of financial position.

Rationale for the enforcement decision

9. The enforcer based its decision on the following considerations:

    a. Possible loss relating to a receivable: According to IFRS 5, paragraph 18, the carrying amounts of all the assets and liabilities in a disposal group are to be measured in accordance with applicable IFRSs, immediately before the initial classification of the disposal group as held for sale. Therefore, the receivable from the customer should have been tested for impairment immediately before classification of the division as held for sale and the resulting loss would have been recognised against the net carrying amount of the disposal group at initial classification as held for sale. Moreover, since the sales contract stipulated that the seller would refund the buyer in the event that the receivable was not collected, the expected sales price of the disposal group should have been adjusted to take into account the potential refund.
    b. The expense relating to the discounting effect: The 'fair value less costs to sell' of the disposal group should have incorporated the effect of discounting given that payment was deferred until 2013.
    c. The provision on transaction costs: The expected transaction costs were to be considered as an additional cost of the transaction and, therefore, were a component of the “costs to sell”.

10. All three items, for an aggregate amount of m.u. 2.2 million euro, should therefore have been taken into account in the calculation of “fair value less costs to sell” and not be presented as provisions relating to continuing operations of the issuer in its statement of financial position.

II Decision ref EECS/0211-02 - Classification of subsidiary held for sale

Financial year end: 31 December 2009
Category of issue: Classification of subsidiary held for sale
Standards or requirements involved: IFRS 5 - Non-current assets Held for Sale and Discontinued Operations
Date decision taken: 6 December 2010

Description of the issuer’s accounting treatment

11. The issuer reported a subsidiary as held for sale and its results as those from discontinued operations in its annual financial statements for both 2008 and 2009.

12. The issuer’s 2008 financial statements had previously been reviewed by the enforcer. In that review, the enforcer had accepted that the shareholders had, at a general meeting of the company, authorised management to sell 51% of its shares in the subsidiary. The enforcer had accepted that the subsidiary be accounted for as an asset held for sale and presented as a discontinued operation in the issuer’s 2008 financial statements.

13. This accounting treatment, however, had been continued in the issuer's 2009 financial statements and for a period considerably longer than the 12 months specified for such treatment in IFRS 5. Furthermore, the issuer applied the same accounting treatment in respect of all three quarterly reports in 2010.

14. In its 2008 financial statements the issuer showed a loss from discontinued operations of m.u. 2.7 million against a total loss of m.u. 2.3 million . For 2009, the corresponding amounts were a loss of m.u. 0.9 million compared with a total profit of m.u. 1.2 million.

15. The enforcer was concerned that the treatment of the subsidiary as a disposal group and discontinued operations for such a long period might not be in accordance with IFRS 5.

The enforcement decision

16. The enforcer found that presentation of the subsidiary as a held for sale asset and as a discontinued operation did not comply with IFRS 5 as the issuer did not meet the necessary criteria, as set out in paragraphs 7-8 of the standard, in order to present a disposal group as such for a period longer than 12 months.

Rationale for the enforcement decision

17. Under IFRS 5, a disposal group is classified as held for sale where its carrying amount will be recovered principally through sale rather than continuing use. The sale should be expected to be complete within one year from the date of classification (paragraph 8).

18. A disposal group can, exceptionally, be classified as held for sale/discontinued after a period of 12 months if it meets certain criteria as indicated by paragraph 9 of the standard.

19. In this case, the relevant criteria established by Appendix B are as follows from B1 (c):"During the initial one-year period, circumstances arise that were previously considered unlikely and, as a result, a non-current asset (or disposal group) previously classified as held for sale is not sold by the end of that period, and:(i) during the initial one-year period the entity took action necessary to respond to the change in circumstances;(ii) the non-current asset (or disposal group) is being actively marketed at a price that is reasonable, given the change in circumstances, and (iii) the criteria in paragraphs 7 and 8 are met".

20. The issuer supplied the enforcer with evidence in the form of various draft agreements and correspondence with investment bankers in order to demonstrate that the subsidiary met the criteria for classification as a disposal group over an extended period.

21. The enforcer found that the agreements were not sufficiently related to the subsidiary in its present condition as at the point of classification as required by paragraphs 7 and 8. This requires the disposal group to be available for immediate sale in its present condition subject only to terms that are usual and customary for sales of such disposal groups.

22. Furthermore, it became clear that the issuer had made certain organisational changes during 2010 which resulted in additional activities being transferred to the subsidiary. This fact confirmed that the subsidiary was not available for sale in its present condition as at the point of classification as required by paragraph 7. The enforcer also noted that the shareholders' authorisation to sell the subsidiary in 2008 was only granted for one year and that this was not prolonged by the subsequent shareholders' meeting in 2009.

III Decision ref EECS/0211-03 – Impairment of financial assets

Financial year end: 31 December 2009
Category of issue: Financial instruments – Impairment of trade accounts receivable
Standards or requirements involved: IAS 39
Date decision taken: 6 January 2011

Description of the issuer's accounting treatment

23. The issuer's accounting policies in its 2009 financial statements disclosed that amounts receivable are initially recognised at fair value and subsequently measured at amortised cost, using the effective interest rate method less any impairment loss. The notes to the accounts indicated that carrying amounts are reviewed at each accounting reference date with a view to assessing any impairment. The notes also disclosed that the objective evidence that the financial assets have been impaired would include, for example, the failure by a third party to fulfil its obligations to the company. The impairment loss in respect of financial assets measured at amortised cost is computed as the difference between the net carrying value of the assets and the present value of the future cash flows discounted at the original effective interest rate.

24. At 31 December 2009, entity A, a related company, being a subsidiary of the issuer's principal 95% shareholder, was indebted to the issuer for m.u 10 million. The amount receivable was overdue by 90 days. The debt was still outstanding at 31 March 2010, when the financial statements were drawn up, and was now overdue by 180 days. As at 31 December 2009, the amounts receivable from entity A accounted for 51 % of the issuer's current assets, and 23 % of its total assets.

25. Entity A had suffered losses in the two previous years: m.u. 5 million in 2009 and m.u. 5.8 million in 2008 and its current liabilities materially exceeded its current assets (by m.u. 19.3 million in 2009 and by m.u. 15.1 million in 2008). Entity A's 2009 financial statements disclosed that as at 31 December, it had no possibility of borrowing from any financial institution and that its continuing activities were dependent on the financial support of its sole shareholder. The auditor had qualified its opinion in respect of the accounts for going concern risk.

26. On enquiry, the issuer agreed that the amounts due from entity A did show evidence of a possible impairment but that it had not conducted an impairment assessment in respect of the amounts due from its related party on account of the cost involved which it could not sustain given its financial position at that time.

The enforcement decision

27. The enforcer found that, consistent with paragraphs 59 (a) and (b) of IAS 39, there was objective evidence of a possible impairment in the amounts receivable from entity A given its failure to settle its obligations to the issuer and in the light of its severe financial difficulties. The issuer had failed to conduct an impairment assessment and was, therefore, in breach of the requirements of paragraph 63 of IAS 39.

Rationale for the enforcement decision

28. Paragraph 58 of IAS 39 "Financial instruments: recognition and measurement" requires that, at each date of its statement of financial position, an entity should consider whether there is any objective evidence that a financial asset or group of financial assets is impaired. Paragraph 59(b) of the standard

stipulates that objective evidence that a financial asset or group of financial assets is impaired includes a breach of contract (e.g., failure to pay the principal or interest owing. Paragraph 59(a) considers that objective evidence also includes observable data that comes to the issuer about a significant financial difficulty of the obligor.

29. In the presence of objective evidence that the loans and receivables or held-to-maturity investments carried at amortised cost have been impaired, paragraph 63 of IAS 39 requires an entity to measure the present value of the future cash flows discounted at the original effective interest rate of the relevant financial asset.

IV Decision ref EECS/0211-04 – Aggregation of operating segments

Financial year end: 31 March 2010
Category of issue: Aggregation of operating segments into reportable segments
Standards or requirements involved: IFRS 8 –Operating segments
Date decision taken: 9 May 2011

Description of the issuer's accounting treatment

30. In its annual financial statements for the year ended 31 March 2010, the issuer had identified its operating segments as follows:

a.	Segment A	City bus operations
b.	Segment B	Major Towns' bus operations
c.	Segment C	Region A Trains
d.	Segment D	Region B Trains
e.	Segment E	Region C Trains
f.	Segment F	Aviation operations

31. The company disclosed three reportable segments. Segments A and B had been aggregated into one reportable operating segment as had segments C, D and E. Segment F was reported as a single segment.

32. The issuer disclosed that operating segments A and B, and C, D and E had been aggregated on the basis of their similar long term economic characteristics and the similar nature of their products and services.

The enforcement decision

33. The enforcer was of the view that segments A and B had different customers. In the city bus market it is the transport authority that awards the contract and pays for the services whereas the customers in a major towns' bus market are the passengers who pay the company for the service it provides. In view of the fact that the segments have different customers, the two segments do not satisfy one of the aggregation criteria for IFRS 8 which requires segments to have a similar type or class of customer for their products and services (paragraph 12 c).

Rationale for the enforcement decision

34. Paragraph 12 of IFRS 8, 'Operating Segments', states the criteria that must be met to enable the aggregation of two or more operating segments into a single operating segment. The enforcer questioned the

issuer about the basis upon which it had concluded that its city and major towns' bus operations could be aggregated into a single segment.

35. The issuer's analysis of the factors considered in determining that operating segments A and B met all of the criteria in the standard for aggregation into a reportable segment was considered by the enforcer. The enforcer was concerned by the issuer's explanation that each operating segment had a similar type or class of customer.

36. The issuer explained that all of their end customers are members of the public. The fact that they contract through a transport authority to provide services in the city does not change their end customer.

37. The enforcer understood that, in the City bus market, contracts were awarded following a competitive tender process, on a cost per mile basis and, consequently, there is no exposure to near term passenger revenue risk. The ticket prices paid by passengers are set by a transport authority and not the issuer. By contrast, the enforcer understood that, in the major towns' bus market, ticket prices were generally set by the company and its revenues were, therefore, the fares paid by the customers travelling on the particular bus. In this set of circumstances the company was exposed to passenger revenue risk.

38. The enforcer noted the principal risks and uncertainties facing the bus division disclosed in the narrative reports which specifically highlighted the effects of the economic downturn, the effects that the loss of City bus contracts could have, the effects of changes to the concessionary fares scheme and the potential impact from the Competition Authority referral.

39. It appeared to the enforcer that each of the above risks would affect the city and major towns' bus segments in different ways but generally through the action of the operating segment's customer. For example, the decision to award or withdraw a City bus contract rested with the transport authority not with the issuer's end customer, the bus passenger. In contrast the decision to withdraw from a route in the major towns' bus market, generally, rests with the company but would be largely influenced by bus passengers' actions that may have contributed to the route becoming uneconomically viable.

40. The issuer explained that whilst it had provided additional information in its management report about the company's bus operations in the city and major towns this did not mean that they were reportable segments as they believed that both operating segments exhibited similar economic characteristics. The issuer reported a segment operating profit margin of 10 percent for their bus operations in 2010. The margin for their operations in city was within one percentage point of those in major towns and the long term trends were similarly close.

41. The enforcer was of the view that the company's bus operations in the city and major towns had different customers and, therefore, should not have been aggregated to form a single reportable segment.

V Decision ref EECS/0211-05 – Distribution of non-cash assets to shareholders

Financial year end: 31 December 2010
Category of issue: Distribution of non-cash assets to shareholders
Standards or requirements involved: IAS 39 – Financial instruments: Recognition and measurement, IFRIC 17 – Distribution of Non-cash Assets to Owners
Date decision taken: 4 December 2010

Description of the issuer's accounting treatment

42. The issuer had two core businesses which following shareholder approval on 29 June 2010, were demerged. The issuer retained one of the businesses, X, while a new entity ABC was created to run the second business (business Y). All of the business Y's subsidiaries' shares were contributed to ABC, whose shares were then distributed to the issuer's shareholders. As a result, on the 2nd July 2010, all of the issuer's shareholders received one ABC share for each share held in the issuer. The ABC shares are now publicly traded.

43. On 2 July 2010, in view of the listing of ABC shares, the issuer and its financial advisers proposed a reference market price of m.u. 11.40 per share. The opening quoted price on the listing day was m.u. 13.00 a share rising to m.u. 14.80 per share at the close.

44. At 30 June 2010, the carrying amount of the dividend payable was m.u. 2.6 billion, calculated as the number of ABC shares to be issued at the reference market price of m.u. 11.40 per share, being considered to be the fair value of the assets to be distributed.

45. As regards the valuation of the liability on settlement (ie 2 July 2010), the issuer considered the following facts as required by IFRIC 17, paragraph 13:

   a. there had been no significant change in the market conditions in the period from 29 June to 2 July;
   b. the volume and volatility of ABC shares had been significantly higher than those of the market in the first month following the initial quotation. The entity had, therefore, prepared an analysis that aimed to demonstrate that once the market price was adjusted for the unusual "eagerness" from market participants observed in the first month, on 2 July the adjusted market price of ABC would have been m.u. 11.70 per share, close to the reference market price of m.u 11.40 per share used on 30 June; and
   c. the obligation towards the shareholders had to be settled prior to quotation.

46. As a consequence, the issuer concluded that the fair value assessment required by IFRIC 17, paragraph 13 had to be determined before any market price was available, and that the market prices observed during the first day of quotation were not relevant. The issuer therefore used the reference price of m.u. 11.40 per share to assess the liability on 2 July 2010.

The enforcement decision

47. The enforcer did not agree with the issuer's view, having regard to paragraph 13 of IFRIC 17 which requires that, "At … the date of settlement, the entity shall review and adjust the carrying amount of the dividend payable".

48. Although IFRIC 17 does not refer specifically to IAS 39, the enforcer was of the view that IAS 39.AG71 and AG72 should be applied in the determination of fair value.

49. Therefore, the enforcer considered that the carrying amount of the dividend payable should be adjusted at the date of its settlement (ie: 2 July 2010) on the basis of the quoted market price of that day.

Rationale for the enforcement decision

50. Whilst IFRIC 17, paragraph 11 provides that “an entity shall measure a liability to distribute non-cash assets as a dividend to its owners at the fair value of the assets to be distributed”, the enforcer was concerned about the fair value measurement when the non-cash assets to be distributed were shares which were to be traded on an active market only from the day when the dividend payable was to be settled.

51. IFRS does not provide specific guidance on how an entity should measure the fair value of newly listed shares to be distributed to owners but the enforcer took the view that the guidance given in AG 71-72 of IAS 39 should be applied.

52. These paragraphs respectively provide that:

   a. - “the existence of published price quotations in an active market is the best evidence of fair value and when they exist they are used to measure the financial liability”; and
   b. - “the current bid price is usually the appropriate price to be used in measuring the fair value of an asset held”.

53. In addition to the specific requirements noted above, whenever market evidence exists (level 1 in fair value hierarchy according to IAS 39), it should be used instead of internal valuation.

54. Adopting the opening market price of m.u. 13.00 per share, the effect on the issuer’s equity attributable to owners of the parent and on the issuer’s net result was an increase in the issuer’s net result of m.u 360 million.

VI Decision ref EECS/0211-06 – Investment properties

Financial year end: 31 December 2010
Category of issue: Fair value of investment property
Standards or requirements involved: IAS 40 – Investment property
Date decision taken: 30 November 2010

Description of the issuer’s accounting treatment

55. The issuer is a real estate company specialised in industrial property. The investment properties (including those held for sale) constitute more than 95% of the total assets.

56. The issuer measures its investment property using the fair value method, in application of IAS 40, paragraph 30. In its annual and half-yearly financial statements, the issuer stated that "for determining the fair value of the real estate, the latter is measured using the 'new-build value less obsolescence' and not the return based expected rent value."

57. Valuations are conducted by an independent real estate appraiser. The appraiser determined the value of both the land and the construction. The appraiser stated that the new-build value was determined by means of a detailed measurement and calculation, from which obsolescence was then deducted. In order to determine the deduction, the appraiser took account of the age of the property and the nature of its use, e.g. assembly versus heavy industry. According to the appraiser, this method of calculation is complex but gives a very precise result.

58. The issuer argued that the fair value is based on the price at which the property could be exchanged, on the date of the valuation, between knowledgeable, willing parties in an arm's length transaction, as required by IAS 40, paragraph 36.

59. According to the issuer, the most important sellers and buyers of industrial property are the owner-operators of industrial property. Owners who rent out industrial property, such as the issuer, constitute a very small market and transactions in industrial property between owner-lessors are limited. Even more than for logistics or semi-industrial property, users of industrial property take a strategic decision regarding personnel and investment in installations. Users of industrial property thus have a limited choice between renting, buying or erecting a building that meets their specific requirements (the "Rent-buy-make" decision). This "Rent-buy-make" decision is taken on the basis of the cost-benefit analysis between, on the one hand, the new-build value of a new structure and, on the other hand, the new-build value less obsolescence of an existing building versus the rental income charged for it. For this reason, according to the issuer, the new-build value less obsolescence was, in this case, a suitable method for determining fair value.

The enforcement decision

60. The enforcer found that a valuation based on new-build value less obsolescence does not reflect the fair value of investment property as it does not reflect market conditions as required by IAS 40.38 (according to the valuer it was less subject to market swings. Nor does it take account of information from a variety of sources, including discounted cash flow projections based on reliable estimates of future cash flows, supported by the terms of any existing lease contracts.

Rationale for the enforcement decision

61. IAS 40, paragraph 40, states that "The fair value of investment property reflects, among other things, rental income from current leases and reasonable and supportable assumptions that represent what knowledgeable, willing parties would assume about rental income from future leases in the light of current conditions. It also reflects, on a similar basis, any cash outflows (including rental payments and other outflows) that could be expected in respect of the property."

62. A potential buyer, when determining the price he is willing to pay for investment property, will also take account of existing lease contracts. A valuation based on new-build value less obsolescence takes no account of this consideration.

63. The enforcer also pointed out that IAS 40, paragraph 46(c) specifically provides that: " In the absence of current prices in an active market [...] an entity considers information from a variety of sources, including: [...] discounted cash flow projections based on reliable estimates of future cash flows, supported by the terms of any existing lease and other contracts [...] and using discount rates that reflect current market assessments of the uncertainty in the amount and timing of the cash flows.

64. It was confirmed that:

   a. there were no readily available points of comparison for the type of real estate involved;
   b. the new-build value less obsolescence does not reflect rental income from current leases;
   c. the new-build value less obsolescence does not reflect any discounted cash flows based on reliable estimates of future cash flows, or recent prices of similar properties on less active markets; and
   d. the new-build value less obsolescence is less subject to changing market conditions whereas fair value should reflect market conditions (paragraph 38 of IAS 40).

VII Decision ref EECS/0211-07 – Disclosure on financial instruments

Financial year end: 31 December 2009
Category of issue: Risk disclosures
Standards or requirements involved: IFRS 7 – Financial instruments: Disclosures, IAS 1 - Presentation of Financial Statements
Date decision taken: 30 September 2010

Description of the issuer's accounting treatment

65. The issuer is a debt issuer whose business is the securitisation of a portfolio of underlying investments (e.g. securities, funds and loans) and financing the purchase of same through the issuance of listed, note-specific, limited recourse Notes.

66. Depending on the use, or otherwise, of derivative financial instruments to mitigate some of the risks (e.g. interest rate risk, currency risk, other price risk) of holding the underlying investments, individual Notes behave either as pass-through securities (i.e. the risk of the underlying investments is passed directly to the note-holders) or the note-holders may hedge some/all of the interest rate risk, or currency risk and be left with the underlying other price risk (or counterparty risk if a total return swap is used) , with derivative counterparties sharing the risks.

67. The repayment of the Notes is dependent upon the performance of the underlying investments/collateral, and the ability of the derivative counterparties to honour their obligations. Note-holders bear the ultimate risks and rewards of ownership of the underlying investments.

68. The matter considered by the enforcer was whether, in circumstances where an issuer's sole source of finance is the issuance of listed limited recourse Notes, an issuer should consider its Note-holders as being amongst the primary users of the financial statements and accordingly, provide disclosure of the Note-holders' exposure to risks in the financial statements, (as distinct from the risks faced by the company's shareholders) in accordance with IFRS 7. Such risks would include, amongst others, Note-holders' exposure to other price risk, concentration risk, and sensitivity analysis to the underlying portfolio.

69. The enforcer was also concerned as to what level of aggregation of risk disclosures was appropriate given the Note-specific nature of the underlying investments i.e. investments are allocated as collateral to specific Notes, therefore, the risk profile of individual Notes may differ.

70. In the light of correspondence with the issuer , the enforcer was concerned that issuer's perceptions as to who might reasonably be considered to be the primary users of limited recourse debt issuers' financial statements may be too narrowly focused on the company's shareholders , rather than the providers of the main source of finance to the issuer i.e. the Note-holders. Indications in this regard included the fact that the disclosures provided by the issuer had tended to be boilerplate, minimal in nature, and of limited usefulness to Note-holders. For example, the enforcer was of the view that such disclosures did not adequately disclose other price risk, sensitivity analysis and counterparty risk disclosures.

The enforcement decision

71. The enforcer concluded that:

   a. the issuer's perception of who could reasonably be considered to be among the users of its financial statements (a limited recourse debt issuer) had become too narrow, being limited to the company's shareholders rather than including Note-holders; and

b. the enforcer found that the risk disclosures required by IFRS 7 should be enhanced to include those relating to the Note-holders, by individual series of Notes where practicable, so as to ensure that significant differences between the various series of Notes were not obscured.

Rationale for the enforcement decision

72. IAS 1, paragraph 9 states that the objective of financial statements is to provide information about the financial position, financial performance and cash flows of an entity that is useful to a wide range of users in making economic decisions.

73. The standard also states that omissions or misstatements of items are material if they could, individually or collectively, influence the economic decisions that users make on the basis of the financial statements.

74. The objective of IFRS 7, as noted in paragraph 1, is to require entities to provide disclosures in their financial statements that enable users to evaluate the significance of financial instruments for the entity's financial position and performance. IFRS 7, paragraph 33 states that, amongst other matters, for each type of risk arising from financial instruments, an entity shall disclose:

   a. the exposures to risk and how they arise;
   b. its objectives, policies and processes for managing the risk and the methods used to measure the risk;

75. Paragraph B3 of Appendix B to IFRS 7 states that, an entity is to decide, in the light of its circumstances, how it aggregates information to display the overall picture without combining information with different characteristics. Similarly, an entity shall not disclose information that is so aggregated that it obscures important differences between individual transactions or associated risks.

VIII Decision ref EECS/0211-08 – Presentation of fair value changes in the Profit and Loss account

Financial year end: 31 December 2009
Category of issue: Presentation of fair value changes in Profit or loss for the period
Standards or requirements involved: IAS 1 – Presentation of Financial Statements
Date decision taken: 10 December 2010

Description of the issuer's accounting treatment

76. The issuer, a real estate company, presents changes in the fair value of investment property (separated in two lines for realized and unrealized) and fair value changes in derivative financial instruments in its profit and loss account after subtotals for operating results and net finance.

The enforcement decision

77. The enforcer found that, whilst IAS 1 does not prescribe the presentation of fair value changes in the profit and loss account, the issuer should revise its presentation such that fair value changes be taken into account in the determination of operating results (IAS 1, Basis of Conclusions). The enforcer also concluded that presentation of a subtotal "net finance" is misleading if it excludes the fair value changes in derivative financial instruments (mainly interest swaps).

Rationale for the enforcement decision

78. The enforcer was concerned that the presentation of fair value changes for investment property outside operating results is not in accordance with IFRS.

79. The issuer noted that there are no detailed requirements in IAS 1 on how to present fair value changes in the income statement. The issuer indicated that many real estate companies use a similar presentation.

80. The enforcer referred to IAS 1, Basis of Conclusions, paragraph 56, in which the following rationale is provided: "The Board recognizes that an entity may elect to disclose the results of operating activities, or a similar line item, even though this term is not defined. In such cases the Board notes that the entity should ensure that the amount disclosed is representative of activities that would normally be regarded as "operating". In the Board's view it would be misleading and would impair the comparability of financial statements if items of an operating nature were excluded from the results of operating activities, even if that had been industry practice. For example it would be inappropriate to exclude items clearly related to operations (such as inventory write-downs and restructuring and relocation expenses) because they occur irregularly or infrequently or are unusual in amounts. Similarly, it would be inappropriate to exclude items on the grounds that they do not involve cash flows such as depreciation and amortization expenses."

81. The enforcer was of the view that fair value changes in investment property are a normal part of the activities of a real estate company that has opted to account for investment property in accordance with the fair value model under IAS 40 and which features in the issuer's description of its business model. Similarly, the enforcer found that presentation of a subtotal "net finance" is misleading if it does not include the fair value changes in derivative financial instruments.

IX Decision ref EECS/0211-09 – Financial instruments - Disclosure

Financial year end: 31 December 2008
Category of issue: Financial instruments - disclosure
Standards or requirements involved: IFRS 7 - Financial instruments: Disclosures
Date decision taken: 2 July 2010

Description of the issuer's accounting treatment

82. The issuer is an offshore services company which operates on a global basis serving the oil and gas market, the offshore renewable market and the market for submarine power interconnectors. The issuer charters construction support and fast support vessels, and provides installation and lay equipment for rent.

83. At the end of 2008, the issuer's liquidity position was very tight such that the directors described it as 'unsatisfactory' in the management report. During the first quarter of 2009, the situation worsened with the result that the issuer was in breach of its covenants at 31 March 2009. The financial statements were authorized for issue at the end of April 2009.

84. The directors' and auditors' reports both emphasized the considerable risk of not being able to continue as a going concern.

85. The issuer's borrowings at 31 December 2008 included 7 loans in different currencies. The notes to the financial statements disclosed that "key financial covenants include; no dividend, free cash requirement, pledge accounts, various equity requirements and limitation on the ability to incur new debt". Further, the notes indicated that there was "ample" compliance with all covenants as at the balance sheet date. No additional information about the covenants was included in the financial statements. Upon request from the enforcer however, the issuer confirmed that, at 31 December, it had been close to breaching the covenants in respect of free cash-flows and equity ratio requirements.

The enforcement decision

86. The enforcer found that the issuer should have disclosed additional information about the covenants relating to each loan or group of loans including the amount of headroom as deemed appropriate under IFRS 7. The subsequent breach of the covenants represented a material event after the reporting period and should have given rise to relevant disclosures required by paragraph 21 of IAS 10 – Events after the reporting period, in relation to material non-adjusting events after the reporting period.

Rationale for the enforcement decision

87. According to paragraphs 31-32 of IFRS 7, an entity shall disclose information that enables users of its financial statements to evaluate the nature and extent of risks arising from financial instruments to which the entity is exposed at the end of the reporting period.

88. The enforcer is of the view that disclosure of information about covenants is necessary to a greater extent in situations where the issuer is close to breaching its covenants, and in situations where uncertainty is expressed in relation to the going concern assumption. Given the fact that, at the end of 2008, there was a considerable risk of breach of covenants in the near future, the enforcer found that the issuer should have given additional information relating to the conditions attached to its loans. Among other things, the information should have include details on how close the issuer was to breaching the different covenants.

89. The enforcer also argued that a breach of covenants after the balance sheet date, but before the financial statements were authorised for issue, constituted a material non-adjusting event after the end of the reporting period which required further disclosure in accordance with IAS 10.

90. Specifically, the enforcer argued that identification of which covenants were breached after the end of the period, the new covenants required as a consequence of the breaches and acknowledgement of the consequences for the maturity analysis for financial liabilities as at the year-end were all relevant to the issuer's situation. The enforcer also pointed to the apparent inconsistency between the information provided in the directors' report and that which was included in the financial statements.