COMMITTEE OF EUROPEAN SECURITIES REGULATORS

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6th extract from EECS's database of enforcement decisions

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Introduction

EU 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 CESR group charged with accounting issues, CESR-Fin, EECS is a forum in which all EU National Enforcers of financial information, whether CESR members or not, 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 International Financial Reporting Interpretations Committee (IFRIC).

As proposed in CESR Standard No 2 on Financial Information, 'Co-Ordination of Enforcement Activities', CESR 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, CESR 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, or oversight of IFRS requirements, 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 CESR, 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;

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

Decision ref.EECS/0809-01: Impairment of available for sale equity instruments

Financial year end: 31 December 2007
Category of issue: Impairment of available for sale equity instruments
Standard involved: IAS 39
Date of the decision: 13 November 2008

Description of the issuer's accounting treatment
The issuer is a large life insurance and pension group with 3% of its financial assets, excluding derivatives, invested in equity instruments. In its 2007 consolidated financial statements, there was a € 45 million charge to profit and loss relating to the impairment of equity instruments.

The issuer stated, in its summary of accounting policies, that a significant or prolonged decline in the fair value of an equity instrument below its cost was considered to be objective evidence of impairment always resulting in a loss being recognised in the income statement.

The issuer further disclosed in a note that equity securities held in an unrealised loss position below cost for a specified period or which were significantly below cost at the balance sheet date were evaluated for possible impairment.

When asked to explain its treatment, the issuer noted that IFRS does not give any quantitative thresholds determining what should be considered ' significant' or 'prolonged' and does not require an entity to define these terms. The issuer added that, when conducting its impairment test, equity investments which had a market to book value of less than a certain percentage, unrealised losses of more than a threshold amount or were in an unrealised loss position for a specified period of time were further analysed for evidence of impairment. The equity investments were impaired to fair value unless documentation is available supporting recovery of that value in the short term.

The enforcement decision
The enforcer did not accept the issuer's accounting treatment. In the view of the enforcer, a significant or prolonged decline in the fair value of an equity instrument as determined by the issuer in the aforementioned situations is, of itself, objective evidence of impairment. No further evaluation is required or, indeed, permitted, in such circumstances.

Rationale for the enforcement decision
IAS 39 paragraph 61 provides examples of what might be considered objective evidence of impairment for an investment in an equity instrument and which includes a significant or prolonged decline in the fair value of an investment in an equity instrument below its cost. No further evaluation is required to establish whether the investment is impaired in such circumstances.

The issuer should, therefore, impair its equity instruments where the decline in value is either significant or prolonged (defined by the management judgement under IAS 39 paragraph 61) regardless of whether there is documentation supporting recovery of their fair value in the short term.

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Decision ref.EECS/0809-02: Accounting policies for impairment for available for sale financial assets

Financial year end: 31 December 2007
Category of issue: Accounting policies for impairment of available for sale financial assets
Standard involved: IAS 39
Date of the decision: 13 April 2009

Description of the issuer's accounting treatment
The issuer, a bank, disclosed in its 2007 financial statements that equity instruments classified as available for sale assets were considered to be impaired when there was objective evidence that the assets were impaired and where there was both a significant <u>and</u> prolonged decline of fair value below costs.

The category of available for sale assets represented 5% of the bank's total assets.

Applying this policy, the issuer did not recognise any impairment losses in its interim financial statements of June 2008.

The enforcement decision
The enforcer did not accept the accounting policy applied by the issuer and disagreed with the criteria applied to the determination and recognition of impairment losses in respect of equity instruments.

Rationale for the enforcement decision
IAS 39 paragraph 61 states that, in addition to the types of events described in paragraph 59, objective evidence of impairment for an investment in an equity instrument includes information about significant changes with an adverse effect that have taken place in the technological, market, economic or legal environmental in which the issuer operates, and indicates that the cost of the investment in the equity instrument may not me recovered. The paragraph goes on to say that *"A significant <u>or</u> prolonged (emphasis added) decline in the fair value of an investment in an equity instrument below its cost is also objective evidence of impairment*".

The standard is clear that the decline needs only to be significant <u>or</u> prolonged to be considered objective evidence of impairment. There is no requirement that both criteria are met.

IAS 39 does not indicate quantitative thresholds that may satisfy the criteria of 'significant' or 'prolonged'. Issuers should, however, refer to the thresholds they apply in their description of the relevant accounting policy in accordance with IAS 1 paragraph 122[1].

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Decision ref.EECS/0809-03: Impairment of available for sale financial assets

Financial year end: 31 December 2008
Category of issue: Impairment of available for sale financial assets
Standard involved: IAS 39
Date of the decision: 1 April 2009

Description

[1] With reference to IAS 1 issued by the IASB in September 2007 and endorsed in December 2008.

The issuer, a bank, has interests in equity instruments classified as available for sale financial assets in accordance with IAS 39. These stocks are all listed on an active market.

The issuer explains, in the description of its accounting policy for available for sale financial assets, that a "*significant or prolonged decline of the fair value of an equity instrument triggers a further analysis and that an impairment is recognised, if necessary, after this further analysis*." This analysis is not described in the notes to the financial statements.

The issuer explained its accounting treatment by reference to IAS 39 paragraph 59. This paragraph states that financial assets are impaired if, and only if, there is objective evidence of impairment as a result of one or more events that occurred after the initial recognition of the asset (a 'loss event') and that that loss event (or events) has an impact on the estimated future cash flows of the financial assets that can be reliably estimated.

The issuer argued therefore, that, where there is a significant or prolonged decline in the value of an equity instrument, as referred to in paragraph 61 of the standard, further analysis must be undertaken to determine whether that decline has an impact on the estimated future cash-flows of the financial assets.

The issuer referred to the IFRIC Update dated March 2004, which, it argued, indicated that the wording "*a significant or prolonged decline in the fair value of an investment in an equity instrument below its cost is also objective evidence*" represented an unequivocal trigger for consideration of the measurement principles set out in paragraphs 67 and 68 of the standard. The issuer considered that an "unequivocal trigger" means that a further analysis should be undertaken.

The enforcement decision

The enforcer did not accept the issuer's accounting policy that a significant or prolonged decline in the fair value of an equity instrument prompted further analysis as the decline is, of itself, objective evidence of impairment. No further evaluation is required or, indeed, permitted in such circumstances.

Rationale for the enforcement decision

IAS 39 paragraph 58 states that, at the end of each closing period, an entity should assess whether there is any objective evidence that a financial asset or group of financial assets is impaired. If such evidence exists, the entity shall, for available for sale financial assets, apply IAS 39 paragraph 67 to determine the amount of the impairment loss. According to paragraph 67, *"when a decline in the fair value of an available for sale financial asset has been recognised in other comprehensive income and there is objective evidence that the asset is impaired, the cumulative loss that had been recognised in other comprehensive income shall be reclassified from equity to profit or loss as a reclassification adjustment even though the financial asset has not been derecognised"*.

Therefore, according to the enforcer, there is a direct and explicit link between the existence of an "objective evidence of impairment" and the recognition, in profit or loss, of the cumulative loss recognised in other comprehensive income.

A reading of IAS 39 paragraph BC107 indicates that paragraph 59 focuses on the assessment of impairment of debt instruments and paragraph 61 on equity instruments. Paragraph 61 states that, in addition to the type of events listed in paragraph 59, for equity instruments, other changes in the economic, technological etc, environment can also be considered objective evidence of impairment. The paragraph goes further and states that a significant or prolonged decline in the fair value of an investment in an equity instrument below its cost is also objective evidence of impairment.

The enforcer disagreed that the assessment of impairment of equity instruments should be made solely on the basis of paragraph 59 and believed paragraph 61 to be the relevant paragraph.

According to the enforcer, the purpose of paragraph 61 is to provide guidance on the application of the principle established in paragraph 58. Specifically, paragraph 61 underlines the fact that, for equity instruments that are listed on an active market, a decline (either significant or prolonged) in market value below cost is the ultimate indication that the equity instruments are impaired.

The enforcer also disagreed with the issuer's interpretation of wording included by IFRIC in its March 2004 update. According to the enforcer, "unequivocal trigger for measurement" means that paragraphs 67-68 should be applied without further analysis.

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Decision ref.EECS/0809-04: Cash Flow Statements

Financial year end: 31 December 2006
Category of issue: Cash flow statements
Standard involved: IAS 7
Date of the decision: 2 June 2008

Description of the issuer's accounting treatment
The issuer presented a non-cash element of a sales transaction as a cash transaction in its consolidated cash flow statement. The cash transaction related to the sale of a subsidiary as follows:

- The issuer had granted a loan to a subsidiary. As a result of the sale of the subsidiary to a third party, the loan was no longer eliminated on consolidation but recorded on the balance sheet. The movement in the book value of the loan, a non-cash transaction, was classified as a cash outflow from investing activities in the cash flow statement.

- The aggregate amount of cash received as consideration for the sale of the subsidiary was reported as an incoming cash flow from investing activities and was not recorded net of the cash and cash equivalents disposed of with the subsidiary. Furthermore, disposal costs were not taken into account.

The enforcement decision
The enforcer found that the issuer had failed to comply with IAS 7 in a number of respects, given that a non-cash element of a cash transaction had been reported as a cash transaction in the cash flow statement.

Rationale for the enforcement decision
As a result of the non compliance with IAS 7 cash flows from operating activities were materially overstated and the cash flows from investing activities were materially understated.

The cash receipt from investing activities was incorrect as it was not reported net of cash and cash equivalents disposed of as required by IAS 7 paragraph 16 and IAS 7 paragraph 42. In addition, the issuer had not disclosed, in aggregate, the amount of the assets and liabilities other than cash or cash equivalents in the subsidiary over which control is lost as required by IAS 7 paragraph 40d.

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Decision ref.EECS/0809-05: Classification and valuation of written puts on minority interests

Financial year end: 31 December 2007
Category of issue: Minority interests and puttable instruments
Standard involved: IAS 32, IAS 39
Date of the decision: 21 October 2008

Description of the issuer's accounting treatment
The issuer had acquired several companies over a number of years, including the reporting year in question.

The issuer's strategy is to acquire the majority of the acquiree's shares but to leave a minority interest outstanding for a limited amount of time, after which it acquires those interests too. To this end, the issuer assumes an unconditional liability to purchase the remaining outstanding shares for an amount determined by the results achieved by the acquired companies, largely, revenue and earnings growth.

Under the terms of the contract, the issuer can choose whether to pay for these minority shares in cash or in its own shares. If the issuer opts for payment by way of its own shares, the number of shares to be paid are calculated at the time of the purchase of the minority interests.

In its financial statements, the issuer classified the minority interests as part of group equity, disclosing the existence of unconditional liabilities in a note to the accounts.

The enforcement decision
The enforcer found that, in accordance with IAS 32 paragraph 23, the minority interests should be classified in the balance sheet as a financial liability as the shares are to be paid for either in cash or a variable number of the issuer's own equity instruments.

Rationale for the enforcement decision
IAS 32 paragraph 23 stipulates that a contract which contains an obligation for an entity to purchase its own equity instruments for cash or another financial asset cash gives rise to a financial liability for the present value of the redemption amount. This is the case even if the contract itself is an equity instrument.

When the financial liability is recognized initially under IAS 39, its fair value (the present value of the redemption amount) is reclassified from equity. Subsequently, the financial liability is measured in accordance with IAS 39.

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Decision ref.EECS/0809-06: Disclosure of key management personnel compensation and related party transactions with key management

Financial year end: 31 December 2007
Category of issue: Share-based payment
Standard involved: IAS 24
Date of the decision: 6 January 2009

Description of the accounting treatment

The issuer granted shares to key management as part of their remuneration package. The related costs were not included in the total of the compensation disclosed for key management personnel but were noted separately.

The issuer subsequently bought back some of the shares from key management but did not disclose either the number of shares involved or the amount for which they were repurchased .

Both the issue and the subsequent repurchase of the shares were significant in relation to the total remuneration package for key management personnel.

The enforcement decision
The enforcer concluded that the issuer should disclose the information as required by IAS 24 paragraphs 16 and 17(a).

Rationale for the enforcement decision
IAS 24 paragraph 16(e) requires disclosure of key management personnel compensation in total for a number of identified categories, including share-based payments. Compensation for share-based payment, although provided elsewhere, was not included in the total compensation disclosed and was significant in relation to that amount (20%).

IAS 24 paragraph 17 also requires information about transactions and balances that is necessary for an understanding of the potential effect of the relationship with related parties on the financial statements. Disclosure should include the amount of the transactions. The enforcer concluded that both the number of shares bought back and the amount for which they were purchased should also be disclosed in accordance with this paragraph.

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Decision ref.EECS/0809-07: Contingent liabilities

Financial year end: 31 December 2007
Category of issue: Contingent liabilities
Standard involved: IAS 37
Date of the decision: 28 April 2008

Description
The issuer builds, develops and manages airports.

In May 2004, a roof-section of the boarding area of a terminal collapsed killing 4 people and wounding 4 others. The accident resulted in the temporary closure of the terminal and led to legal action against the issuer.

Both the investigation and the reconstruction were still in progress when the 2007 accounts were published and no action had yet been brought in connection with the accident. Experts were continuing with their appraisals, mainly in connection with the expert report that was to be presented to the civil courts determining the cause of the accident and assessing the respective responsibilities of the various parties involved. The report was expected in the summer 2008.

Financial damages arising from the accident consisted of additional costs and operating losses relating to the unavailability of the building. The real nature and extent of the damages, including whether they qualify for compensation and the details of any compensation payments made had yet to be established. The issuer considered that, at the current stage of proceedings, there was no requirement to record the impact of the accident in the financial statements.

Compensation agreements had been arranged with the victims' claimants, all of which were covered by the issuer's insurance policy. The insurers were also party to these transactions. In each case, compensation paid by the insurance agents was subject to a waiver of any judicial proceedings or appeals against the issuer and its insurers. If compensation is ultimately payable to third parties by the issuer, this is expected to be covered by the insurance policies it has taken out .

The issuer considered that the conditions for recognising a provision or disclosing a contingent liability, particularly the conditions set out in paragraphs 14 and 28 of IAS 37, had not been fulfilled. Hence, the issuer did not recognise any provision in respect of the accident in its 2007 accounts nor did it disclose any related contingent liability. Furthermore, the issuer did not disclose its underlying analysis of the situation in the notes to its 2007 financial statements.

The enforcement decision
The enforcer agreed that, in accordance with IAS 37 paragraph 14, the conditions for establishing a liability were not fulfilled. The enforcer did, however, conclude that a contingent liability should be disclosed as required by IAS 37 paragraph 28.

Rationale for the enforcement decision
IAS 37.14 requires a provision to be recognised when an entity has a present obligation as a result of a past event; it is probable that an outflow of resources embodying benefits will be required to settle the obligation and a reliable estimate of the obligation can be made.

At the date of the financial statements, there was no current obligation for the issuer. In particular, no action had been brought in connection with the accident. It was not yet probable that an outflow of resources would be required to settle the obligation. In any event, if compensation were payable to third parties by the issuer, the insurance policies were expected to cover the outflow. In the enforcer's view, no provision was required.

The enforcer was, however, of the opinion that IAS 37 paragraph 28 applied to the case and that the issuer should disclose a contingent liability.

The fact that the real nature and extent of the damages, including whether they qualify for compensation and details of any compensation payments remained to be established all indicated the level of uncertainty attaching to the issue. In the view of the enforcer, however, the degree of uncertainty was not such that the possibility of an outflow of resource could be considered remote. Had this been the case, no disclosure under IAS 37 paragraph 28 would have been required.

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Decision ref.EECS/0809-08: Disclosures regarding share capital

Financial year end: 31 March 2008
Category of issue: Financial instruments and share capital
Standard involved: IAS 32
Date of the decision: 30 November 2008

Description of the issuer
The issuer, a closed-ended fund, has share capital comprising two subscriber shares of €1 each which do not participate in the profits of the issuer, and in excess of 50 million participating preference shares of no par value, which are classified on the face of the Balance Sheet as a component of 'Participating Shareholders' Equity'.

The issuer's financial statements stated that its participating and subscriber shares are classified as equity in accordance with the issuer's articles of association. The participating preference shares are to be redeemed when the issuer's useful life of 15 years expires.

The issuer argued that the participating preference shares be presented as equity on the basis that this was the legal form of these instruments.

The enforcement decision

The enforcer did not concur with the analysis that the participating preference shares should be presented as equity. Rather, the enforcer was of the opinion that these shares were a financial liability of the issuer in accordance with IAS 32.

Rationale for the enforcement decision

IAS 32 paragraph 18 provides that *'The substance of a financial instrument, rather than its legal form, governs its classification on the entity's balance sheet'*. Similarly, IAS 32 paragraph 15 requires that an issuer of a financial instrument *' shall classify the instrument … on initial recognition as a financial liability, a financial asset or an equity instrument in accordance with the substance of the contractual arrangement and the definitions of a financial liability, a financial asset and an equity instrument.'*

The enforcer concluded that the shares should be shown as a financial liability as they are mandatorily redeemable upon expiration of the issuer's limited life of 15 years (IAS 32 paragraph 11).

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