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Decision ref.EECS/1208-01: Merger

Financial year end: 31 October 2007 / Prospectus / Pre-clearance

Category of issue: Business Combination, Reverse Acquisition

Standard involved: IFRS 3

Date of the decision: 10 June 2007

Description of the issuer's accounting treatment

Entities A and B are two publicly listed groups. In September 2005, entity B, (the issuer), acquired 68 % of the shares and 76.94 % of the voting rights of entity A. This acquisition was fully financed in cash. After the acquisition, the Board of entity A included 3 members appointed by entity B, 3 former members of entity A's board and 3 independent members. The former chairman of entity A remained chairman of the new Board.

Entity A was included in the issuer's 2006 consolidated financial statements as a subsidiary. The purchase price was allocated to identifiable intangible assets and the residual amount to goodwill.

In June 2007, the issuer and entity A decided to merge. Largely for tax reasons, the merger took the legal form of the issuer merging with entity A. After the merger, the Board of the new entity (A+B) included 3 members appointed by former entity B, 2 members appointed by former entity A and 2 independent members. The new chairman of the Board was the former chairman of entity B. In the first discussions regarding the prospectus, the issuer indicated to the enforcer that entity A would become the consolidating entity.

The enforcement decision

The enforcer found that entity B (the issuer) should remain the parent entity in this case.

Rationale for the enforcement decision

Paragraph 3.b of IFRS 3 states that the standard does not apply to business combinations involving entities under common control. Considering that, in 2005, the issuer obtained control of entity A and that the merger did not modify this control, the enforcer was of the opinion that entity B should remain the consolidating entity despite the legal form adopted for the merger.

In addition, the enforcer was of the opinion that, because of the continuum in terms of control, the assets and liabilities of neither entity should be revalued. Therefore, the enforcer concluded that the assets and liabilities of both groups should remain at their carrying amounts as presented in the consolidated financial statements of the issuer on the day before the merger.

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Decision ref.EECS/1208-02: Control of a subsidiary

Financial year end: 30 March 2007 / Pre-clearance

Category of issue: Control, Subsidiary

Standard involved: IAS 27

Date of the decision: 5 December 2007

Description of the issuer's accounting treatment

The issuer, entity A, acquired an indirect holding of 44.4 % equity interest in entity B, a private company.

Entity B has a very specific kind of articles of incorporation ("*société en commandite simple*"), which is sometimes chosen for partnerships and which generally has the following characteristics:

- There is no Board of Directors as in other forms of incorporation;
- The directors who manage the entity have extended powers (as individuals they can enter into transactions which, in other forms of incorporation, would require a decision by the Board);
- The shareholders are divided between limited partners ("*associés commanditaires*") and general partners ("*associés commandités*"). The general partners are liable on their own goods;



- The financial and operational policies are only decided by the general and limited partners;
- The articles of association of the entity state how major decisions are taken.

The articles of association of entity B state that:

- Ordinary decisions (all decisions without modification of the articles of association) should be carried by a majority of the general partners (one person to one vote) and a majority in voting rights among the limited partners;
- Collective decisions should be approved unanimously by the general partners and by a majority both in number and voting rights among the limited partners;
- Capital increases should be voted by 2/3rd of the general partners (one share to one vote) and a majority both in number and voting rights among the limited partners;
- Changes in managing directors should be voted by a majority of the general partners and a majority, both in number and voting rights, of the limited partners.

Entity B has 33 general partners holding 85 % of the voting rights and 7 limited partners representing the remainder. The issuer appointed 11 general partners holding 74 % of the voting rights and 3 limited partners representing 12 % of the voting rights. Hence, the issuer has the majority of voting shares of the general and limited partners but not a majority by number.

The issuer considered that at this stage, with a 44 % holding, it does not control entity B. The issuer, however, plans to hold more than 50 % of entity B in a few months without any change to the numbers of either the general or limited partners.

The issuer concluded that entity B would be controlled and hence, fully consolidated once it holds more than 50 % of the voting rights.

The enforcement decision

The enforcer agreed that the issuer does not control entity B.

Rationale for the enforcement decision

The enforcer concluded that entity B is not controlled by issuer for the following reasons:

- The issuer cannot take any decision of its own as even ordinary decisions require the approval of 17 general partners (only 11 are appointed by the issuer);
- None of the criteria set out in paragraph 13 of IAS 27 are met by the issuer, i.e. there is:
 - o No power over more than half of the voting rights by virtue of an agreement with other investors: no such agreement exists;
 - o No power to govern the financial and operating policies of the entity under a statute or an agreement: no such agreement exists;
 - o No power to appoint or remove the majority of the members of the board of directors or equivalent governing body: no board of directors or equivalent body is in place;
 - o No power to cast the majority of votes at meetings of the board of directors or equivalent body: no board of directors or equivalent body is in place;
 - o No de facto control as the issuer cannot take any decision of its own and there is no history showing that the issuer sets decisions at the level of entity B.

As a consequence, the enforcer informed the issuer that, all other facts remaining unchanged, even with more than 50 % of the equity interest in entity B, the issuer would still not control entity B because:

- IAS 27 paragraph 13 states that control is presumed to exist when the parent owns more than 50 % of the voting rights, unless it can be clearly demonstrated that such an ownership does not constitute control;
- If the general and limited partners remain unchanged, the issuer will not be able to take any decision of its own as it will not have the majority in number of the general partners. Therefore, there will be a clear indication that this ownership does not constitute control.

Control of entity B should however be reassessed if there is a change in the structure of the organization effecting the general and limited partners.

Decision ref.EECS/1208-03: Significant Influence

Financial year end: 31 December 2005 / Annual Financial Statements

Category of issue: Significant Influence, Associates

Standard involved: IAS 28

Date of the decision: 6 November 2006

Description of the issuer's accounting treatment

The issuer, an entity in the software business, was one of three shareholders in entity B. As at 31 December 2005, the majority shareholder held 61.01 % of voting shares, another member held 19.99 % of voting shares and the issuer held the remaining 19 %. The board consisted of six members. The majority shareholder was represented by four out of the six board members, while the issuer and the third shareholder were represented by one member each.

A shareholders' agreement between the owners of entity B mandated that certain board and shareholder resolutions required either unanimity or a qualified majority. For reasons of confidentiality, further details of the shareholders' agreement may not be published.

There was no indication that the majority shareholder and the other minority shareholders acted in concert.

The issuer had provided entity B with maintenance and hosting services and, during the year, had sold the entity a software license of material value.

The issuer did not account for its investment in entity B as an associate, citing lack of significant influence over the entity. The issuer pointed out that it only had one representative on the board, while the majority shareholder was represented by four out of the six members. In the issuer's opinion, his representative functioned to protect the rights of the minority. Further, the issuer also asserted that the majority owner of entity B used its influence as the parent to control and govern its subsidiary. The issuer, referring to the ways in which significant influence is usually demonstrated (IAS 28, paragraph 7), noted that the only criteria met in this instance was that it had representation on the board.

The enforcement decision

The enforcer concluded that the issuer had significant influence over entity B, and that B, therefore, should be accounted for as an associate.

Rationale for the enforcement decision

According to IAS 28 paragraph 2, significant influence is the power to participate in the financial and operating decisions of the investee but is not control or joint control over the policies. If an investor holds 20 % or more of the voting power of the investee, it is presumed that the investor has significant influence unless it can be clearly demonstrated that this is not the case. Conversely, if the investor holds less than 20 % of the voting power of the investee, it is presumed that the investor does not have significant influence, unless such influence can be clearly demonstrated (IAS 28, paragraph 6). In the enforcer's opinion, in certain cases, whether significant influence exists should also be assessed when an investor holds less than 20 %.

The fact that one investor holds a majority share of the voting power can indicate that other investors do not have significant influence. A substantial or majority ownership by an investor does not, however, necessarily preclude another investor from having significant influence (IAS 28 paragraph 6).

IAS 28 paragraph 7 describes the ways in which significant influence by an investor is usually evidenced. The issuer stated that only IAS 28 paragraph 7.a (board representation) was met in this case.

In the enforcer's opinion, the shareholders' agreement strengthened the issuer's opportunity to participate in the financial and operating policy decisions of entity B. In the opinion of the enforcer, the representation on the board of directors combined with the additional rights the issuer had under the shareholders' agreement, gave the issuer the power to participate in policy decisions, in accordance with IAS 28 paragraph 7.b.

In addition, there was evidence of material transactions between the investor and the investee and indications that the issuer provided entity B with essential technical information. Both these facts are stated examples of how significant influence might be evidenced (IAS 28 paragraph 7).

Based on an assessment of all the facts, the enforcer concluded that the issuer had significant influence over entity B and that entity B should be considered an associate and accounted for using the equity method of accounting as described in IAS 28 paragraph 13.

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Decision ref.EECS/1208-04: Significant Influence

Period end: 31 December 2005 /Annual Financial Statements

Category of issue: Associates, Significant Influence

Standard involved: IAS 28

Date of the decision: 6 November 2006

Description of the issuer's accounting treatment

The issuer controlled 25 % of shares in entity A as at 31 December 2005. Two other shareholders in entity A controlled 31 % each. The remaining 13 % of the shares was owned by several different shareholders. The issuer was not represented on the entity's A board of directors as at 31 December 2005 although he had been previously represented, the board member having voluntarily withdrawn from the position. The issuer did not try to appoint a new member on the board although a shareholders' agreement gave the issuer the right to be represented for a specific period provided that its ownership interest remained above a certain level.

The issuer did not treat entity A as an associate in its annual report for 2005.

In the issuer's opinion, it did not have significant influence over entity A, due to the fact that the issuer was not represented in the board of directors of entity A and since two other shareholders controlled almost 65 % of the shares in entity A. The issuer also pointed out the absence of any of the usual indicators of significant influence as set out in IAS 28 paragraph 7.

The enforcement decision

The enforcer found that the issuer had not clearly demonstrated that it did not have significant influence over entity A, and that entity A therefore should be accounted for as an associate.

Rationale for the enforcement decision

According to IAS 28 paragraph 2, an associate is an entity over which the investor has significant influence. Significant influence is defined in the same paragraph as the power to participate in the financial and operation policy decisions of the investee. In the enforcer's opinion, "power" refers to the ability to participate in the financial and operation policy decisions of the investee.

In the enforcer's opinion, this understanding is also supported by IAS 27 IG 2 which gives a general description of the concept of "power" albeit primarily intended in the context of potential voting rights: *"...power refers to the ability to do or affect something. Consequently, an entity has ...significant influence when it currently has the ability to exercise that power, regardless of whether... significant influence is actively demonstrated or passive in nature"*

The enforcer considered IAS 27 IG 2 to be relevant for an understanding of IAS 28.

According to IAS 28 paragraph 6, if an investor holds 20 % or more of the voting power it is presumed to have significant influence unless it can be clearly demonstrated otherwise. IAS 28 paragraph 7 describes how existence of significant influence is usually evidenced.

There was, therefore, a presumption that the issuer, with the holding of 25 % of the voting power, had significant influence over entity A. The issuer argued that, in concluding that it did not have significant influence over entity A, it had considered whether it had actually exercised influence in practice over the

period. The enforcer was of the view that the ability to participate in the financial and operation policy decisions of the investee should also have been assessed.

The issuer's representative had voluntarily withdrawn from his position on the board of entity A, and the issuer had not tried to get a new representative on the board. The shareholders' agreement however gave the issuer the right to be represented on the board of directors of entity A with the present ownership interest during a specific period described in the agreement. There was no other agreement between the two main shareholders, or any other indications, that the issuer did not have significant influence.

Based on the above, the enforcer concluded that the issuer had not "clearly demonstrated" that it did not have significant influence over entity A, and that entity A should be considered an associate in accordance with IAS 28 paragraphs 2, 6 and 7 and accounted for using the equity method as described in IAS 28 paragraph 13.

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Decision ref.EECS/1208-05: Disclosure on risks in the management report
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Financial year end: 31 December 2007 /Annual Financial Statements

Category of issue: Disclosure, Risks

Standard involved: IFRS 7

Date of the decision: 30 April 2008

Description of the issuer's accounting treatment

The issuer, a financial institution, decided to describe the risks relating to its US residential backed mortgage securities (and similar assets linked to ABS and CDO) within the management report (a management discussion and analysis (MDA)), which was published together with its financial statements. The MDA was not clearly evidenced as having been audited, since it is not subject to audit requirements, but only a limited review procedure.

The description included, among other things, an analysis of net exposure (at the year-end and for the comparative periods) to ABS and CDO before hedging and warranties (with an indication of the loss percentage), a description of each item type of the Super Senior CDO portfolio with indications of vintages, attachment points, loss percentage, quality of underlying assets and a detailed description of exposures to mono-line insurers, etc.

The notes to the financial statements did not include any cross-reference to this section of the management report, but the entity and its auditors considered that the accounts complied with IFRS 7.

The enforcement decision

The enforcer concluded that the accounts did not comply with IFRS 7.

Rationale for the enforcement decision

Paragraph B6 of Appendix B of IFRS 7 allows the disclosures required by paragraphs 31-42 to be given either in the financial statements "*or incorporated by cross-reference from the financial statements to some other statement, such as a management commentary or risk report*". As the standard requires that this second report be "*available to users of the financial statements on the same terms as the financial statements and at the same time*", the enforcer found the issuer's presentation was not acceptable.

As the information provided was significant in terms of understanding the impacts of risks on the financial position of the issuer relating to financial instruments, the information was, therefore, required by IFRS 7. A specific cross-reference should, therefore, have been included between the financial statements and the relevant paragraphs included in the management report.

Second, paragraph B6 requires that the information is made available on the same terms as the financial statements. In the enforcer's view, this means that any information provided in order to comply with IFRS 7 should be audited. The indication that the relevant disclosures in the management report were not audited was, therefore, not acceptable.

* * *

Decision ref.EECS/1208-06: Recognition of intangible assets

Financial year end: 31 December 2005 / Annual Financial Statements

Category of issue: Intangible Assets

Standard involved: IAS 38

Date of the decision: 10 December 2007

Description of the issuer's accounting treatment

In recent years the issuer had acquired several international mobile telephony and broadband companies. In mobile telephony, there are typically two different types of customer relationships: pre-paid and post-paid. For accounting purposes, the issuer recognized the two types of customer relationships as one intangible asset separately from goodwill and amortised on a linear model.

The enforcer evaluated the customer relationships acquired as part of the purchase of entity A, an international mobile telephone business. The issuer valued the two types of assets separately, using an earnings methodology. The pre-paid customer relationships were found to generate net positive cash-flows for more than twice as long as the pre-paid relationships.

The issuer considered pre-paid and post-paid customer relationships to be a singular intangible asset, based on IAS 38 paragraphs 8 and 12. The issuer's rationale was, at least in part, based on the argument that neither of the customer relationships arose from contractual or other legal rights (IAS 38 paragraph 12.b). Furthermore the issuer also doubted whether either the pre-paid or post-paid customer relationships qualified as a separate intangible asset according to IAS 38 paragraph 12.a. The issuer knew of no transactions having occurred where pre-paid and post-paid customer relationships had been sold separately from each other, but could not rule out that it had happened or that it was possible.

On the basis that neither pre-paid nor post-paid customer relationships met the criteria in IAS 38 paragraph 12, the specific provisions of paragraph 37 relating to complementary assets were not considered applicable by the issuer. The issuer also maintained that its practice of viewing pre-paid and post-paid customer relationships as a singular intangible asset was consistent with international industry practice.

The enforcement decision

The enforcer concluded that the two types of customer relationships should be recognized as two separate intangible assets in accordance with IAS 38 paragraphs 35-37.

Rationale for the enforcement decision

The issuer maintained that, as the customer relationships were a single asset under IAS 38, paragraph 12, the requirements of paragraphs 36 and 37, which deal with related intangibles, was not applicable. As paragraph 36 addresses the specific topic of intangible assets that are separable only with a related tangible or intangible asset, the enforcer was of the view that the paragraph was relevant to the case.

According to IAS 38 paragraph 36, if an intangible asset acquired in a business combination is only separable from the entity together with another related asset, the acquirer should recognize the group of assets as a single asset, but only if the individual fair values of those assets cannot be measured reliably. In the purchase price allocation of entity A, the fair values of each of the customer relationships had been calculated separately. The enforcer concluded that the criteria set out in IAS 38 paragraph 36 were not met, such that the customer relationships were not a group of assets that could be recognized as a single asset.

A group of complementary intangible assets can be recognized as a single asset (paragraph 37) provided that the individual assets have similar useful lives. Based on the described profile of net cash-flows generated by the two different types of customer relationships acquired on acquisition of entity A, the enforcer concluded that the useful lives could not be regarded as similar.

The enforcer decided the case on the basis that application of paragraphs 36 and 37 of IAS 38 would not permit pre-paid and post-paid customer relationships to be recognized as a single intangible asset. The enforcer, therefore, did not find it necessary to conclude whether or not the customer relationships represented one or two intangible assets according to IAS 38, paragraph 12.

* * *

Decision ref.EECS/1208-07: Indefinite useful life

Financial year end: 31 December 2005 / Annual Financial Statements

Category of issue: Intangible Assets

Standard involved: IAS 38

Date of the decision: 6 November 2006

Description of the issuer's accounting treatment

The issuer, an entity in the software industry, acquired a publishing business in 2004 that had more than 500 customers using software licensed by the acquired company.

The acquisition cost of the business was estimated at \$16.2 million, of which \$5.8 million was allocated to specific customer contracts. The amount allocated to customer contracts consisted of two elements: 1) discounted cash-flow relating to existing contracts and 2) discounted cash-flow relating to expected renewal of existing contracts. Most of the contracts were renewable annually although some were to be renewed every second year. The valuation was based on a range of assumptions and management judgment regarding the number of customers who were expected to renew their licenses and how many times they were expected to do so.

The issuer considered the customer contracts to have indefinite useful life because they were expected to be renewed. Even though a customer contract could not be infinite, the issuer explained that its useful life was not clear and a definite lifespan could not be determined.

The issuer drew attention to the fact that practically all the customers (and more than the number assumed at the acquisition date), had chosen to renew their licences, and that the value of customer contracts at the balance sheet date was expected to be at least equal to the estimated value at the acquisition date.

The issuer periodically reviewed the contracts for impairment and would recognise and impairment loss if the contracts were impaired. Operationally, the issuer recognised an impairment loss equal to the value of the specific customer contract when a customer chose not to renew its license. The issuer argued that this ensured that any impairment of customer contracts was recognised on a timely basis in the profit and loss account.

The enforcement decision

The enforcer did not agree with the issuer that the customer contracts and related customer relationships had an indefinite useful life.

Rationale for the enforcement decision

Customer contracts and the related customer relationships are contract-based intangible assets. They are assumed to be identifiable regardless of whether the rights are transferrable or separable from the entity in accordance with IAS 38 paragraph 12.b, IFRS 3 paragraph 46.b and IFRS 3 paragraph IE B.3.

The relationship between customer contracts and the related customer relationships is discussed in IAS 38 BC 71.b. This states that, in reality, customer contracts and the related customer relationships are two separate intangible assets. The fair value of customer contracts is the expected future cash flow under the contract and expected renewals from customers would not affect that fair value. Expected renewal will, however, affect the fair value of the related customer relationship.

In conducting its purchase price allocation, the issuer had allocated value to both customer contracts and to the related customer relationships, assuming both types of intangible assets to have indefinite useful lives.

Customer contracts

According to IAS 38 paragraph 94, the useful life of an intangible asset that arises from contractual rights shall not exceed the period of the contractual rights. The renewal period shall be included in the useful life of the asset only if there is evidence to support renewal by the entity without significant cost. In this case, it is the customers who have the right to renew their contract. In the enforcer's opinion, the customer contracts should be amortised over the remaining life of the contract at the acquisition date.

Customer relationships

An intangible asset is regarded as having an indefinite useful life when, based on an analysis of all the relevant factors, there is no foreseeable limit to the period over which the asset is expected to generate net cash inflows for the entity as set out in IAS 38 paragraph 88. Paragraph 90 lists the factors that should be considered in that assessment and which include technical, technological, commercial or other types of obsolescence. IAS 38 paragraph 92 explains that the useful life of computer software in particular is likely to be short because of rapid changes in technology and the susceptibility to technological obsolescence.

The issuer based its treatment partly on the fact that the duration of the useful life of the relationships was unclear. This is, however, often the case for intangible assets. Uncertainty about useful life does not, however, provide a basis for regarding useful life as indefinite as is explained in IAS 38 BC 65.a.

In the enforcer's opinion, the lifetime of the customer relationship could not, in this case, be longer than the life of the licensed software itself as a customer would not choose to renew the contract if the product was obsolete. Although the term indefinite does not mean infinite, an analysis of all relevant factors does not, in the enforcer's opinion, support the issuer's conclusion that there is no foreseeable limit to the period over which customers will renew their contracts.

The issuer argued that the chosen model for impairment, where the value allocated to a customer relationship is expensed when a customer chooses not to renew its licences, ensures that impairment of acquired customer contracts is reflected timely in the profit and loss account. The enforcer noticed that such a model implies that revenues from a customer are recognised during the lifetime of the customer relationship, while expenses are charged in the profit and loss account when a customer relationship is ended. The enforcer did, therefore, not agree that the chosen model implies that the impairment of acquired customer contracts is reflected timely in the profit and loss account.

In the opinion of the enforcer, the customer relationships could not be considered to have an indefinite useful life.

* * *

Decision ref.EECS/1208-08: Classification of financial instruments

Period end: 31 December 2007 / Annual Financial Statements / Pre-clearance decision

Category of issue: Equity Instruments, Minority Interests, Liability

Standard involved: IAS 32

Date of the decision: 15 January 2008

Description of the issuer's accounting treatment

The issuer is a finance conglomerate that, as a bond issuer, prepared its first IFRS financial statements for the year ended 31 December 2007.

The issuer has an operating subsidiary B which has a series of A-shares which have voting rights. The issuer owns 70 % of A-shares and the rest are held by external shareholders. Under a shareholders' agreement, entity B is obliged to pay an annual dividend of 5 %. The dividend payment is cumulative even if entity B does not have sufficient distributable funds at the time the payment is due.

In the issuer's consolidated opening IFRS balance sheet as of 1 January 2006, and in the interim financial statement for 2007, the A-shares of entity B were classified as equity instruments. As the issuer consolidates

entity B in its financial statements as a subsidiary and the 30 % of A-shares owned by external parties were reported as a minority interest.

The enforcement decision

The enforcer found that the issuer's classification of the A-shares as equity instruments in the issuer's consolidated opening IFRS balance sheet and interim financial statement of 2007 did not comply with IAS 32.

Rationale for the enforcement decision

IAS 32 paragraph 11 defines a financial liability to include, amongst others, any liability that includes a contractual obligation to deliver cash or financial assets to another entity. The criteria for classification of a financial instrument as equity or liability are provided in IAS 32 paragraph 16. This states that the instrument is an equity instrument rather than a financial liability if, and only if, the instrument does not include a contractual obligation either to deliver cash or another financial asset to the entity or to exchange financial assets or liabilities with another entity under conditions that are potentially unfavorable to the issuer.

IAS 32 paragraph AG29 explains that when classifying a financial instrument in consolidated financial statements, an entity should consider all the terms and conditions agreed between members of a group and holders of the instrument in determining whether the group as a whole has an obligation to deliver cash or another financial instrument in respect of the instrument or to settle it in a manner that results in classification as a liability.

Furthermore, when a subsidiary issues a financial instrument and the parent of the group agrees additional terms directly with the holders of that instrument, the group may not have discretion over distribution or redemption. According to AG 29, to the extent that there is such an obligation, the instrument is classified as a financial liability in the consolidated financial statements.

Therefore, it was the enforcer's opinion that since entity B is obliged, on the basis of the shareholders' agreement, to pay an annual cumulative dividend to the holders of A- shares and the issuer does not have discretion over the distribution of such dividend, A-shares should be classified as a financial liability in the issuer's consolidated financial statements.

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Decision ref.EECS/1208-09: Classification of financial instruments

Period end: 31 January 2007 / Annual Financial Statements

Category of issue: Minority Interests, Equity Instruments

Standard involved: IAS 32

Date of the decision: 15 May 2007

Description of the issuer's accounting treatment

The issuer (a bank) has an operating subsidiary X, which has two classes of shares (A and B). Only A-shares give voting powers. B-shares are issued for capitalization purposes to meet entity X's regulatory capital requirements under Basel. Ownership of A and B shares is split between the issuer and a number of other shareholders.

Entity X is a mortgage company. The business is generated wholly by the shareholders who act as sales agents for new housing loans. Under the terms of a shareholders' agreement, each shareholder is obliged to capitalize entity X (in the form of additional investment in B shares) to the extent that they generate business. In substance, X does not seek to make a profit.

The shareholder agreement also stipulates that the issuer, the majority shareholder in X, has agreed to buy the B-shares of the minority shareholders through a put option and under the following conditions:

- The minority shareholders can exercise their put options when their ownership in B-shares exceeds the regulatory capital requirement for the business that it has generated to entity X.
- The issuer's obligation to buy B-shares from a minority shareholder is limited to the amount that the issuer is required to capitalize entity X in order to meet its share of X's regulatory capital

requirements. In other words, the issuer is obliged to buy shares when its ownership in B shares is lower than the regulatory capital requirement for the business that it has generated to entity X.

- The minority shareholders can exercise their put options every three years. The exercise price is the original price paid by the shareholders.

Under the terms of the shareholder agreement, capitalization of entity X through the issue of new B shares is to be performed prospectively every six months based on estimated business growth.

In the issuer's consolidated financial statements the B shares owned by minority shareholders were reported as a minority interest. The rationale for this accounting treatment is that the issuer believes that he can always avoid a situation where he would be obliged to buy B-shares from the minority shareholders. As the capitalization of entity X takes place every six months on prospective basis, the issuer can plan the optimal capital increase well in advance in order to avoid the possible purchase obligation.

The enforcement decision

The enforcer did not agree with the issuer's decision to classify B-shares as minority interests and found that the shares with a contingent put option were a financial liability in accordance with IAS 32 paragraphs 11 and 16.

Rationale for the enforcement decision

The enforcer was of the opinion that the issuer has a clear contractual obligation to buy B-shares from the minority shareholders under agreed terms and that this contractual obligation is a financial liability as defined in IAS 32 paragraphs 11 and 16. IAS 32 paragraphs 11 and 16 define a financial liability to be a contractual obligation "*to deliver cash or another financial asset to another entity*".

If there is an unconditional right to avoid delivering cash or another financial liability, the instrument would be considered an equity instrument (paragraph 19). Otherwise, according to IAS 32 paragraph 25, a financial instrument qualifies as a financial liability if the contingent payment condition is beyond the control of both the issuer and the holder of the instrument. Examples include a change in stock market or consumer prices indices, interest rate or taxation requirements. Paragraph 25.a stipulates that the contingent consideration must be genuine. A contingent settlement provision that requires settlement in cash or variable number of the entity's own shares only on the occurrence of an event that is extremely rare, highly abnormal and very unlikely to occur is not considered genuine and, hence, an instrument including such a provision is an equity instrument (IAS 32 paragraph AG28).

The enforcer believes that the contingent settlement provision is genuine. The enforcer sees it to be in the normal course of business that mortgage companies might be required to increase regulatory capital either due to an increase in business or because of unexpectedly high credit losses. Even though the risk of sudden substantial losses related to X's business operations is currently considered to be low, the contingent settlement provision is genuine.

It was the enforcer's opinion that, based on the shareholders' agreement, the issuer does not have an unconditional right to avoid delivering cash or another financial asset to settle the obligation in the sense intended by paragraph 25 of IAS 32. The minority shareholders' holdings of B-shares should be treated as a financial liability in the issuer's consolidated financial statements.

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Decision ref.EECS/1208-10: Deferred tax asset
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Financial year end: 31 December 2006 / Annual Financial Statements

Category of issue: Deferred Tax

Standard involved: IAS 12

Date of the decision: 18 January 2008

Description of the issuer's accounting treatment

The issuer develops and sells automotive solutions to manufacturers in different lines of business. The issuer had incurred substantial losses in the years 2002-2006, except for 2005 when it made a minimal profit before tax. The year 2005 profit before taxes included significant non-operating gains.

In its 2005 and 2006 consolidated balance sheets, the issuer recognised a deferred tax asset in respect of carried forward losses which will expire during the period 2010 to 2014.

The deferred tax asset less deferred tax liabilities represented 24 % and 51 % respectively, of the consolidated shareholders' equity as at the 2005 and 2006 year end.

The issuer recognised a deferred tax asset in 2005 on the basis of anticipated performance in the years from 2006 to 2009, based on budgets prepared in the autumn of 2005. The issuer argued that the budgets were realistic as there were positive indications from customers about future orders. The issuer also had plans to expand selling efforts to new markets and separately, to sell new products that were developed recently or whose development would be finalized soon. The issuer was taking measures to increase sales, implementing new programs to improve both productivity and profitability.

The net profit before tax of the first three quarters of 2005 was positive but the fourth quarter saw a significant loss, leading to a minimal net profit before tax for 2005. The issuer argued that the 2005 performance overall was good and that the losses recorded in the 4th quarter of 2005 were due to non-recurring events which were not likely to be repeated such as: lower profitability in certain business areas, the need to invest heavily in a new enterprise resource planning system and the sales of lower-margin products in the last quarter. The entity had also made significant investments in developing new products. The issuer stated that as these factors would not affect future performance there was no reason to believe that the budgets were not attainable.

The issuer retained the deferred tax asset in its 2006 balance sheet on the basis of its 2007 and subsequent budgets which included high growth rates. This was due to expected sales of new products which were the result of long-term product development, the potential for sales in new markets for which the issuer had already initiated or planned to initiate marketing and selling effort and for improved overall performance.

The enforcement decision

The enforcer found that the recognition of deferred tax assets on losses carried forward was not in accordance with IAS 12 paragraphs 34-36. Specifically, the issuer was not able to provide convincing evidence that sufficient taxable profits would be generated against which the unused tax losses could be offset.

Rationale for enforcement decision

Consolidated financial statements as of December 31, 2005

According to IAS 12 paragraph 35, the existence of unused tax losses is strong evidence that future taxable profit may not be available against which to offset the losses. Therefore when an entity has a history of recent losses, the entity recognizes deferred tax assets arising from unused tax losses only to the extent that the entity has sufficient taxable temporary differences or there is convincing other evidence that sufficient taxable profit will be available.

As the issuer had a history of recent losses and as it did not have sufficient taxable temporary differences (IAS 12 paragraph 36.a), the issuer was required to provide convincing other evidence that sufficient taxable profit would be available against which the unused tax losses could be offset.

The unused tax losses in question did not result from identifiable causes which were unlikely to recur (IAS 12 paragraph 36.c); on the contrary, the losses in 2002-2004 were due to ordinary business activities. There were no tax planning opportunities available to the issuer that would create taxable profit in the period in which the unused tax losses could be offset (IAS 12 paragraph 36.d).

The enforcer was of the opinion that as of December 31, 2005 it was not probable that the entity would generate taxable profits before the unused tax losses expired (IAS 12 paragraph 36.b). The issuer's argument regarding the good performance in 2005 was not supported by results as the issuer would have suffered a net loss before tax had it not been for non-operating gains. The issuer was not able to produce any evidence that

the lower profitability of certain business areas, the investments in new ERP-system or product development, the sale of lower margin products were unlikely to recur in the future.

The issuer did not provide convincing evidence about the availability of future taxable profits. The issuer's anticipation of improved future trading could not alone be regarded as meeting this requirement. When assessing the use of carry-forward tax losses, more weight should be given to revenues from existing orders or confirmed contracts rather than those that are merely expected from improved trading.

The anticipated future performance was based on budgets that the issuer had prepared in the autumn 2005 and which were not realistic when compared with historical performance. The dramatic drop in earnings of the last quarter in 2005 should have prompted the issuer to re-assess the reliability of those budgets as a basis for the recognition of a deferred tax asset.

The company had explained in its 2005 annual report that customer behavior had changed during the year, leading to dramatically shortened delivery times, a decrease in the order backlog and an increased number of open bids. As a consequence, the predictability of the business had weakened during the year. The enforcer was of the view that the company should have taken these facts into account when considering whether to recognize the deferred tax asset in its 2005 financial statements.

Consolidated financial Statements December 31, 2006

In the enforcer's view, the same considerations applied to the issuer's presentation of the tax asset in its 2006 accounts as in those of 2005.

In addition, the enforcer noted that the unreliability of the issuer's estimates was further evidenced by the significant variances between the profit forecasts given by the issuer to the markets during the year and the actual interim and full year consolidated results for 2006.

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Decision ref.EECS/ 1208-11: Classification of inventories

Period end: 30 June 2007 / Annual Financial Statements

Category of issue: Presentation of Financial Statements

Standard involved: IAS 1

Date of the decision: 31 January 2008

Description of the issuer's accounting treatment

The issuer produces wines and various spirits including whisky, cognac and brandy.

On the face of its balance sheet, the issuer classifies all inventories within current assets. The issuer is of the view that the ageing process of the stock, some 15 years, should be considered to be part of the normal operating cycle for the following reasons:

- For a significant proportion of sales, the ageing process is conducted internally, although some amounts are acquired from third parties,
- Many final products are blends of different primary products, each having been submitted to a different ageing period. The mix of the primary products is adapted to suit consumer taste.
- The production process is adapted to the changes in customer demand. This means, in particular, that inventories intended for use over several years might, instead, be used much more rapidly.

The enforcement decision

The enforcer agreed with the issuer's classification of the stock as current.

Rationale for the enforcement decision

IAS 1 paragraph 57 states that an asset should be classified as current if it satisfies any one of four criteria. The enforcer decided that the accounting presentation adopted by the issuer was acceptable on the grounds that it meets the requirements of the first criterion of the paragraph, that an asset should be classified as current when it is expected to be realized in, or is intended for sale or consumption in the entity's normal

operating cycle. In this case, the ageing process is considered to be part of the issuer's operating cycle. The fact that the asset may not be realized within twelve months after the balance sheet date (IAS 1 paragraph 57.c) is not relevant as only one of the stated criteria has to be satisfied.

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Decision ref.EECS/1208-12: Post Retirement Benefit

Period end: 31 December 2006 / Annual Financial Statements

Category of issue: Post retirement benefit

Standard involved: IAS 19

Date of the decision: 13 March 2008

Description of the issuer's accounting treatment

In its 2006 financial statements, the issuer disclosed the existence of a voluntary fund established in order to provide a post-retirement benefit plan ("Plan") to employees who: (i) have completed five years of service and (ii) have a permanent contract with the company.

Because the issuer considered the Plan contributions to be voluntary, the issuer did not record any related liability in its consolidated financial statements. The issuer did, however, assume some responsibility in respect of the Plan on the signing of a contract with a Pension Fund Manager to establish the Fund.

The issuer has a history of paying the benefits to their employees, even increasing them to keep pace with inflation since the commencement of the Plan.

The main characteristics of the Plan were as follows:

- (i) the Plan is totally funded by the issuer;
- (ii) the contributions for the Plan are made periodically;
- (iii) the liability is calculated based on a percentage of the salaries of Plan participants, subject to a floor and ceiling, dependent on the years of service;
- (iv) the financing of the Fund is determined as a function of the fair value of the assets and the liability arising from past services;
- (v) any increase in the benefit is assumed by the issuer.

The issuer argues that he should not have to recognize the plan because, according to the underlying contract, he can terminate the contributions to the fund, if and when he wishes. The issuer also argues that no contributions were expected as of the balance sheet date as the fund had a surplus.

The termination clauses of the contract establish that:

- (i) if the issuer stops its contributions, that fact must be communicated to the participants of the Plan and to the fund manager with a three month notice period; and,
- (ii) the issuer assumes the following responsibilities:
 - (1) the issuer must immediately purchase lifetime annuities from an insurance company for all the retired employees who are already receiving benefit when the termination of the contribution is communicated, at the % level established by their years of service;
 - (2) the issuer has to ensure the immediate payment of the pensions benefit to the active participants who are aged 65 or above (national retirement age), at the % level established by their years of service;
- (iii) after satisfying these requirements, the surplus of the fund should be used to purchase (through an insurance company) life-time annuities, actuarially determined according to the years of service of each participant who has not yet reached retirement age;
- (iv) if there remains a surplus after all the participant rights have been satisfied, the surplus should be used to improve the participants' pension benefit.

The enforcement decision

The enforcer found that the accounting treatment of the issuer did not comply with IAS 19.

Rationale for the enforcement decision

The enforcer did not consider the Plan to be a defined contribution plan on the basis that the issuer has a legal or constructive obligation to pay further contributions if the fund does not have sufficient assets to pay all employee benefits relating to employee service in the current and prior periods (IAS 19 paragraph 7). All other post-employment benefit plans that do not qualify as a defined contribution plan are, by definition, defined benefit plans (IAS 19 paragraph 7). Defined benefit plans may be unfunded, or they may be wholly or partly funded.

The enforcer also considered IAS 19 paragraph 26(a) and (c) which, again, indicate that the issuer's plan is a defined benefit plan. This paragraph provides examples where an enterprise's obligation is not limited to the amount that it agrees to contribute to the fund. These examples include: (a) a plan benefit formula that is not linked solely to the amount of contributions (which is the case in this instance); and (c) those informal practices that give rise to a constructive obligation.

According to the terms of the Plan, if the issuer opts to terminate, he is responsible for discharging the liability as at the date of the notice communicating the termination to members.

IAS 19 paragraph 52 explains that an enterprise should account not only for its legal obligation under the formal terms of a defined benefit plan, but also for any constructive obligation that arises from the enterprise's informal practices. Informal practices give rise to a constructive obligation where the enterprise has no realistic alternative but to pay employee benefits.

In the view of the enforcer, even if the Plan were not considered to be a defined benefit plan under IAS 19 paragraph 26, the issuer would have a constructive obligation to provide the benefit having done so for 2005 and 2006. That practice has also created a valid expectation on the part of employees that the amounts will be paid in the future.

The enforcer informed the issuer that it should account for the Plan as a defined benefit plan in accordance with IAS 19. This means that the issuer has to recognize, at a minimum, its current present liability less the plan assets as well as the benefit relating to the employees' years or service as defined under the Plan and that will be paid at national retirement age.

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Decision ref.EECS/1208-13: Presentation of half-yearly financial statements
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Period end: Half-yearly Financial Statements

Category of issue: Half-yearly financial Statements

Standard involved: IAS 34

Date of the decision: 22 February 2008

Description of the issuer's accounting treatment

The issuer prepared its first half yearly financial report in accordance with IAS 34 as required by the Transparency Directive (the Directive). The financial report did not, however, contain all the information required either by IAS 34 or by the Directive. Specifically, the statements did not disclose certain explanatory notes required by IAS 34 paragraph 16 as follows:

- segmental information in accordance with IAS 34 paragraph 16(g);
- related party transactions; and
- other disclosures relating to revenue and taxation in accordance with IAS 34 paragraph 16(c)

The enforcement decision

The enforcer was of the opinion that the half-yearly report prepared by the issuer was not in accordance with IAS 34.

Rationale for the enforcement decision



Issuers preparing half-yearly financial statements in compliance with IAS 34 are required to include explanatory notes. The information to be included in these explanatory notes is outlined, primarily, in IAS 34 paragraphs 15-18.

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Decision ref.EECS/1208-14: Presentation of half-yearly financial statements
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Period end: Half-yearly Financial Statements

Category of issue: Half-yearly financial Statements, Business Combinations

Standard involved: IAS 34, IFRS 3

Date of the decision: 13 May 2008

Description of the issuer's accounting treatment

The issuer prepared its first half yearly financial report in accordance with IAS 34 as required by the Transparency Directive. The half-yearly cash-flow statement disclosed the cash outflows relating to a number of acquisitions made in the period. The note relating to acquisitions, however, disclosed only the name of the acquirees and the dates of acquisition.

Disclosures not included in the half-yearly financial statements in this case included:

- the cost of the combination and a description of the components of that cost;
- the fair value of assets and liabilities acquired and the carrying amounts, determined in accordance with IFRS, prior to acquisition;
- a description of the factors that contributed to any cost that resulted in the recognition of goodwill;
- the profit or loss of the acquiree post acquisition; and
- details of what the revenue and profit or loss of the combined entity would have been had the acquisition occurred at the beginning of the period.

The enforcement decision

The enforcer was of the opinion that the half-yearly report prepared by the issuer did not comply with IAS 34.

Rationale for the enforcement decision

IAS 34 requires issuers to disclose in their half-yearly financial statements, if material, information concerning the effect of changes in the composition of the issuer during the half-year period, including business combinations and the acquisition of subsidiaries (IAS 34 paragraph 16.i). In the case of business combinations, an issuer is required to disclose the information required by IFRS 3 (paragraphs 66-73).

The enforcer was of the view that issuers are expected to ensure full compliance with all of the disclosure requirements contained in IFRS 3 paragraphs 66-73 in respect of material acquisitions entered into during half-yearly reporting periods.

In accordance with IAS 34 paragraph 23 issuers who propose not to disclose such information on the grounds of materiality should make that assessment on the basis of the half-yearly period financial data as opposed to the full year financial data.

Decision ref.EECS/1208-15: Presentation of comparative information in interim financial statements

Financial year end: 31 December 2007 / Prospectus

Category of issue: Interim Financial Statements, Comparative Information

Standard involved: IAS 1, IAS 8, IAS 34

Date of the decision: 11 February 2008

Description of the issuer's accounting treatment

As part of its approval of a prospectus of an issuer with securities traded on a regulated market, the enforcer examined the half-yearly consolidated financial statements for the period 1st January – 30th June 2007 and

quarterly consolidated financial statement for the period 1st January – 30th September 2007 which were incorporated by reference into the prospectus.

The enforcer found that comparative information in both sets of financial statements was only provided in respect of the period 1st January – 31st December 2006 or as at 31st December 2006. The financial statements, therefore, did not comply with IAS 34 in respect of comparative information for the income statement, the statement showing changes in equity or the cash flow statement and relevant additional information.

The issuer explained that its Board of Directors decided not to comply with IAS 34 as far as comparative information was concerned on the basis of the provisions of IAS 1 paragraph 40. This states that, in some circumstances, it is impracticable to reclassify comparative information for a particular prior period to achieve comparability with the current period. For example, data may not have been collected in the prior period in a way that allows reclassification, and it may not be practicable to recreate the information.

The issuer informed the enforcer that none of its subsidiaries was obliged to prepare consolidated financial statements for interim periods before 31st December 2006; the issuer and its subsidiaries did not prepare data for the purposes of consolidation and did not process data in terms of reporting under IFRS in 2006. Additionally, the issuer informed the enforcer that preparation of comparative information for periods as required by IAS 34 would be both time-consuming and expensive.

The enforcement decision

The enforcer was of the view that there was insufficient evidence to exempt the issuer from presenting comparative information for prior periods as required by IAS 34.

Rationale for the enforcement decision

IAS 34 paragraph 20 specifies the comparative information to be included in interim financial statements (condensed or complete) as follows:

- balance sheet – as of the end of the immediately preceding financial year,
- income statement – for the comparable interim periods (current and year-to-date) of the immediately preceding financial year,
- statement showing changes in equity and cash flow statement – for the comparable year-to-date period of the immediately preceding financial year.

The enforcer also pointed out that according to Commission Regulation (EC) No 809/2004 of 29 April 2004 on prospectuses Annex I point 20.6.2 the interim financial information presented in the registration document must include comparative statements for the same period in the prior financial year, except that the requirement for comparative balance sheet information may be satisfied by presenting the years end balance sheet.

In coming to its conclusions, the enforcer also took account of the following:

- When referring to IAS 1 paragraph 40 the issuer did not identify precisely why preparation of comparative information as required by IAS 34 would be impracticable;
- The issuer did not refer to the definition of “impracticable” defined in IAS 8 paragraph 5 (“Applying the requirement is impracticable when the entity cannot apply it after making every reasonable effort to do so”) and did not ensure that it had made every reasonable effort to prepare comparative information for the periods specified in IAS 34;
- Although the preparation of information for comparative periods as defined in IAS 34 would have been time-consuming and costly, it would not necessarily have been impracticable for the issuer to have provided the relevant information as required by the standard.