Summary of ESMA 24th Extract from the EECS's Database of Enforcement

Summarized below are the topics covered in the 24th batch of extracts, covering the period from May 2018 to October 2019. For full details of the accounting treatment applied by the company and the rationale for the enforcement decision, please refer to the report from ESMA.

Standard	Topic
IFRS 15, *Revenue from Contracts with Customers*	**Identification of performance obligation** The company operates in the oil and gas industry providing geophysical services that enable its customers to receive surveys related to measurements together with subsurface geology images designed to evaluate potential oil reserves in a given area. Surveys are provided to customers through two different contracts: exclusive (proprietary) or non-proprietary multi-client licensing agreements. A multi-client licensing agreement can be sold either as primary sale or as secondary sale arrangements. The company considered that it provides a significant service of integrating the good or service with other goods or services promised in the contract into a bundle of goods or services that represent the combined output for which the customer has contracted and that the final license has a character of a right to use license. **The enforcement decision** The enforcer did not object to the company's analysis and the way to account for revenue in accordance with IFRS 15. Based on the understanding of the activity and the contracts, the enforcer considered that any service component would not have any significant value.
IFRS 7, *Financial Instruments: Disclosure*	**Liquidity risk of notes with early redemption option** The company issued loan notes (i.e. financial liabilities) that all have a contractual maturity date of 2040. Both the company and the noteholders have an option to early redeem the notes before the maturity date. The company has the option to call the loan notes by giving an irrevocable notice to the noteholders, subject to a 5-day notice period. The noteholders have a put option to early redeem the loan notes before the maturity date, subject to a 10-day notice period. However, all noteholders have signed a waiver that waives their right to exercise the option to early redeem for at least 12 months from the year-end date. Furthermore, every two weeks the noteholders can subscribe for or request the redemption of loan notes (in addition to the aforementioned put option) through a "bi-weekly liquidity process". The company makes the final decision on whether or not to execute these redemption requests. The company confirmed that it has not denied any redemptions requests during the year.

	In the liquidity maturity analysis table, the company classified these loan notes as having a maturity 'greater than five years'. However, in recent years, material redemptions and repurchases of notes have occurred as part of the normal course of business and driven by the liquidity needs of the noteholders. **The enforcement decision** The enforcer did not agree with the classification of these loan notes in the liquidity maturity analysis and required that the company present the loan notes as maturing in the 'greater than one-year' time range. The enforcer also required that the company enhance disclosures relating to liquidity risk in terms of how it is managed and of the assumptions used in the liquidity analysis. The decision was based on the fact that material redemptions was occurring each year through the bi-weekly liquidity process of the noteholders; a process that was not binding for the company and was therefore not considered to represent a contractual obligation for the company. As such, it should not be reflected in the assessment of the earliest contractual maturity date for the purposes of preparation of the liquidity maturity analysis table. Based on the contract, there is a possibility that after a 12-month period the noteholders could seek full redemption and the company would be required to repay the notes early.
IFRS 9, *Financial Instruments* & IAS 12, *Income Taxes*	**Deferred tax assets (DTAs) related to a change of accounting policy due to first application of IFRS 9** In 2018, a bank applied IFRS 9 for the first time. The specific transition requirements and in particular the expected credit loss (ECL) impairment model had a negative impact on the opening balance of retained earnings as of 1 January 2018. According to the tax rules applicable at 1 January 2018, the negative equity impact due to the adoption of the IFRS 9 ECL was deducted from the 2018 taxable profit, and a DTA were recognised with a corresponding effect on retained earnings. Before the 2018 year-end, a change in the tax law was enacted according to which the effect of provisions deriving from the first-time application of the IFRS 9 ECL model recognised as of 1 January 2018 is deductible for tax purposes progressively over 10 years. The company changed the amount of DTAs assessed as recoverable from the initial assessment. Given the change of the tax law, the company recognised the impact of the additional DTAs in profit or loss. **The enforcement decision** The enforcer did not object to the company's accounting treatment that recognised the impact of the change of the tax law in profit or loss.

IFRS 10, *Consolidated Financial Statements*	**Assessment of de-facto control** The company is an industrial company that holds 39% of the capital of Company X. The company is controlled by Company Y, which is controlled by the controlling shareholder A. Person A also holds 4% of Company X through Company Z. Together with Z; the company holds 43% (40% 1 January 2017) of the capital in Company X. 21 institutional shareholders together hold 37% of the shares of Company X, each of them holding voting rights up to a maximum of 3% (the 10 most important holding together 22%), while the remaining 20% of the shares of Company X are spread among the public. There are no arrangements between either the institutional shareholders or the public to consult with any of the others or to make collective decisions, and the company owns no call or put options. **The enforcement decision** In the view of the enforcer, the company has de facto power over Company X since it has the practical ability to direct the relevant activities unilaterally. Consequently, the company should consolidate Company X in accordance with IFRS 10. In reaching this decision the enforcer was considering (i) that the issuer holds significantly more voting rights than any other vote holder and the other shareholdings are widely dispersed; (ii) the voting patterns at previous shareholders' meetings; and (iii) the fact that the issuer and Company X have the same CEO and the same CFO, the enforcer considered that the issuer had since 2017 the practical ability to direct the relevant activities of Company X, and thus de facto power over Company X.
IFRS 15, *Revenue from Contracts with Customers*	**Disaggregation of revenue** The company is a producer of primary minerals and secondary mineral sand products ('secondary mineral products'). It completed two major projects over the last few years in an effort to enhance its revenue. These projects led to recovery of secondary mineral products from waste streams and from mineral sands concentrate products. The company disclosed in the segment reporting note in its financial statements that it disaggregated revenue by its three major product lines A, B and C. Product

	lines A and C relate to primary mineral products. In a presentation on its website coinciding with the publication of its 2018 earnings announcement, the revenue of product lines B was disaggregated into a primary mineral line (product line B1) and a secondary mineral products line (product line B2), resulting in the presentation of four product lines. In determining the disaggregation of revenue, the company determined that the split into the three major product categories was appropriate, despite differences in the underlying economic characteristics. Consequently, the revenue for both the primary and secondary products of one major product line was aggregated for disclosure purposes in the segment-reporting note. **The enforcement decision** In the view of the enforcer, the company should provide further disaggregation of revenue in accordance with IFRS 15:114 in its IFRS financial statements. The enforcer considered that external economic factors have a different impact on the price per ton for both primary and secondary mineral products, as primary minerals are of a higher quality grade compared to the secondary mineral products. Moreover, the enforcer established that the company used other information (beyond the segment disclosures in the financial statements) to evaluate its financial performance. Given that the secondary mineral products have a different customer base and that their price is more volatile compared to that of primary minerals, further disaggregation of revenue for Product line B should have been provided in accordance with IFRS 15.
IAS 34, *Interim Financial Reporting*	**Presentation of condensed interim income statement** The company is a biotech company. Its half-yearly condensed income statement only consisted of the following lines and subtotals: *revenue; gross profit/loss; profit/loss before financial items; profit/loss before tax; and profit/loss for the period*. The amount of revenue for the period was limited as many of the expected products were not being sold or distributed yet. Furthermore, in addition to limited information in the interim income statement, there were no additional notes to the lines or sub-totals, providing disclosures about the line items that were included.

	This meant that no lines of costs were presented, nor information specified in the notes. In the annual financial statements, the following costs were presented in the statement of profit or loss: *production costs; sales and marketing costs; research and development costs; administrative expenses; financial expenses; and total income taxes*. While production costs and total income taxes could be calculated by users of the interim financial statements, for sales and marketing, research and development and administrative costs, only the aggregate amount for these three types of costs can be calculated. The interim financial report included disclosures regarding the increase in total overheads due to clinical studies in one jurisdiction giving some information on the costs in the period. **The enforcement decision** The enforcer required the company to provide additional lines in the interim condensed income statement, in particular research and development costs as the enforcer found that the information presented in the income statement by the company was too condensed. The enforcer considered that the IFRS IC's Agenda Decision on condensed statement of cash flows from July 2014 was relevant in this case. The IFRS IC Agenda Decision concluded that a three-line presentation alone is unlikely to meet the requirements in IAS 34. Consequently, the enforcer considered that the very condensed income statement alone failed to meet the requirements of IAS 34 with regards to the presentation of the income statement.
IFRS 15, *Revenue from Contracts with Customers*	**Accounting for a framework agreement** The company is an industrial company active in the automotive sector producing and selling automotive parts to original equipment manufacturers (OEMs). In the production process of those parts, the company uses the moulds it has designed but constructed by a third-party supplier. Once the OEM selects the company as supplier for the parts, both parties sign a nomination letter containing information such as the estimated program life, the estimated annual volume of parts, start of production date, the specification of the

	moulds to be used, the number of moulds to be used, the price of the moulds and the price for the parts etc. The nomination letter stipulates that the moulds become the property of the OEM but includes no commitment for the customer (the OEM) for the quantity of parts. Commitments on quantities of parts are only established when the OEM issues purchase orders. In Step 1 of IFRS 15 (identification of the contract with a customer), the company considered that the nomination letter qualified as a sales contract for both the moulds and the parts. The company acknowledged that the quantity of parts to be purchased under the contract was not determined; it only indicated an estimated minimum quantity of parts. According to the company, history has proven that in all cases parts will be delivered and the company argues that they can make a reliable estimate of a minimum number of parts and that there is a high probability (based on historical experience) that the actual number of parts will not be lower than this amount. Consequently, the company determined that enforceable rights and obligations are created for both parties, for the moulds as well as for the parts, and thus there is a contract for both sets of items; hence, a single contract for the sale of both moulds and parts. **The enforcement decision** The enforcer disagreed with the analysis and considered that the two performance obligations should not be combined; they should be accounted for separately.
IFRS 15, *Revenue from Contracts with Customers* & IFRS 16, *Leases*	**Identifying components in lease contracts** The company is a commercial real estate company whose core business covers the management and development of properties. Most of its income is generated by its lessor and asset manager activities. Gross revenue comprises rental income and operating costs charged to tenants. Examples of operating costs are waste disposal, property management, costs for communal facilities, gas, electricity and warm water. Under local laws and regulations, the lessor bears all costs that occur when using and operating the property. The operating costs of the building as a whole and of the specific rental unit will be charged to the tenant.

	For some utilities (gas and electricity) the tenant can enter into direct purchase agreements with third parties. In the specific case at hand, if the lessor enters into an agreement with a provider, it charges the costs to the tenants based on the tenant's consumption. These costs are operating costs of the rental unit and not of the building. In most cases, the company itself enters into purchase agreements after concluding the rental agreement, without bearing any consumption risk. Rental income arising from the lease component falls within the scope of IFRS 16. However, the company identified the non-lease components stipulated in the lease contracts and assessed whether they should be split out and accounted for separately in accordance with IFRS 15. For the operating costs of the building, the company concluded that it acts as a principal and therefore applied IFRS 15 to operating costs of the building charged to its tenants. For operating costs of the rental unit, the company determined that it acts as an agent. The company assessed that the considerations for warm water, gas and electricity did not to constitute a separate non-lease component and thus allocated the consideration to the components identified under IFRS 16:B33. **The enforcement decision** The enforcer did not object to the company's accounting treatment for the operating costs of the building. However, the enforcer disagreed with the accounting treatment of the company's service to arrange for the operating services of the rental unit. Contrary to the company, the enforcer concluded that these services are separate non-lease components, and as such that they shall be accounted for under IFRS 15. In addition, the enforcer concluded that the company was acting as the principal for supplying warm-water and as an agent for arranging the supply of gas and electricity. According to the enforcer, the fact that the issuer acts as an agent is only relevant for the presentation of the consideration and not for identification of separate components in a lease contract. When the issuer acts as an agent for services that are non-lease components, the issuer shall recognise revenue only in the amount of any fee or commission to which it expects to be entitled in exchange for arranging

	for the specified goods or services to be provided by the third party in accordance with IFRS 15. The enforcer concluded that in the fact pattern the issuer acted as principal when supplying warm water from the central heating plant in the house. The issuer purchases the necessary utilities (e.g. oil and gas) for this service, and produces warm water on demand, thus controlling the warm water before it is transferred to the tenant. According to IFRS 15, the relevant criterion is whether the issuer obtains control of the services before they get passed to an individual tenant. The enforcer concluded that in the fact pattern the issuer acts as an agent regarding its service to arrange for gas and electricity, as the issuer cannot control gas and electricity before they are transferred to the tenant. Indicators for the assessment of control are the ultimate responsibility for gas and electricity supply of the third-party provider as the issuer (i) bears no consumption or inventory risk, (ii) is not able to set its own prices and (iii) does not earn any margin on the service. The fact that the issuer chose the provider in the first place does not give the issuer control over the delivered gas or electricity.