Report

26th Extract from the EECS's Database of Enforcement

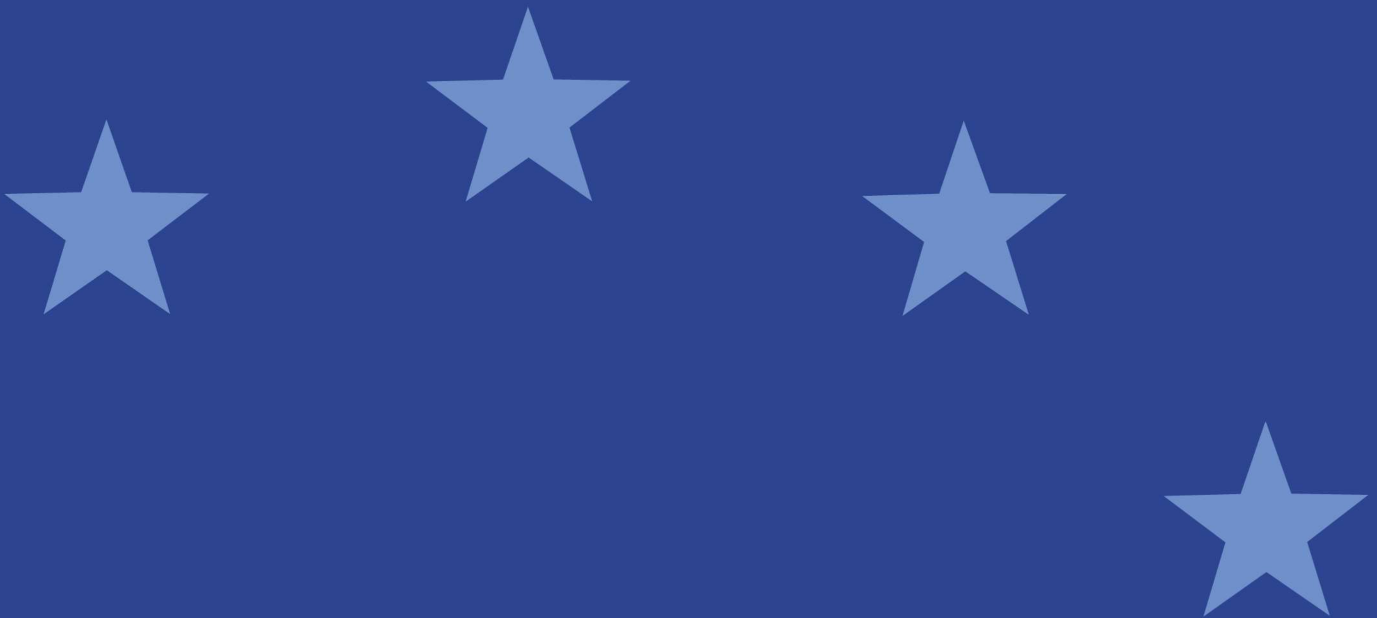

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Table of Contents

I. Decision ref EECS/0122-01 – Consideration of credit enhancements in the measurement of expected credit losses 5

II. Decision ref EECS/0122-02 – Measurement of net realisable value of inventory 7

III. Decision ref EECS/0122-03 – Costs to make the sale in calculating the net realisable value of inventories 8

IV. Decision ref EECS/0122-04 – Recognition of revenue over time 9

V. Decision ref EECS/0122-05 – Significant financing component 11

VI. Decision ref EECS/0122-06 – Presentation of litigation proceeds as revenue 12

VII. Decision ref EECS/0122-07 – Impairment test of cash generating unit comprising right of use assets 13

VIII. Decision ref EECS/0122-08 – COVID-19 impairment indicators 15

IX. Decision ref EECS/0122-09 – Identifying cash-generating units (GGUs) 16

X. Decision ref EECS/0122-10 – Operating Segments 17

XI. Decision ref EECS/0122-11 – Change in the composition of cash and cash equivalents 19

The decisions included in this report were taken by national enforcers in the period from March 2020 to November 2021. ESMA will continue to publish further extracts from the database on a regular basis.

List of abbreviations and acronyms used in this report

BC	Basis for Conclusions
CEO	Chief Executive Officer
CGU	Cash-Generating Unit
CODM	Chief Operating Decision Maker
COVID-19	Coronavirus Disease 2019
ECL	Expected Credit Loss
EEA	European Economic Area
EECS	European Enforcers Coordination Sessions
ESMA	European Securities and Markets Authority
IAS	International Accounting Standards
IASB	International Accounting Standards Board
IFRIC	International Financial Reporting Interpretations Committee Interpretation
IFRS	International Financial Reporting Standards
IFRS IC	International Financial Reporting Standards Interpretations Committee
VIU	Value in Use
WACC	Weighted Average Cost of Capital

The European Securities and Markets Authority (ESMA) publishes extracts from its confidential database of enforcement decisions on financial statements, with the aim of strengthening supervisory convergence and providing issuers and users of financial statements with relevant information on the appropriate application of the International Financial Reporting Standards (IFRS). According to its founding regulation, ESMA shall act in the field of financial reporting to ensure the effective and consistent application of European legislation.

In order to fulfil these responsibilities, ESMA organises the European Enforcers Coordination Sessions (EECS), a forum of 38 European enforcers from all European Economic Area (EEA) countries with responsibilities in the area of enforcement of financial information.

With responsibility for the coordination of supervision of almost 4,500 issuers listed on the regulated markets in the EEA preparing IFRS financial statements, EECS constitutes the largest regional enforcers' network with supervision responsibilities for IFRS.

Through EECS, European enforcers discuss and share their experience on the application and enforcement of IFRS. In particular, they discuss significant enforcement cases before and/or after decisions are taken in order to promote a consistent approach to the application of IFRS. In addition, EECS produces technical advice on ESMA Statements and Opinions on accounting matters and reviews accounting practices applied by European issuers to enable ESMA to monitor market developments and practices.

In taking enforcement decisions, European enforcers apply their judgement, knowledge and experience to the facts and circumstances of the individual cases they consider. Relevant factors may also include other areas of national law beyond the accounting requirements. Interested parties should, therefore, carefully consider the circumstances when reading the cases. As IFRS are principles-based, there can be no one single way of dealing with numerous situations which may seem similar but in substance are different.

Decisions taken by enforcers do not provide generally applicable interpretations of IFRS; this remains the role of the IFRS Interpretations Committee (IFRS IC). The decisions published in each extract are based on the IFRS requirements valid at the time of the IFRS financial statements and may be superseded by subsequent developments in IFRS.

The publication of selected enforcement decisions informs market participants about which accounting treatments European enforcers may consider as complying with IFRS; i.e. whether the treatments considered are within the accepted range of those permitted by IFRS. Such publication, together with the rationale behind the decisions, contributes to a consistent application of IFRS in the EEA.

In accordance with the provisions of the ESMA Guidelines on Enforcement of Financial Information, cases submitted to the enforcement database are considered to be appropriate for publication if they fulfil one or more of the following criteria:

- The decision refers to a complex accounting issue or an issue that could lead to different applications of IFRS;
- The decision relates to a relatively widespread issue among issuers or within a certain type of business and, thereby, may be of interest to other enforcers or third parties;

- The decision addresses an issue on which there is no experience or on which enforcers have inconsistent experiences;
- The decision has been taken on the basis of a provision not covered by an accounting standard.

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I. Decision ref EECS/0122-01 – Consideration of credit enhancements in the measurement of expected credit losses

Financial year end: 31 December 2018
Category of issue: Measurement of the expected credit losses (ECL), Credit enhancements
Standards or requirements involved: IFRS 9 *Financial Instruments*

Description of the issuer's accounting treatment

1. The issuer is a limited company which provides loans to property owners arranged in portfolios (portfolio loans). The loans are financed through the issuance of participation loans (debentures) listed on a stock exchange. In the financial statements of the issuer, the portfolio loans and debentures are accounted for at amortised cost.[1]
2. Debenture agreements include a repayment clause according to which the issuer's obligation to repay the respective debenture is limited to the actual cash flow received from the related portfolio loans. A debenture holder is not guaranteed to receive repayment of either the nominal amount or the interest. The right to repayment is limited to the assets contained in the related portfolio and any amounts received by the issuer in relation to the respective portfolio loans. The debenture holder is not entitled to any other assets held by the issuer.
3. The issuer does not recognise allowances for expected credit losses (ECL) on portfolio loans. The issuer believes that there is no need to calculate ECL, as the repayment clause would compensate the issuer for any potential credit loss on portfolio loans and credit losses on the portfolio loans would therefore not have any impact on either the issuer's income statement or equity.
4. The issuer argues that the repayment clause in the debenture agreement is in substance a credit enhancement to the portfolio loans and should be considered as a financial guarantee in accordance with paragraph B5.5.55 of IFRS 9. As the provider of the financial guarantee is the holder of the debenture loan, in case of a portfolio loan default, there are no payments from the debenture holder to the issuer.
5. With respect to the requirement of paragraph B5.5.55 that credit enhancement shall be part of the contractual terms, the issuer believes that a financial guarantee does not have to be explicitly included in the contractual terms of the debt instrument to be considered a part of these contractual terms.

The enforcement decision

6. The enforcer concluded that the issuer shall measure loss allowances for ECL on portfolio loans without taking into consideration the contractual terms of debentures.

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[1] In the jurisdiction in which the issuer is registered, there is an exception under the accounting rules for applying IFRS in the separate financial statements, which permits the use of amortised cost in the measurement of financial instruments, even if IFRS 9 would require fair value measurement. For this reason, issues related to the application of the measurement requirements of IFRS 9 are not relevant in this case.

Rationale for the enforcement decision

7. According to paragraph 5.5.1 of IFRS 9 an entity shall recognise a loss allowance for ECL on financial assets carried at amortised cost. When ECL are estimated, future cash flows from credit enhancements shall be taken into account in accordance with paragraph B5.5.55 of IFRS 9 which states that "for the purposes of measuring expected credit losses, the estimate of expected cash shortfalls shall reflect the cash flows expected from collateral and other credit enhancements that are part of the contractual terms and are not recognised separately by the entity".
8. In its March 2019 Agenda Decision,[2] the IFRS IC confirmed that according to paragraph B5.5.55 the cash flows expected from a credit enhancement are included in the measurement of ECLs if the credit enhancement is both (a) part of the contractual terms; and (b) not recognised separately by the entity. Moreover, the IFRS IC concluded that, if a credit enhancement is required to be recognised separately by IFRS, an entity cannot include the cash flows expected from it in the measurement of ECL.
9. Since, in the issuer's portfolio loan agreements, there is no reference to the repayment clause in the debenture agreement, the credit enhancement is not an explicit part of the contractual terms of the portfolio loans.
10. Moreover, the mere fact that the debt instrument (portfolio loans) is entered into at the same time as the debenture, which is a result of the business model and risk management strategy of the issuer, is not sufficient to conclude that credit enhancement is integral to the portfolio loan agreements.
11. The repayment clause is an arrangement between the issuer and the holder of the debenture and, therefore, not a part of the arrangement between the issuer and the receiver of the portfolio loan. Therefore, the repayment clause should be recognised separately by the issuer.
12. In addition, the enforcer pointed out that the wording of paragraph B5.5.55 as well as the wording of the IFRIC Agenda Decision indicate that in order to constitute a credit enhancement, there should be a cash flow to the issuer resulting from the credit enhancement in addition to the cash flows from the original portfolio loan. Since the compensation for losses on portfolio loans is only achieved by a corresponding reduction in the repayment of the debenture loan, there is no such cash flow.

[2] IFRIC Update March 2019.

II. Decision ref EECS/0122-02 – Measurement of net realisable value of inventory

Financial year end: 31 December 2018
Category of issue: Inventories, Net realisable value
Standards or requirements involved: IAS 2 *Inventories*

Description of the issuer's accounting treatment

13. The issuer is a biotechnology company that develops ingredients for cosmetic products. The inventory consists mainly of unrefined products used to produce the signature ingredient and quantities of the signature ingredient. The issuer measured its inventory at cost.
14. In 2017, the issuer renewed a five-year exclusivity agreement with a skincare retail company whose plan was to market and sell skincare products containing the issuer's ingredient. The agreement contained provisions regarding the payment of exclusivity fees, royalties and the price per unit of the ingredient. Based on this agreement, the issuer received a payment related to exclusivity fees in 2017. The agreement, however, did not contain any firm commitment of the skincare retailer to acquire the ingredient of the issuer nor a renewal option to be exercised by the issuer (the extension of the contract was solely dependent on the skincare retailer's decision). The issuer, however, expected that the contract would be renewed beyond 2022, and thus an additional payment related to exclusivity fees would occur in 2022 or 2023. According to the issuer, the payment of the exclusivity fees would exceed the book value of the inventory.
15. Upon request and considering that there had been no sales of the ingredient since the entering into force of the contract, the issuer considered that the net realisable value of the inventory should take into account potential future fees to be received by the issuer in the event that the exclusivity agreement signed with the skincare retail company was extended.
16. The issuer claimed that the example in paragraph 31 of IAS 2 regarding the determination of net realisable value is not exhaustive and that the possible future fees for extending an exclusivity agreement should be considered by analogy as a "firm sales or service contract" and taken into account when calculating net realisable value. The issuer argued that (i) the inventory is held to fulfil the exclusivity agreement which ends in 2022, and that (ii) future payments from a potential renewal of the exclusivity agreement beyond 2022 should be taken into consideration when determining the net realisable value of the inventory.
17. The issuer further claimed that if the exclusivity agreement is not renewed, the issuer will be able to sell its products to other customers. Therefore, future cash flow from sales to other customers should also be taken into account to support the value of the inventory. In this respect, the issuer expected the sales to other clients to increase significantly in the future.

The enforcement decision

18. The enforcer did not agree with the issuer's accounting treatment concerning the measurement of the inventory. The issuer was not able to estimate the net realisable value of the inventories or to provide reliable evidence for the value of the inventories based on historical sales or forecasts as at 31 December 2018.

19. The enforcer disagreed with the issuer's assessment that the extension of the exclusivity agreement, which is not under the control of the issuer, can be considered similar to a firm sales and service contract in paragraph 31 of IAS 2. The enforcer concluded that future payments related to the exclusivity agreement cannot be considered when calculating the net realisable value of the inventory because the issuer had no unconditional right to receive such future cash flows (e.g., no binding agreement). Therefore, the enforcer required the issuer to write-down the inventory.

Rationale for the enforcement decision

20. According to paragraph 9 of IAS 2, inventories shall be measured at the lower of cost and net realisable value. Paragraph 31 of IAS 2 states that "*Estimates of net realisable value also take into consideration the purpose for which the inventory is held. For example, the net realisable value of the quantity of inventory held to satisfy firm sales or service contracts is based on the contract price.*"
21. Even if the enforcer agreed that the purpose for which the inventory was held should have been taken into consideration in accordance with paragraph 31 of IAS 2, it was the enforcer's opinion that the option to extend the exclusivity agreement could not be regarded as an example equivalent to a firm sales and service contract in paragraph 31 of IAS 2.
22. Although the issuer assumed that the extension of the contract was certain, the renewal of the contract depended on the decision of the skincare retailer and there was no documentation available to support the retailer's intention or decision to renew the contract. Therefore, the issuer could not demonstrate that (i) there was a right to receive any future exclusivity cash flows (as no binding agreement existed) and (ii) the contract included firm sales commitments (the contract only specifies the sales price and price regulation mechanisms per unit of the signature ingredient in case these sales would occur).
23. Finally, based on historical information, sales of the ingredient were immaterial at the time of the examination. Furthermore, the issuer could not demonstrate (e.g., based on reasonable assumptions related to prices and quantities) how the removal of the exclusivity clauses would support an increase of the sales to other customers to corroborate the value of the inventory.

III. Decision ref EECS/0122-03 – Costs to make the sale in calculating the net realisable value of inventories

Financial year end: 31 December 2019
Category of issue: Definition of "costs necessary to make the sale", net realisable value
Standards of requirements involved: IAS 2 *Inventories*

Description of the issuer's accounting treatment

24. The issuer is a sports retailer whose inventories had been increasing over the years and amounted to 37% of its sales in 2019 (25% in 2015). The issuer experienced declining sales in 2019 and launched a campaign to sell its obsolete and aged stock at reduced price to

reduce storage costs and inventory. In this process the issuer determined the net realisable value at a lower amount than the book value.

25. In calculating the net realisable value, the issuer considered that "*estimated costs necessary to make the sale*", which are part of the definition of net realisable value in paragraph 6 of IAS 2, only relate to the incremental costs of selling the aged and discounted inventory during the campaign period. The issuer did not consider marketing costs or transportation costs from the warehouses to the stores within the calculation, noting that a part of the already incurred overall marketing costs was allocated to the campaign. Therefore, the issuer considered that these costs were not incremental.

The enforcement decision

26. The enforcer disagreed with the issuer and considered that all costs necessary to make the sale of the entire inventory as of 31 December 2019 should be considered when calculating the net realisable value and not only the incremental costs for the campaign to sell the aged and discounted inventory

Rationale for the enforcement decision

27. The enforcer acknowledged that IAS 2 does not define "costs necessary to make the sale". However, the enforcer considered that these costs relate to the sale of the entire inventory and not just part of it. Furthermore, the enforcer considered that the costs should have included the marketing and distribution costs related to the sale of the inventory at year-end and not only incremental marketing costs related to a single campaign.

28. In its June 2021 Agenda Decision,[3] the IFRS IC observed that IAS 2 does not allow an entity to limit "costs necessary to make the sale" to only those that are incremental, thereby excluding costs that the entity must incur to sell its inventories but that are not incremental to a particular sale.

IV. Decision ref EECS/0122-04 – Recognition of revenue over time

Financial year end: 30 June 2018
Category of issue: Revenue recognition, Performance obligations satisfied over time
Standards or requirements involved: IFRS 15 *Revenue from Contracts with Customers*

Description of the issuer's accounting treatment

29. The issuer is a ship building company that enters into long-term contracts for the construction of vessels. The construction period is usually from one and a half to three years, depending on the type of vessel to be built.

[3] Costs Necessary to Sell Inventories (IAS 2 Inventories)

30. For shipbuilding contracts, the issuer uses a standard contract (a contract template used within the industry) intended to cover all the important aspects of a contract situation for construction of vessels.

31. The issuer recognised revenues from the shipbuilding contracts over time in accordance with paragraph 35(c) of IFRS 15, concluding that (i) the entity's performance does not create an asset with an alternative use to the entity and (ii) the entity has an enforceable right to payment for performance completed to date.

32. In the issuer's opinion, the contract does not provide the customer with any termination rights for reasons other than the issuer's failure to perform as promised. Therefore, the contract entitles the issuer to continue to transfer to the customer the goods or services promised in the contract and to require the customer to pay the consideration promised in exchange for those goods or services throughout the life of the contract. In such circumstances, an entity has, in accordance with paragraph B11 of IFRS 15, a right to payment for performance completed to date and to require the customer to perform its obligations.

33. The issuer has no past experience of customers terminating or attempting to terminate shipbuilding contracts for reasons other than the seller’s default, nor does it have knowledge that this has occurred at any other shipyards known to the issuer.

The enforcement decision

34. To adequately support the accounting treatment, the enforcer requested the issuer to perform an assessment of applicable national laws to the contract (paragraph 37 of IFRS 15) and to consider whether any legislation or legal precedent could supplement or override the contractual terms per paragraph B12 of IFRS 15. Taking into account that the issuer’s extended assessment of such items also led to the conclusion that revenue from the contracts should be recognised over time in accordance with paragraph 35(c) of IFRS 15, the enforcer did not object to the issuer's accounting treatment.

Rationale for the enforcement decision

35. The enforcer agreed with the issuer’s assessment that the issuer’s performance does not create an asset with an alternative use to the entity referred to in paragraph 35(c) of IFRS 15. The enforcer also agreed with the issuer that the contract did not give the customer any termination rights for reasons other than the issuer’s failure to perform as promised.

36. There are no statements in the contract asserting that contract provisions on termination by the customer are exhaustive. Furthermore, it is stated in the contract that the validity and understanding of the contract shall be subject to a specified national law that in certain cases gives the customer a termination right for other reasons than the seller’s default. Therefore, the enforcer requested the issuer to analyse if the customer had termination rights based on national law and noted that the issuer must perform an assessment according to paragraphs 37 and B12 of IFRS 15.

37. The issuer performed a more detailed analysis of this matter. According to the issuer's legal opinion, while the contract was exhaustive in relation to the customer's right to terminate the contract, based on the national law applicable to the contract and the way the contract was drafted, it cannot be ruled out that a customer would be able to terminate a contract in certain

circumstances. Nevertheless, the issuer did not identify situations where signed shipbuilding contracts were terminated on the basis of national law (and not the contract).

38. Taking into account the legal analysis of applicable national legislation provided by the issuer and the lack of identified legal precedent of termination of such contracts for reasons other than the issuer's failure to perform, the enforcer did not object to the recognition of revenue over time in accordance with paragraph 35(c) of IFRS 15.

V. Decision ref EECS/0122-05 – Significant financing component

Financial year end: 30 June 2018
Category of issue: Revenue recognition, Significant financing component in the contract
Standards or requirements involved: IFRS 15 *Revenue from Contracts with Customers*

Description of the issuer's accounting treatment

39. The issuer is a ship building company that enters into long-term contracts for the construction of vessels. The construction period is normally from one and a half to three years depending on the type of vessel to be built.

40. According to the signed contracts, 20% of the fixed contract price is paid during the construction period, while 80% of the fixed contract price is paid at the time of delivery of the vessel ("physical transfer") to the customer. Revenue from these contracts is recognised over time in accordance with paragraph 35(c) of IFRS 15.

41. When assessing the existence of a significant financing component, the issuer considered that although the revenue from these contracts is recognised over time, there was no gradual transfer of control of the asset. In the issuer's view, the assessment of a significant financing component should be based on the "physical transfer" which occurs at the end of the construction, rather than on the timing of revenue recognition and transfer of the goods over time in accordance with paragraph 35(c) of IFRS 15.

42. In accordance with the issuer's assessment, there was no significant financing component as the major part (80%) of the fixed contract price is paid at the time of delivery and, as such, the fixed contract price did not significantly deviate from the cash selling price in accordance with paragraph 61 of IFRS 15.

The enforcement decision

43. The enforcer concluded that the issuer's assessment of payments during construction as advance payments was not in accordance with paragraphs 60 and 61 of IFRS 15. Therefore, the enforcer requested the issuer to reassess the existence of a significant financing component in relation to the shipbuilding contracts.

Rationale for the enforcement decision

44. The enforcer noted that, in accordance with paragraph 61 of IFRS 15, one of the factors to consider when assessing whether there is a significant financing component, is the expected length of time between when the entity transfers the promised goods and services to the customer and when the customer pays for those goods and services. Therefore, the enforcer

considered that the issuer should have assessed the existence of a significant financing component by comparing the timing of payments to the timing of transfer of goods or services which is determined in relation to the issuer's contracts by paragraph 35(c) of IFRS 15.

45. Consequently, the issuer was required to assess whether the contracts included a significant financing component in accordance with paragraphs 60 and 61 of IFRS 15 in relation to the 80% of the price being paid in arrears (i.e., to assess whether the issuer was providing financing to the customer) instead of assessing whether the 20% of the price was paid in advance (i.e., whereby the customer was providing a financing to the issuer). While making this assessment, the issuer was also required to take into consideration paragraph 62(c) of IFRS 15.

VI. Decision ref EECS/0122-06 – Presentation of litigation proceeds as revenue

Financial year end: 31 December 2019
Category of issue: Presentation of ligation proceeds as revenue
Standards or requirements involved: IFRS 15 *Revenue from Contracts with Customers*

Description of the issuer's accounting treatment

46. An issuer's patent was infringed by a third-party company after its license for the patent had expired. An out-of-court settlement resulted in a renewal of the license contract and in a lump-sum payment as a compensation for the infringement of the patent.

47. The issuer recognised the entire amount (income related to licence contract and the lump-sum payment) in the year in which the settlement was agreed upon and the consideration was received. The total amount was presented as revenue from equipment sales in the statement of profit or loss of the issuer, and further disaggregated in the notes as proceeds from patent litigation and arbitration settlements. Over the years, the issuer has considered income from patents licencing as revenue from ordinary activities.

The enforcement decision

48. The enforcer concluded that the issuer should not present the amount of the settlement that related to the infringement of the patent as revenue because, in relation to this part of the settlement, the third-party company is an infringer and is not acting as a customer as defined in paragraph 6 of IFRS 15.

Rationale for the enforcement decision

49. The enforcer agreed with the issuer that patent licencing is part of its ordinary business activities, and that a licensee can generally be considered a customer. Therefore, income recognised by the issuer that relates to the renewal of the licence (i.e., the revenue recognised in the period from the day of the settlement agreement) shall be considered revenue from contracts with a customer and falls within the scope of IFRS 15.

50. However, the enforcer observed that litigation settlements to remedy infringements of the issuer's patents were of a different nature than licencing and were not within the issuer's ordinary business activities as it was an uncommon source of income. Although the infringement was remedied, the enforcer did not consider that an infringer of patent can be considered a "customer" as defined in IFRS 15. Therefore, in accordance with paragraph 6 of IFRS 15 and paragraph 98 of IAS 1, the enforcer concluded that the issuer shall report the amount received from litigation and arbitration settlements which related to the remediation of the infringement of the patent as "other income" (instead of "revenue") and to present it separately in the statement of profit or loss.

VII. Decision ref EECS/0122-07 – Impairment test of cash generating unit comprising right of use assets

Financial year end: 31 December 2020
Category of issue: Impairment test of a cash-generating unit with right-of-use assets
Standards of requirements involved: IFRS 16 *Leases*; IAS 36 *Impairment of Assets*

Description of the issuer's accounting treatment

51. The issuer is a retail company that leases commercial premises where it carries out its business activity. In accordance with paragraph 22 of IAS 36, the issuer determines the recoverable amount of right of use assets associated with lease contracts at the level of each commercial premises which, together with other assets, represent the cash-generating unit (CGU) to which the right of use asset belongs.

52. In this assessment, the issuer considers that (i) the right-of-use assets do not generate cash inflows that are largely independent of those from other assets and (ii) the CGU would be disposed of together with the associated lease arrangements and the fair value less costs of disposal for each CGU would take into account the associated lease arrangements. For this reason, the issuer deducted the lease liabilities when determining the net carrying amount of the CGU. In addition, the issuer calculated the value in use (VIU) by deducting the estimated cash outflows to settle the lease liability from the projected cash flows of the CGU, and then discounted these net cash flows.

53. The issuer estimated the VIU discount rate using the weighted average cost of capital (WACC) determined applying the Capital Asset Pricing Model. The issuer did not take into account the application of IFRS 16 in the calculation of the WACC (discount rate). Instead, when determining the WACC, the issuer defined a set of comparable companies in the sector and estimated a gearing ratio, without considering the liabilities arising from lease arrangements. Hence, the WACC calculated by the issuer did not consider how leased assets are specifically financed by the issuer.

The enforcement decision

54. The enforcer did not agree with how the impairment test was performed by the issuer. The enforcer concluded that, if the carrying amount of the lease liabilities is deducted from the carrying amount of the CGU, the same amount should be deducted from the recoverable amount of the CGU. Therefore, the enforcer disagreed with the issuer's approach consisting in deducting the cash outflows related to the lease liabilities in the VIU cash flow projections.

55. Furthermore, the enforcer considered that the VIU discount rate should reflect the impact of IFRS 16 on the composition of the carrying amount of the CGU.

Rationale for the enforcement decision

56. The enforcer agreed with the issuer that the right of use associated with the lease contracts is subject to impairment according to paragraph 33 of IFRS 16 and each CGU includes the right of use associated with the lease contracts, based on paragraph 22 of IAS 36.

57. Furthermore, the enforcer did not oppose the judgement applied by the issuer when concluding that it is necessary to deduct the lease liabilities from the carrying amount of the CGU in accordance with paragraph 76 and 78 of IAS 36. However, taking into account paragraph 78 of IAS 36 and the IFRS IC discussions in November 2015[4] and May 2016[5], the enforcer concluded that, if the carrying amount of the lease liabilities is deducted from the carrying amount of the CGU, an equivalent deduction should be made to the recoverable amount of the CGU (VIU) in order to provide a meaningful comparison. Whether the lease liabilities are deducted from both the carrying and recoverable amount of the CGU, or from neither, the outcome of both scenarios would be identical and, thereby, the impact on the impairment test would be neutral. Therefore, the enforcer required that the lease payment outflows that are already included in the measurement of the lease liability be excluded from the value in use estimation of the CGU and instead the carrying amount of the lease liabilities be directly deducted from the recoverable amount of the CGU (VIU).

58. Regarding the discount rate, paragraph A17 of IAS 36 states that WACC should be used only as a starting point to estimate the discount rate. The enforcer acknowledged that it is common practice for issuers to use WACC in VIU calculations directly. Nonetheless, the enforcer pointed out that the inclusion of the right of use asset in this scenario had changed the asset base being tested for impairment. Therefore, when estimating the WACC to obtain the discount rate, the issuer should take into account the lease liabilities in its capital structure and its related average interest rate.

59. The enforcer required the issuer to determine the impact of IFRS 16 when estimating the discount rate and, where material, to adjust the recoverable amount of the respective CGU(s).

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[4] 412643EA-AF72-4CB6-B62A-05A9B18E2302 (ifrs.org)

[5] Considering recognised liabilities in determining recoverable amount and carrying amount of a cash-generating unit (IAS 36) (ifrs.org)

VIII. Decision ref EECS/0122-08 – COVID-19 impairment indicators

Financial year end: 31 December 2020
Category of issue: Impact of COVID-19 travel restrictions and social distancing rules on impairment testing; Impairment indicators for long-term assets
Standards of requirements involved: IAS 36 *Impairment of Assets*

Description of the issuer's accounting treatment

60. The issuer is a maritime transport group focused on carrying passengers and cars, Roll on Roll off freight and Container Lift on Lift off. Although its operations were significantly impacted due to COVID-19 travel restrictions and social distancing rules, in its 2020 annual financial statements the issuer disclosed that it had not identified any impairment indicators during 2020.

61. The issuer based its assessment on past experiences where the entity had experienced serious shocks to its activity levels and the time taken for recovery relative to the remaining life of its operating assets.

62. According to the issuer, the downturn was a one-off event and would not have material impact on its long-life vessels. The issuer also considered that travel restrictions were causing pent-up demand which would materialise once restrictions were lifted. Regarding the profit reduction in 2020, the issuer noted paragraph 14 of IAS 36 and considered that cash flows should be considered over the life of the assets.

63. The issuer temporarily withdrew one ship from service in 2020. However, the issuer did not consider that the non-operation of that ship for the summer 2020 season met the definition of "idle" in paragraph 12(f) of IAS 36.

64. The issuer focused on the expression "*shall* consider" within paragraph 12 of IAS 36 and held the view that, should any of the situations in paragraph 12 (a) to (h) of IAS 36 exist, an entity shall consider those situations. However, these situations would not automatically constitute an indicator of impairment requiring an assessment of recoverable amount. Thus, the issuer did not estimate recoverable amounts.

The enforcement decision

65. The enforcer concluded that the impact of COVID-19 restrictions provided a strong indication that one or more of the impairment indicators in IAS 36 were triggered for the issuer during 2020. The enforcer requested that the issuer estimate the recoverable amount of the fleet at 31 December 2020 in accordance with paragraph 9 of IAS 36, and where relevant, recognise an impairment. In addition, the enforcer required the issuer to improve its disclosures regarding the impairment triggers and impairment tests carried out (such as sensitivity analysis and headroom).

Rationale for the enforcement decision

66. With regards to paragraph 12(b) of IAS 36, the enforcer considered that COVID-19 restrictions and social distancing rules had an adverse effect on the market and economic environment in which the issuer operated which gave rise to a severe decline in the issuer's activities (e.g., one vessel was fully withdrawn from service during 2020 due to the decrease in demand). The issuer disclosed material declines in revenues, EBIT and profit.

67. The enforcer also noted that, taking into account that travel restrictions and social distancing rules imposed by government were still applicable, it was not clear when the activity levels of the issuer would return to normal and whether COVID-19 could be considered a one-off situation.

68. With regards to paragraph 12(f) of IAS 36, the enforcer considered that the ship temporarily withdrawn from service in 2020 was an idle asset and the issuer had an over capacity of vessels with a higher supply than demand.

69. Other factors the enforcer considered relevant in the context of the identification of impairment indicators were:

   - the issuer agreed a temporary increase in its leverage covenant with all its lenders;
   - an independent valuer of the issuer noted it was difficult to value the vessels due to the abnormal conditions prevailing as at 31 December 2020; and
   - the issuer had sought independent valuations on its vessels which could indicate the issuer had concerns.

IX. Decision ref EECS/0122-09 – Identifying cash-generating units (GGUs)

Financial year end: 31 December 2019
Category of issue: Identifying CGUs, Impairment testing of CGUs
Standards of requirements involved: IAS 36 *Impairment of Assets*

Description of the issuer's accounting treatment

70. The issuer is a sports retailer with physical stores in several countries as well as an online store. To support its activities the issuer also owns two warehouses where most of the inventory is stored. At 31 December 2019, the issuer concluded that, due to a significant decline in its sales and activities, indicators of impairment of its assets existed, prompting the issuer to conduct impairment tests. The issuer considered that its warehouses were separate CGUs as they operated the online store, which accounted for circa 16% of total group revenue in 2019. In doing so, the issuer noted that paragraph BCZ17 of IAS 36 suggests that a broader interpretation of what constitutes an active market within paragraph 70 of IAS 36 is possible.

71. The issuer determined the recoverable amount based on VIU as it was not possible to estimate a reliable fair value. To meet the requirements of paragraph 70 of IAS 36, the issuer

considered that the existing transfer pricing agreement between the warehouses and stores represented the best estimate of an arm's length transaction. The transfer pricing model secures a certain result margin in each store. The issuer noted that the pricing model was in line with OECD guidelines and was supported by benchmark analysis on similar companies. Following the assessment, the issuer concluded that no impairment loss should be recognised for the warehouses.

The enforcement decision

72. The enforcer disagreed with the assessment that the warehouses were separate CGUs. Instead, the enforcer considered that the warehouses should be considered as corporate assets and should have been allocated to the different store CGUs. Therefore, the enforcer required the issuer to perform an impairment test on this basis. Furthermore, the enforcer also considered that the issuer should have assessed whether the online sales from the warehouses should have been identified as separate CGUs.

Rationale for the enforcement decision

73. The enforcer noted that, except for the cash flows from online sales, the cash flows to the warehouses were vastly dependent on the cash flows of the stores. The enforcer could not consider the transfer pricing agreement equivalent to an arm's length transaction, noting the fact that the prices online for external clients and in physical stores were identical and thus warehouses are required to adjust their pricing to provide physical stores with a predefined margin.

74. Furthermore, the enforcer disagreed with the issuer's assessment regarding the existence of an active market in relation to sports equipment products transferred between the warehouse and the stores. In accordance with Appendix A of IFRS 13, in an active market, transactions take place with sufficient frequency and volume to provide pricing information on an ongoing basis. The enforcer noted that the volumes the issuer generates in most markets where it operates were of such a size that the conditions set out in IFRS 13 are not met.

75. Finally, the enforcer noted that using transfer pricing as a basis for the cash flows in the impairment testing would mean that impairment losses would never be recognised on any of the assets relating to the store CGUs (unless a decision to close the store is taken).

X. Decision ref EECS/0122-10 – Operating Segments

Financial year end: 31 December 2018
Category of issue: Identification of multiple business units as operating segments
Standards or requirements involved: IFRS 8 *Operating Segments*

Description of the issuer's accounting treatment

76. The issuer provides transportation and logistics services. Its main activities comprise the manufacturing and sale of product A. Secondarily, the issuer also provides e-commerce and retail solutions for a second line of products (product B).

77. Group structure: the issuer is organised in five business units (four geographical areas within Europe as well as e-commerce and retail). Each business unit has a manager who, together with the CEO, form the executive Board management. The CEO receives an internal reporting package each month with finance information both on group and per business unit level. According to the issuer, the CEO is the Chief Operating Decision Maker (CODM) per IFRS 8.

78. Although the issuer has identified several business units which are based on geographical areas and different products, it has disclosed only one segment in its annual report, which comprises the entire group. The issuer considers that the business units do not meet the definition of operating segments as prescribed in paragraph 5(b) of IFRS 8 because the resources are allocated to the group as a whole.

79. The issuer set up an integrated supply chain between the different business units and legal entities. Local sales forces are not dedicated to one product only. Financing is also provided at the group level. Although the CODM obtains information about the operating results, sales and cash flows for each business unit, the issuer argues that it does not make resource allocation decisions based on the information received from each business unit. In this respect, the issuer considered that the operating profit information included in the reporting package does not reflect the operating result of each business unit as reported in accordance with the respective local requirements. Therefore, the issuer considered that operating profit information received per unit was not relevant to the determination of the operating segments.

The enforcement decision

80. The enforcer disagreed with the issuer's assessment that there is only one operating segment. The issuer was required to change its segment reporting information and to consider each business unit as an operating segment in accordance with paragraph 5 of IFRS 8. Accordingly, the enforcer concluded that the issuer should provide additional information, including information on the results of the business units.

Rationale for the enforcement decision

81. Paragraph 5(b) of IFRS 8 requires an operating segment to have an operating result that is reviewed regularly by the CODM in order to make decisions about resources to be allocated to the segment and assess its performance. The enforcer disagreed with the issuer's interpretation of "operating result" as a profit that must be calculated in accordance with local accounting requirements. Rather, the enforcer considered that the "operating result" should be interpreted as some form of operational profitability, and that profitability measures may exclude certain costs compared to the result calculated in accordance with the respective local requirements.

82. The enforcer considered multiple factors to demonstrate that the business units constitute operating segments:

- the inclusion of an operating result per geographical area and retail in the reporting package that were reviewed by the CODM;

- the fact that the managers of the business units were not only part of the executive management and had direct contact to the CODM, but also had operational responsibility as they were either CEO or chairman of the legal entities;

- the existence of manufacturing units within all business units;

- the allocation of budget at the business unit level;

- the reporting to the Board at the level of business units, whereas the board of directors normally receives information at the segment level only; and

- the linkage of business managers' bonus to the key figures of the respective business units.

83. Accordingly, the enforcer concluded that all criteria in paragraph 5 of IFRS 8 were met in relation to the business units. This was also in line with the management approach as specified in paragraphs BC 9 to BC 17 in the IFRS 8 Basis for Conclusions, where it is implied, among other factors, that entities should report segments that correspond to internal management reports.

XI. Decision ref EECS/0122-11 – Change in the composition of cash and cash equivalents

Financial year end: 31 December 2019
Category of issue: Definition of cash and cash equivalents, Classification of cash-flows from operating activities, Change in accounting policies, Accounting estimates
Standards of requirements involved: IAS 7 *Statement of Cash Flows;* IAS 8 *Accounting Policies, Changes in Accounting Estimates and Errors*

Description of the issuer's accounting treatment

84. The issuer uses the indirect method to report the cash flows from operating activities. Historically, the issuer has considered bank overdrafts as part of cash and cash equivalents following the application of paragraph 8 of IAS 7. On 1 January 2019, the issuer changed its classification of bank overdrafts as cash and cash equivalents because the bank account balances no longer fluctuated from being positive to overdrawn and overdrafts no longer formed an integral part of the issuer's cash management. Hence, the issuer considered that, as of January 2019, the bank overdrafts no longer met the requirements set out in IAS 7 to be classified as cash and cash equivalents.

85. The issuer considered the change in the classification of bank overdrafts as a voluntary change in accounting policy in accordance with paragraph 14(b) of IAS 8. Hence, the issuer applied this change retrospectively and adjusted the impacted comparative amounts for the 2018 cash-flows in the 2019 consolidated cash flow statement. In doing so, the issuer excluded bank overdrafts from cash and cash equivalents and presented the difference as a

movement in trade and other payables which resulted in a material decrease in the cash flows from operating activities.

The enforcement decision

86. The enforcer concluded that the change in the classification of bank overdrafts did not constitute a change in accounting policy in accordance with IAS 8 and, therefore, did not agree with the retrospective application of the change in classification of banks overdrafts in the statement of cash flows. The enforcer also disagreed with the issuer's reclassification of the outstanding bank overdrafts as a part of the item "trade and other payables" within the cash flows from operating activities.

87. Furthermore, the enforcer considered that the change in the composition of cash and cash equivalents should be presented separately from cash flows from operating, investing and financing activities as a reconciling item in the 2019 consolidated cash-flow statement.

Rationale for the enforcement decision

88. Based on paragraph 47 of IAS 7, the enforcer considered that a change in cash management constitutes a change in facts and circumstances. Therefore, in accordance with paragraph 16(a) of IAS 8, this is not a change in accounting policy and therefore it should not be accounted for retrospectively. Hence, the 2018 comparative amounts should not have been adjusted.

89. Furthermore, the enforcer highlighted that, according to paragraph 20 of IAS 7, the reclassification of the outstanding bank overdrafts from cash and cash equivalents did not constitute an adjusting item to determine the cash flow from operating activities when using the indirect method for determining cash flows from operating activities.

90. The enforcer considered that, based on paragraph 45 of IAS 7, the reclassification of the outstanding bank overdrafts should have been disclosed as a reconciling item of the components of cash and cash equivalents in the 2019 statement of consolidated cash flow statement.