

Beyond the GAAP

N°17 – November 2008

Editorial

With barely a month to go until the end of the accounting period, there are still many questions regarding the impact of the financial crisis on accounting. The publication of the "reclassification" amendment, the accounting assessment of cash equivalent, determining the discount rates for impairment tests and for social contributions... Europe has been pressing the IASB to provide concrete responses on specific subjects such as the impairment of AFS. However, to date the IASB has not announced any short-term amendments. In this context, management estimates will play a bigger role than ever in the preparation of financial statements. The way in which these estimates are presented will probably be explained very carefully in the financial statements for 2008."

Happy reading!

Michel Barbet-Massin

Jean-Louis Lebrun

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News

Two new trustees appointed at IASCF

Dr Clemens Boersig and Noriaki Shimazaki were appointed Trustees of the IASC Foundation on 24 November. They will take up their roles on 1 January 2009, with a three-year mandate.

Dr Clemens Boersig is Chairman of the Supervisory Board of Deutsche Bank AG. Noriaki Shimazaki is Vice President of Sumitomo Corporation, one of the biggest trading companies in Japan.

Amendment to IAS 39 and IFRS 7

The IASB published an updated version of the amendment to IAS 39 and IFRS 7 on 27 November 2008. It relates to the effective date and transition requirements for the amendment on the reclassification of financial assets (see October 2008 issue of Beyond the GAAP). The IASB clarified that assets can be reclassified retroactively with effect from 1 July 2008 if, and only if, the reclassification was made prior to 1 November. After this date, assets cannot be reclassified retroactively.

This amendment confirms the position taken by the Board in its October meeting (October 2008 issue of IASB Update).



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IFRS news

➤ Revision of IFRS 1 – First-time Adoption of International Financial Reporting Standards

The IASB has published a revised version of IFRS 1 – *First-time Adoption of International Financial Reporting Standards*. The revised version of IFRS 1 does not comprise any significant technical changes.

Since its initial publication in June 2003, this standard had become unclear due to successive modifications. In 2007, the IASB proposed to modify IFRS 1 in order to make it easier to understand.

According to the IASB, the revision will allow it to accommodate more easily any future changes that might be made. This pertains especially to the modifications proposed in the exposure draft *Additional Exemptions for First-time Adopters*, published on 25 September this year (see September 2008 issue of *Beyond the GAAP*).

The revised standard is effective for entities applying IFRSs for the first time on or after 1 January 2009. Early application is permitted.

➤ Publication of IFRIC 17 - Distributions of Non-cash Assets to Owners

On 27 November, the IASB published IFRIC 17 – *Distributions of Non-cash Assets to Owners*. This interpretation addresses issues relating to the measurement and recognition of a debt corresponding to dividends payable, in the event that an entity decides to distribute non-cash assets to its owners. According to this interpretation:

- a debt should be recognised when the dividend is authorised by the appropriate body and is no longer at the discretion of the entity's management;
- the debt should be recognised at the fair value of the assets distributed;
- any difference, at the date of distribution, between the carrying amount of the assets distributed and the amount of the debt should be recognised in profit and loss at the date of distribution;

- the entity should provide additional disclosures if the assets held for distribution to shareholders meet the definition of a discontinued operation.

This interpretation is particularly targeted at spin-offs which are not under the control of the parent company. The IFRIC has clarified that IFRIC 17 is only applicable to distributions in which equity holders within the same class are treated equally. Moreover, it does not apply to common control transactions.

IFRIC 17 is to be applied prospectively and is obligatory for annual periods beginning on or after 1 July 2009.

➤ Consolidation

During November, the Board completed its discussions preliminary to the publication of the exposure draft on Consolidation.

This exposure draft is expected to be published near the start of December, with a comment deadline of 20 March 2009.

The latest discussions focused particularly on the treatment of potential voting rights and involvement of fund managers in the control of entities when these fund managers also invest in the fund.

➤ First decision on the Debt/Equity project

Following their joint meeting in October 2008, the IASB and the FASB decided to make a new distinction between debt and equity using the "basic ownership instrument" and "perpetual instruments" approaches. November saw the first consequence of this decision, when the two Boards decided to exclude any form of equity derivatives from share capital. So far, the Board has not shown any inclination to make an exception for stock options.

➤ New standard for recognition of financial instruments

The Board has decided to revise IAS 39, Financial Instruments. The scope of the revision will be decided following round-table discussions on the subject. The first of these round-table discussions has just been held in London, on 14 November of this year.

The decision to put a revision on the agenda for the future means that the Board will not be making any further modifications to IAS 39 before the 2008 closing of accounts, despite requests from the European Commission at the end of October this year. The revision will be carried out in conjunction with the FASB.

This project will allow the Board to make good use of the comments on the Discussion Paper, *Reducing complexity in Reporting Financial Instruments*, which was published in September 2008.

➤ Accounting rules to the rescue of financial markets

Following their meeting in Washington on 15 November 2008, the G20 leaders approved a declaration of common principles reflecting their commitment to reinforcing co-operation, working together to restore growth, and carrying out the necessary reforms of the financial markets.

In this declaration, the members of the G20 ask their finance ministers to take action in order to:

- avoid regulatory policies that exacerbate the ups and downs of the cycle;
- align global accounting standards, particularly for complex securities in times of stress;

- strengthen credit derivatives markets and reducing their systemic risks, including on OTC markets;
- review incentives for risk-taking and innovation reflected in compensation practices;
- review the mandates, governance, and capital needs of the international financial institutions, define the scope of systemically important institutions and determine their appropriate regulation or oversight.

Two areas are particularly relevant to accounting standards:

Strengthening transparency and accountability:

Several actions are to be taken by 31 March 2009. These include "enhanc(ing) guidance for valuation of securities (...) especially during times of stress" and strengthening "the required disclosure of complex financial instruments by firms to market participants."

In the medium term, the G20 members ask the main accounting standards bodies to work actively towards creating a single high-quality global standard. The G20 members also recommend that financial institutions should provide enhanced risk disclosures in their reporting.

Reinforcing international co-operation:

The G20 members feel that this requires accelerated progress in the convergence of regulatory practices such as accounting standards and auditing.

The G20 declaration can be accessed here:
<http://www.whitehouse.gov/news/releases/2008/11/20081115-1.html>

Europe

⇒ ARC approves adoption of IFRIC 12

On 6 November, the Accounting Regulatory Committee (ARC) approved the adoption of IFRIC 12 - *Service Concession Arrangements* by the European Union.

In line with the procedure for adoption of standards by the European Union, the ARC made its decision based on:

- EFRAG's opinion, dated 23 March 2007;
- the advice of the Standards Advice Review Group (SARG) on EFRAG's opinion;
- the findings of the effect study on IFRIC 12 – Service Concession Arrangements.

Adoption of the interpretation by the European Union is scheduled for the first quarter of 2009, which is more than two years since its publication by the IASB. The European Union is expected to introduce specific transition arrangements. Application will be mandatory from the first day of the annual period beginning after the publication date of the European regulation adopting IFRIC 12.

If the interpretation is adopted in the first quarter of 2009, application will be obligatory from 1 January 2010 for entities whose accounting period coincides with the calendar year.

It should be noted that IFRIC 12 had a projected effective date of 1 January 2008 when it was published in November 2006. Some companies have opted for early application of the principles of IFRIC 12.

⇒ EFRAG approves adoption of IFRIC 15 and IFRIC 16

At the beginning of November, the European Financial Reporting Advisory Group (EFRAG) issued a positive opinion on the adoption of IFRIC 15 and IFRIC 16 by the European Union.

- IFRIC 15, which deals with the accounting treatment of real estate construction contracts, is mandatory retrospectively from 1 January 2009 (see May 2008 issue of *Beyond the GAAP*).

- IFRIC 16, which relates to hedges of net investments in foreign operations, is effective prospectively from 1 October 2008 (see May 2008 issue of *Beyond the GAAP*).

The European regulation adopting these interpretations is expected in the first quarter of 2009. They can only become effective at the EU level once this regulation has been published in the Official Journal of the European Union.

⇒ European Commission adopts consolidated IFRS applicable in the EU

On 3 November, the European Commission adopted a consolidated version of all the IFRSs approved between 29 September 2003 and 15 October 2008, including the amendments to IAS 39 and IFRS 7. In addition, all cross-references have been updated.

The new regulation repeals and replaces regulation no. 1725/2003 of 29 September 2003 and all subsequent modifications up to 15 October 2008.

The Member States unanimously approved the adoption of this regulation, which replaces the 18 previous regulations.

The consolidated version enables users to refer to one single legal document. It is a key stage in the Commission's simplification programme, which aims to reduce the administrative burden on EU companies.

The consolidated text is available at the following link:
http://ec.europa.eu/internal_market/accounting/ias_fr.htm

Proposed improvements to IFRSs

For the second year in a row, the IASB is proposing to make amendments to the IFRSs on subjects which – in theory – are of minor importance and on which there is a broad consensus. However, it is apparent that the 2008 crop of amendments could have significant impact on financial statements, if they are adopted as is. Here is a select list of the key amendments.

➤ *Classification of investment expenditures in the cash flow statement*

The IASB is proposing to amend IAS 7 to clarify that only expenditures resulting in the recognition of an asset in the balance sheet can be classified as investment flows in the cash flow statement. This means that expenditures on advertising, training, R&D and exploration for and evaluation of mineral resources, which are recognised as expenses, should be classified as operating flows in the cash flow statement. As a range of practices have hitherto been used, this amendment could mean that some investment flows will be transferred to operating flows.

➤ *Determining whether an entity is acting as an agent*

When an entity is acting as an agent, only its commissions are recognised as revenue. Under IAS 18, amounts collected on behalf of third parties shall not be recognised as revenue.

On the other hand, when an entity is acting as a principal, it recognises the amount charged to clients as income and the cost of stock purchased from suppliers as expenses. However, IAS 18 does not provide guidance on determining whether an entity is acting as an agent. In order to fill this gap, the IASB is planning to use indicators adapted from the US standards. Therefore, an entity is acting as a principal when it has exposure to the risks and rewards associated with the sale (for example, the risk incurred by holding the primary responsibility for providing goods or services to a client).

➤ *Impact of IFRS 8 on impairment tests*

IFRS 8 – Operating Segments will replace IAS 14 – Segment Reporting from 2009. IFRS 8 requires entities to identify segments based on internal reporting which is reviewed regularly by the management.

It is permissible to aggregate sectors when they have similar economic characteristics and are not significant. However, where impairment tests are concerned, goodwill must be assigned to a Cash Generating Unit (CGU), or a group of CGUs, which may not be larger than a segment as defined in IFRS 8. The IASB states that the CGU or group of CGUs used as the unit for goodwill impairment testing may not be larger than a segment before aggregation. This may lead entities to allocate goodwill over a larger number of CGUs, which increases the risk of impairment.

➔ Exemption of business combination contracts from the scope of IAS 39

IAS 39 is applicable to all financial instruments, with certain exemptions. One of these exemptions relates to contracts between a buyer and a seller resulting in a business combination at a future date (paragraph 2(g)). In practice, some entities have treated forward contracts resulting in a business combination as exempt from the scope of IAS 39, along with some put or call options that could result in a business combination if the option is exercised. Derivatives are not recognised in the balance sheet. Moreover, derivatives whose exercise price is not fixed have a non-zero fair value. The IASB is proposing to limit the exemption to binding forward contracts with a fixed price. Therefore, options leading to a transfer of control in the future would be derivatives measured at fair value with variation recognised in profit and loss.

The comment period ended on 7 November 2008. For companies whose accounting period coincides with the calendar year, the majority of these amendments will be effective from 2010 at the latest.

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Events/publications

Financium 2008: 6th symposium of financial executives

Financium, held at the Palais des Congrès in Paris, brings together a large number of professionals each year. Visitors include more than 2,000 senior decision-makers representing the whole spectrum of the French economic world: SMEs/SMIs, large corporates and listed companies. This 6th event will comprise seminars, plenary sessions, round-table discussions and workshops on the theme "Globalization and Financial System Crisis: New Challenges for the Chief Financial Officer."

Mazars will be playing an active part in the debates via two workshops:

- 15 December: first workshop, on the theme of reporting and preparation of financial statements: "IFRS 3: what are the implications for external growth operations?" It will be led by Pascal Jauffret, Partner in Doctrine, and Véronique Hermet, Senior Manager, Reporting and Preparation of Financial Statements.
- 16 December: second workshop, on the theme of credit and management of working capital requirements: "Maintaining cash levels in a difficult economic environment: operational tools and methods". It will be led by Valérie Gaultier, Project Director, Credit and Management of Working Capital Requirements, and Luc Marty, Partner in Business Recovery.

Frequently asked questions

- Recognition of cash flow hedge swaps;
- Derecognition of receivables sold in the context of a factoring contract;
- Recognition of convertible bonds: distinguishing between the debt portion and the equity portion;
- Shareholders' agreements and level of control in a joint venture;
- Transfer of risks and advantages on consignment stock;
- Classification of income from advertising sales agencies: commissions or turnover?

Upcoming meetings of the IASB, IFRIC and EFRAG

IASB

15 - 19 December 2008
19 - 23 January 2009
16 - 20 February 2009

IFRIC

8 -9 January 2009
5 - 6 March 2009
7 - 8 May 2009

EFRAG

10 - 12 December 2008
21 - 23 January 2009
25 - 27 February 2009

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The drafting of the present edition was completed on November 30th, 2008.
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