

AMF recommendation 2006-22 Financial statements 2006

Reference texts: Article 223-1 of the AMF General Regulation

Pursuant to EC Regulation 1606/2002 ("IFRS 2005"), European companies with shares admitted to trading on a regulated market must present consolidated financial statements under International Financial Reporting Standards (IFRS) rather than under national accounting standards. This requirement applied for the first time for the 2005 financial year.

In 2006 the AMF conducted a review of the financial statements of the French companies subject to this requirement. It found that a considerable effort had been made to meet the requirement at a high standard of quality.

Beyond this general observation, however, the AMF also noted diverging practices from one issuer to another on a number of specific points.

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1. Presentation of the income statement (IAS 1)

1.1. Reminder regarding certain provisions of the standard

IAS 1 on the presentation of the financial statements does not mandate any particular format. Rather, the standard proposes models that present line items either by nature or by function. These models are built on the no-offsetting principle (i.e. income and expenses must not be offset unless required or permitted by another standard, IAS 1.32) and the requirement that, at a minimum, six essential line items¹ must appear on the face of the income statement.

Paragraph 83 of IAS 1 provides that additional line items, headings and subtotals may be presented on the face of the income statement when they contribute to better understanding by users. Paragraph 86 stipulates that when items of income and expense are material, their nature and amount are to be disclosed separately, either in the income statement or in the notes. Paragraph BC13 of the Basis for Conclusions of IAS 1 indicates that it is possible to present a result from operating activities. When this is done, the IASB notes that company must ensure that the amount presented is fairly representative of activities considered to be 'operating'. Paragraph 85 prohibits presentation of any items as extraordinary items anywhere in the financial statements.

1.2. Use of performance indicators

Many issuers highlight performance indicators (EBIT, EBITDA, etc.) in their financial disclosures. Given the latitude allowed by IAS 1 in regard to presentation, some issuers include these subtotals as intermediate balances on the face of the income statement, in the part relating to operating results, whereas others use them outside of the financial statements.

The recommendations made by the AMF in the past regarding the use of such non-accounting indicators outside the financial statements continue to apply. In this case, it is important that issuers observe certain precautions, notably by defining the balances they use and presenting a reconciliation with the accounting line items.

When issuers include intermediate balances within the income statement to present operating performance, explicitly worded headings should be used to rule out any ambiguity as to which income and expense items are included in these aggregates. In the notes, there should be a clear and precise explanation of the concept behind each of these balances and why they are of interest (for example, because of the way they are used internally) in order to facilitate understanding of the company's performance. Furthermore, such balances should, as far as possible, be presented consistently throughout the financial statements. In particular, it should be possible to reconcile the information provided in the income statement with that provided in the breakdown by business segment (see point 6.2).

¹ Revenue, finance costs, share of the profit or loss of equity-accounted entities, tax expense, post-tax profit or loss of discontinued operations, profit or loss (IAS 1.81).

1.3. Other operating income and expense

Noting the absence of a detailed framework for the presentation of companies' financial performance, France's national accounting board, the Conseil National de la Comptabilité (CNC), on 27 October 2004 adopted Recommendation 2004 R 02 in order to offer, *inter alia*, an income statement format that meets IFRS requirements. Since September 2005, the AMF has recommended the use of these presentation formats, not only for the greater comparability that might result from them – at least in France – but also for the better definitions of intermediate balances that they provide.

To help explain the recurring component of performance, the CNC has proposed the option of including a 'current' operating result that differs from the actual operating result insofar as some operating revenue and expense items are excluded from it. This line item is intended for separate presentation of major events during the period that could make it more difficult to tell how well the entity is performing. It would therefore be used only for a small number of unusual, abnormal or infrequent revenue and expense items of particularly significant amounts. The entity would present these items separately in its income statement to facilitate understanding of current operating performance and provide the user of the financial statements with information that is useful for a forecast-earnings approach (§ 28 of the Conceptual Framework). Such items could include, for example:

- a large and unusual gain or loss on disposal or impairment loss on tangible or intangible non-current assets. In contrast, a company that regularly disposes of non-current assets in the course of its business must not present the result of disposals on this line but must include it in operating profit or loss (example: resale of vehicles by a car-hire company);
- certain restructuring charges: only those restructuring costs that would tend to obscure current operating performance because of their magnitude or unusualness.
- other operating income and expense items such as a very large provision for litigation.

The nature and amount of these items must be precisely described in the notes, and companies are encouraged to indicate how these items are allocated to their various business segments in their segment reporting disclosures. Any items of the same nature that do not have the characteristics just mentioned are included in the current operating result. This will be the case for most impairment losses on assets, restructuring charges, computed expenses of stock option plans, and gains and losses on disposals whenever asset sales occur on a recurring basis.

1.4. Presentation of net finance costs

In October 2004, the International Financial Reporting Interpretations Committee (IFRIC) confirmed the required presentation of the line items composing 'net finance costs'. Taken together, paragraphs 32 and 81 of IAS 1 preclude offsetting finance revenue against finance costs on the face of the income statement. IFRIC agreed, however, that nothing precludes presentation of a subtotal corresponding to the cost of net debt so long as its components are shown separately.

1.5. Presentation of profit or loss attributable to minority interest

Attention is drawn to paragraph 82 of IAS 1, which stipulates that a breakdown of post-tax profit or loss must be given to show the amount attributable to minority interest and the amount attributable to equity holders of the group. These two items must be presented at the foot of the income statement as an allocation of profit or loss, as shown in the illustrative financial statements in paragraph IG 4. Companies therefore must not present a group share of profit or loss obtained by deducting the minority interest share from post-tax profit or loss.

1.6. Discontinuation of "extraordinary gain or loss"

The notion of extraordinary gain or loss, or *résultat exceptionnel* under French accounting principles, does not exist in IFRS. Also, pursuant to paragraph 85 mentioned above, presentation of line items such as restructurings, impairment losses and gains or losses on disposal after the operating and finance revenue and expense items on the income statement is not appropriate.

1.7. Presentation by nature or by function

The AMF's review of 2005 financial statements revealed that some issuers chose a mixed approach that presented expenses both by nature (depreciation and amortisation, employee benefits costs, etc.) and by function (cost of sales, distribution costs, administrative expenses, etc.) on the face of the income statement. IAS 1 offers issuers the option of presenting by nature or by function, either in the income statement or in the notes. The standard does not preclude presentation according to a mixed approach. However, it should be emphasised that IAS 1.89 encourages the use of one of the two forms of presentation, either by nature or by function, in the income statement.

Lastly, when expenses are presented by function in the income statement, the standard requires supplementary information by nature to be disclosed in the notes (in particular for depreciation and amortisation costs and for employee benefits costs) and points out that this information is useful in predicting future cash flows (IAS 1.90, 1.93 and 1.94). Accordingly, the issuer should bear this need in mind when choosing the type of information and level of detail it will provide.

2. Significant accounting policies and estimates by management (IAS 1)

2.1. Significant accounting policies

It is important to remind issuers of their disclosure obligations in regard to accounting policy choices, as the Committee of European Securities Regulators (CESR) did for the first-time application of IFRS. Issuers must present the main analyses and judgements they made in choosing their significant accounting policies (IAS 1.108). This may be the case when an accounting treatment is not set or has not yet been stabilised, or when judgements have allowed management to take a position on significant points, such as in determining which entities are included the scope of consolidation, or whether disposals of receivables or other assets are treated as sales or as financing transactions, etc.

It should be stressed, however, that disclosures presented under the heading of significant accounting policies must not simply reproduce the main provisions of the accounting standard in question. This would have little informative benefit and would pointlessly inflate the volume of the notes. Information tailored to the specific characteristics of the entity is of more interest to the user. For example, IAS 18 on revenue recognition requires a description of the accounting methods adopted in this regard, without really going into any further detail. A mere mention that revenue is recognised when acquired is in some cases too brief to enable the user to understand this major element of the entity's activities (IAS 1.108 and 1.113).

2.2. Management estimates

IAS 1 requires note disclosure of the assumptions and sources of uncertainty relating to estimates made by management as of the balance sheet date whenever there is significant risk that the estimated amounts will be materially adjusted during the following period. As a minimum requirement, the required information pertains to the nature of the assets and liabilities concerned and their carrying value at the balance sheet date (IAS 1.116).

The standard gives examples of the disclosures to be made in this regard. The level of detail to be provided varies with the circumstances so as to help users to understand the judgements management has made in preparing the financial statements. The examples are as follows (IAS 1.120):

- the nature of the assumption or other estimation uncertainty;
- the sensitivity of carrying amounts to the methods, assumptions and estimates underlying their calculation, including the reasons for the sensitivity;
- the expected resolution of an uncertainty and the range of reasonably possible outcomes within the next financial year in respect of the carrying amounts of the assets and liabilities affected;
- an explanation of changes made to past assumptions concerning those assets and liabilities, if the uncertainty remains unresolved.

The information disclosed by issuers on these aspects is often quite limited. As indicated in paragraph IAS 1.116, information on these aspects is highly important for understanding management's judgements on the main transactions subject to estimates or uncertainties, such as measurement of and recognition on impairment of intangible assets including goodwill, provisions, measurement of post-employment obligations, deferred taxes, fair value of investment properties and valuation of share-based payments.

The AMF recommends that issuers improve their disclosure on these aspects, for example by having a special section in the notes on this subject, possibly with cross-references to other, more extensive notes on certain subjects. It may also be useful to remind issuers that IFRS 7, which becomes mandatory on 1 January 2007, requires disclosure of this type of information in detail for financial assets and liabilities, in particular regarding risk exposure and management. (In principle, this means giving an indication of how these assets and liabilities will be affected by different risk factors.)

3. Business combinations (IFRS 3)

IFRS 3 on business combinations requires disclosure of extensive, detailed information regarding business combinations effected during the period. In practice, the information provided is often insufficient. Among the missing items noted in the AMF's review, the following appear to be particularly useful in assessing the impact of acquisitions on financial position and earnings:

- a description of the nature of the businesses acquired;
- the cost of the acquisition and a description of the components of that cost (including acquisition-related expenses);
- the amounts allocated to each category of assets, liabilities and contingent liabilities of the acquired entity upon first consolidation by the acquirer, as well as the amounts of these same categories on the acquired entity's books immediately before the acquisition;
- a description of those items that, because they could not be recognised separately, contributed a portion of any acquisition goodwill that was recognised;
- a description of the items that explain any negative goodwill recognised immediately in the income statement;
- a precise indication of the impacts on the income statement of the period stemming from business combinations effected during that period or prior periods (gains, losses, effects of error corrections or other value adjustments).

Furthermore, in a business combination, the acquirer is allowed a period of twelve months to finalise the allocation of the acquisition cost. This generally entails the use of provisional amounts when the acquirer prepares its financial statements, if those statements must be drawn up shortly after the transaction. For this reason, the finalised carrying amounts of the acquired entity's assets and liabilities at the end of the following period may be different from those initially presented. This specific issue is developed in IFRS 3. Paragraph 62.b(iii) which requires that any comparative information presented for periods ended before the initial accounting for the combination is complete must be presented as if that accounting had been completed at the acquisition date, i.e. corrected for any subsequent adjustments. A consequence of this requirement is that the income statement amounts of depreciation, impairment or gains and losses presented as comparative information may have to be modified. In such case, the modifications should be explained and all the amounts disclosed (IFRS 3.73b).

4. Puts and forwards held by minority interests (IFRS 3, IAS 32, IAS 39)

At the closing date for 2005 financial statements, the accounting treatment of puts and forwards held by minority interests was one of the subjects on which IFRS offered no explicit guidance.

The AMF's analysis of 2005 financial statements has shown that the practices of French issuers did indeed differ on this point. Although they were the exception, some issuers considered that commitments of this kind could not be estimated reliably and therefore recognised no debt obligation arising from them. In practice, such cases ought to be rare. If they occur, however, it is important that the issuer provide an adequate note disclosure as to why the obligation could not be measured reliably. In most cases, these arrangements were reflected in recognition of a financial liability representing the best estimate of the amount of cash to which minority holders could lay claim. The difference between the fair value of this

liability and the net book value of the minority interest was recognised either in acquisition goodwill or as a deduction from equity. Issuers typically stated that any later change in the value of this financial liability would be booked either to profit and loss or to goodwill.

A request for interpretation had been made to IFRIC for the purpose of guiding financial statement preparers in choosing among the available options. The interpretation committee decided not to take this item onto its agenda, fearing that it would be unable to stipulate on a timely basis how the counterpart to this liability should be presented. IFRIC did confirm, however, that pursuant to paragraph IAS 32.23, a financial liability must be recognised whenever the entity has incurred an obligation to pay cash to acquire shares held by minority holders in a controlled company, even if the obligation is conditional on exercise of an option granted to a third party. Once recognised, this liability is accounted for either under IFRS 3 on business combinations or under IAS 39 on financial instruments. IFRIC also stated that if ultimately the option is not exercised, the appropriate treatment would be to reclassify the liability to equity.

In all likelihood, there will be no major change in the guidance on this issue before the 2006 financial statements have to be drawn up. Issuers should therefore continue to spell out in the notes the accounting policy that they follow in this regard, owing to the implicit options existing under IFRS.

5. Impairment of assets (IAS 36)

The standard on asset impairment is particularly important, especially in view of the size of intangible non-current assets and goodwill on the balance sheets of listed French companies. By way of illustration, analysis of the structure of 2005 balance sheets reported by CAC 40 industrial and commercial companies reveals that intangible assets represented on average 23% of total assets and 81% of equity attributable to holders of the group's shares. Therefore the AMF wishes to draw the attention of the issuers most affected by this issue to the need for a high standard of disclosure.

Analysis of issuers' practices in 2005 has identified certain areas for improvement in financial disclosure. These fall into two separate categories: disclosures required by the standard and for which issuers were found to have supplied insufficient information, and disclosures not required by this standard but for which the issuer ought to have provided information as part of its significant management estimates (see 2).

5.1. Disclosures required by the standard

To perform an impairment test, the net book value (carrying value) of an asset or group of assets must be compared with its recoverable value, which is the higher of fair value less costs to sell and value in use.

Paragraphs 126 to 133 of IAS 36 establish detailed requirements whenever a material loss of value is recognised or reversed. In particular, paragraph 130 requires the entity to disclose the events and circumstances that led to recognition or reversal of the impairment loss. In addition, whenever a impairment loss (or reversal) has occurred during the period in a cash-generating unit, paragraph 130 requires:

- a description of the cash-generating unit,
- that the amount of the loss (or reversal) be allocated by asset category within the cash-generating unit and be linked to the entity's primary reporting segment under IAS 14, if applicable.

Regarding recoverable value (IAS 36.130, points (e), (f) and (g)), if this is taken as fair value less costs to sell, the chosen basis must be given (such as whether fair value was determined by reference to an active market); if it is taken as value in use, the discount rate(s) used in the current estimate and previous estimate (if any) must be indicated.

It is important to stress that paragraph 134 requires a long list of disclosures regarding cash-generating units to which a material amount of goodwill or intangible assets with indefinite useful lives has been allocated:²

- (a), (b) the carrying amounts of goodwill and intangible assets with indefinite useful lives allocated to the unit.
- c) the basis on which the unit's recoverable amount has been determined (i.e. value in use or fair value less costs to sell).
- d) if the unit's recoverable amount is based on value in use:
 - (i) a description of each key assumption on which management has based its cash flow projections for the period covered by the most recent budgets.³ (Key assumptions are those to which the unit's recoverable value is most sensitive.)
 - (ii) a description of management's approach to determining the value(s) assigned to each key assumption, whether those value(s) reflect past experience or, if appropriate, are consistent with external sources of information, and, if not, how and why they differ from past experience or external sources of information.
 - (iii) the period over which management has projected cash flows based on financial budgets/forecasts approved by management and, when a period greater than five years is used for a cash-generating unit, an explanation of why that longer period is justified.
 - (iv) the growth rate used to extrapolate cash flow projections beyond the period covered by the most recent budgets, and the justification for using any growth rate that exceeds the long-term average growth rate for the products, industries, or country or countries in which the entity operates, or for the market to which the unit is dedicated.
 - (v) the discount rate(s) applied to the cash flow projections.
- e) if the unit's recoverable amount is based on fair value less costs to sell, the methodology used to determine fair value less costs to sell must be described. If it is not determined using an observable market price for the unit, the following information must also be disclosed:
 - (i) a description of each key assumption on which management has based its determination of fair value less costs to sell,
 - (ii) a description of management's approach to determining the value(s) assigned to each key assumption, and whether those value(s) reflect past experience (see (c)(ii) above).
- f) if a reasonably possible change in a key assumption on which management has based its determination of the unit's recoverable amount would cause the unit's carrying amount to exceed its recoverable amount:
 - (i) the amount by which the unit's recoverable amount exceeds its carrying amount,
 - (ii) the value assigned to the key assumption,
 - (iii) the amount by which the value assigned to the key assumption must change, after incorporating any consequential effects of that change on the other variables used to measure recoverable amount, in order for the unit's recoverable amount to be equal to its carrying amount.

5.2. Items that may have a bearing on significant management estimates

IAS 36 requires systematic annual testing of goodwill and intangible assets with indefinite useful lives (IAS 36.10). It would be helpful if issuers could confirm that such tests were indeed conducted during the period, even if no impairment was recognised, given that significant management estimates may be involved.

² In this case, the significance of the amount is to be assessed in relation to the magnitude of the goodwill line item or the indefinite-life intangible assets line item at the level of the group.

³ It is important to stress that the budgets used to determine value in use must make it possible to value assets in their state at the balance sheet date. Also, the standard does not allow future restructurings and capacity increases to be taken into account (IAS 36.44). This may necessitate restatement of budgets prepared for managerial purposes.

Other kinds of assets are not tested systematically and need only be tested when indicators suggest that an asset has lost value. Issuers are not expressly required to disclose which indicators of loss of value they analyse for this purpose. Considering the guidelines set forth in IAS 1 regarding disclosure of significant accounting policies, presentation of these indicators could provide useful information to users of the issuer's financial statements, especially if the presentation highlights the key indicators for each category of asset.

Similarly, regarding the description of the methodology, it would be particularly helpful if issuers explained in an appropriate way how they have applied the definition of cash-generating unit (smallest set of assets that generates cash inflows largely independent of those generated by other assets or groups of assets; IAS 36.6) to their activities, even if there has been no recognition of impairment to report. It would be helpful because the particular analysis the issuer chooses could have a significant bearing on the magnitude of potential write-downs. Moreover, if an impairment loss is recognised or reversed, having disclosed this information beforehand will facilitate understanding of the items to be provided pursuant to IAS 36.130(d), which states that the same information must be provided whenever an event of this kind has occurred during the period.

5.3. Consistency of assumptions

When testing assets for impairment against value in use, issuers must ensure that the assumptions they employ, in particular relating to budgets and business outlook, are consistent with the assumptions they may have used in measuring deferred tax assets.

6. Segment reporting (IAS 14)

The purpose of segment reporting is to provide a more detailed picture of performance and risks than that provided by the financial statements, through analyses by business segment and geographical area. Segment reporting is required by IAS 14,⁴ which calls for complementary approaches along these two analytical lines. The standard requires issuers to determine a first level of segmentation for which information must be provided in substantially more detail than for the second level.

In general, the segment information provided in issuers' 2005 financial statements is quantitatively greater than it was in their 2004 financial statements under French accounting principles. However, several disclosures specifically required by IAS 14 were not provided in a satisfactory fashion.

6.1. Reportable segments

The way in which the issuer divides the business into segments must be explained more clearly. In particular, the explanation should address the choice of primary and secondary presentation format, which is determined on the basis of the main sources of risk and return to which the group is exposed. Once this choice is made, the segments to be reported in the Notes must be determined. Starting from the breakdown used in internal reporting, significant lower-level segments may be combined into a single upper-level segment only when all the characteristics itemised by the standard are sufficiently similar within that segment. Paragraphs 9 and 34 of IAS 14 specify the relevant criteria for such grouping. Paragraph 9 defines a business segment as a distinguishable component of an entity engaged in providing products subject to risks and returns different from those of other business segments. The standard sets forth criteria for assessing whether a segment does business in a different environment from the other segments. These factors include the nature of the products or services, the nature of the production process, the type or class of customer, the distribution channels used and the regulatory environment (very industry specific for activities such as banking or insurance). Paragraph 34 completes this analytical framework by specifying that reportable business segments cannot be combined unless they are similar in all of the applicable factors in paragraph 9 and also exhibit similar long-term financial performance.

⁴ In November 2006, the IASB produced IFRS 8 on operating segments, which takes the place of IAS 14. Application of this standard will be mandatory from 1 January 2009, but earlier application is allowed.

The precision of the information given on how the segments are determined may be an important consideration, both for the quality of segment reporting and for the quality of disclosure on impairment of assets, which merits a greater effort at transparency from issuers. As it is, many issuers consider their cash-generating units (for the purpose of impairment testing) to correspond to their business or geographical segments.

In this context, the practice of certain issuers who consider themselves to be operating in only one business segment and use only that segment as the primary format for detailed analysis of their performance appears questionable. At the very least, when these issuers are corporate groups with substantial international operations, they should explain why they did not choose the primary approach by geographical segment to meet the requirements of the standard.

As to where the disclosure is placed, some issuers have chosen to present this description elsewhere than in the financial statements themselves. This may raise the issue of whether the financial statements can truly stand by themselves without the other documents in which this information appears. Other issuers have chosen to present the disclosures required by IAS 14 in a number of different sections of the notes. To make it easier for the user of the financial statements, it would be better if all the segment reporting information were presented in one note, with references to this note for the reader in the other parts of the annual financial report.

6.2. Other disclosures

IAS 14 requires issuers to make their best efforts to assign revenue, expenses, assets and liabilities to the various segments on which they report. This is essential if the information presented on segment performance is to make any sense. The standard allows issuers not to allocate items only in those rare cases when the only basis of allocation would be arbitrary or difficult to understand (IAS 14.48).

Information on segment liabilities and reconciliation of the segment data with the consolidated data are, in practice, the disclosures most often lacking at the primary format level, even though these disclosures are mandatory.

At the secondary format level, the disclosures most frequently omitted – despite being mandatory – are those relating to the amounts of segment assets and investment spending by segment.

Lastly, affected issuers must be reminded that application of IAS 14.75 ought to have prompted them to describe how they set transfer prices for intra-group transactions between segments.

7. Standards and interpretations whose application is not yet mandatory (IAS 8)

As part of the IASB's commitment to stabilise the body of standards long enough for users to become better acquainted with IFRS language, a number of standards currently under development will not become mandatory until 2009. Furthermore, the most recently published standards, as well as the most recent interpretations, are not mandatory at end-2006, although early application is recommended.

IAS 8 requires issuers that do not wish to apply an already published new standard before it becomes mandatory to say so and to explain in the notes how the new standard will impact on future financial statements once it is applied. Some standards and interpretations (for example, IFRIC 4 on arrangements containing a lease) were in this situation for the 2005 financial statements. The AMF's review found that, in practice, the disclosure required by IAS 8 was not systematically provided.

With preparation of the 2006 financial statements in the offing, issuers' disclosures in this regard should focus on the standards that will become applicable to their statements for the next few financial years. If the issuer has not completed its analysis of the entire body of new standards and interpretations and cannot confirm that there will be no material impact on the group, it would seem important to indicate at least that such an analysis is under way. Also, a quantitative indication of the impact on the 2006 and 2007 financial statements, as soon as one is available and sufficiently reliable, would be desirable to facilitate understanding of future financial statements, especially if a standard requires restatement of a period already presented. If information of this kind cannot be provided, an issuer may prefer a more narrative approach to help users understand the impact of the coming changes.

Note that the new standards and interpretations issued in 2006 can be classified in two categories: those that could have an impact on the financial statements, and those where the impact is limited to note disclosures.

Application of the interpretations that follow is not mandatory for financial years beginning on 1 January 2006. All of them could, however, have an impact on future years' financial statements and could therefore require a specific description in the Notes to the 2006 financial statements. The starting date of the financial year when application becomes mandatory is shown in parentheses below.

- IFRIC 12 on service concession arrangements (1 January 2008). This interpretation specifies the accounting treatment of concession contracts when the grantor is a public entity and the concession operator is a private entity. IFRIC 12 deals only with the accounting by the operator. It offers two models: recognition of either an intangible asset or a financial asset reflecting the right to receive cash flows from operation of the public sector asset.
- IFRIC 11 on options to purchase shares in a parent entity and treasury share transactions for employee share option plans (1 March 2007). This interpretation clarifies the treatment to be applied in certain special cases of employee benefits involving different entities of a group.
- IFRIC 10 on interim financial reporting and impairment (1 November 2006). The committee concluded that when an entity has recognised an impairment loss in an interim period in respect of goodwill or an investment in either an equity instrument or a financial asset carried at cost, no subsequent reversal of that impairment is possible.
- IFRIC 9 on reassessment of embedded derivatives (1 June 2008). The interpretation concludes that identification and measurement of an embedded derivative cannot occur after the entity becomes a party to the contract unless there is a change in the terms of the contract that significantly modifies the cash flows from the contract, the embedded derivative or both.
- IFRIC 8 on the scope of IFRS 2 (1 May 2006). The interpretation confirms that share-based payments for which the consideration given appears to be less than the fair value of the benefit provided must be accounted for under IFRS 2.
- IFRIC 7 on comparative information to be restated when applying IAS 29, Financial Reporting in Hyperinflationary Economies (1 March 2006).

IFRS 7 on financial instruments disclosure (standard that takes the place of IAS 30 and IAS 32) and IFRS 8 on segment reporting have no impact on the measurement and recognition of transactions.

8. Development costs (IAS 38)

Whenever the criteria set forth in IAS 38 are met, development costs must be recognised as an intangible asset. Paragraph 57 of IAS 38 lists six conditions that must all be met. An intangible asset arising from development is recognised if and only if an entity can demonstrate:

- the technical feasibility of completing the intangible asset so that it will be available for use or sale.
- its intention to complete the intangible asset and use or sell it.



- its ability to use or sell the intangible asset.
- how the intangible asset will generate probable future economic benefits.
- the availability of adequate technical, financial and other resources to complete the development and to use or sell the intangible asset.
- its ability to measure reliably the expenditure attributable to the intangible asset during its development.

In practice, the AMF found that many issuers recognised all research and development costs as expenses for the period. Quite frequently, the reasons that might justify such a decision are not developed at sufficient length in the notes. Bearing in mind that IAS 38.128(b) encourages entities to describe material intangibles controlled by the entity but not recognised because not all the standard's criteria are met, issuers for which this is a prominent matter should explain their situation in regard to these criteria, under the heading of significant accounting policies.

9. Employee benefits (IAS 19)

IAS 19 requires issuers to provide information on a large number of post-employment benefits granted to employees. Among these disclosures, the following items of information, which are important for assessing the issuer's obligations under plans in effect, are often omitted:

- an indication of the cost of the services provided,
- a presentation of the plan assets,
- details of the amounts recognised on the balance sheet and in the income statement.

Furthermore, from 1 January 2006, the standard requires new disclosures on post-employment benefits (see IAS 19, paragraphs 120-121 amended). Among these new disclosures, the AMF draws issuers' attention to the following:

- the reconciliation of the opening and closing balances of the fair value of plan assets (IAS 19.120A(e)).
- the sensitivity of the benefit obligation for post-employment medical costs and the related income-statement items to a variation of one percentage point in the assumed medical cost trend rates (IAS 19.120A(o)).
- a five-year comparison of the present value of the defined benefit obligation, the fair value of plan assets, and the surplus or deficit in the plan (IAS 19.120A(p)).
- indication of any adjustments made to the value of benefit obligations and plan assets over the past five financial years (IAS 19.120A(p)).

10. Share-based payment (IFRS 2)

Several important disclosures required by IFRS 2 are often omitted by issuers. This is particularly true for the assumptions used in the valuation model for stock option plans, such as the risk-free interest rate, dividend distribution assumptions, assumptions on early exercise of options, and volatility (cf. IFRS 2.47).