

AMF recommendation 2009-28

Financial statements 2009

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

The financial crisis has had a major impact throughout the past year. The financial outlook for listed companies has worsened sharply, owing among other things to financing problems and also to a contraction in business in many sectors of the economy. And although there are promising signs that the situation might improve in the months ahead, the forecasts are still clouded by considerable uncertainty.

In this difficult environment, the quality of the financial information contained in annual accounts is vital for investors, who will pay particular attention to the clarity of the financial statements submitted to them. They will closely monitor trends reflected in indicators such as sales and cash positions. Moreover, given the economic and financial context, they will carefully scrutinise disclosures about financial instruments and the main estimates made by management for the year-end accounting close.

For these reasons, as the 2009 year-end approaches, the AMF wishes to draw the attention of issuers to the following topics:

- the consequences of the financial crisis, not only with regard to financial instruments and commitments, but also to how the deteriorating economic situation might affect other key financial statement items (e.g. measurement of impairment losses on assets, post-employment commitments, or the deferred tax position);
- the quality of the information presenting the year's performance and changes in the cash position;
- transactions affecting the consolidation scope of corporate groups (with particular reference to the revised standard on business combinations);
- new standards and interpretations.

Some of these topics are similar to those addressed for the 2008 year-end close. This is partly due to the fact that the general environment remains highly uncertain. But it also stems from the observation that the information provided by issuers is not always satisfactory, despite the AMF's recommendations stressing the importance of certain data that are explicitly required under International Financial Reporting Standards.

The AMF has a statutory remit to "safeguard investments in financial instruments and in all other savings and investment vehicles, ensure that investors receive material information, and maintain orderly financial markets". This means ensuring that disclosures meet the level of quality required by law.

Any and all information provided by an issuer –regardless of the medium, the form or the area concerned– must be accurate, precise and fair. Naturally, those same quality requirements apply to financial and accounting information. Financial statements must be prepared in compliance with accounting standards covering recognition, measurement and, above all, the information to be disclosed in the accompanying notes.

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1. IAS 39 and IFRS 7 – Financial instruments: recognition, measurement and disclosure

On 14 July 2009 the IASB published an exposure draft representing the first phase of the revision of IAS 39. This initial step defined the new categories of financial instruments that will replace the current categories (loans and receivables, assets available for sale, investments held to maturity, assets at fair value, etc.). The IASB plans to publish the final standard in November 2009, so that the new provisions – without being mandatory – can be early adopted for the 2009 accounting period by issuers who wish to do so. Notwithstanding the comments that the IASB may receive on the exposure draft, the AMF feels it would be helpful – in view of the tight publication timetable and the needs of issuers for implementation guidance – to highlight a number of problems in applying the standards for financial instruments that were in force as of the date of the IASB's recommendations.

1.1. IAS 39 – Impairment of available-for-sale instruments (AFS) – equity securities

In the context of the market crisis, information about the criteria used to write down assets classified as “available-for-sale securities” when the portfolio is material is critically important.

On 9 July 2009 the IFRIC discussed a request for guidance that it had received on the meaning of significant or prolonged decline in value. While the IFRIC did not judge it necessary to develop an interpretation, it did highlight a number of practices which are not consistent with IAS 39, and which the preparers of financial statements should take into consideration. These included the following:

- The standard cannot be understood to require the decline in value to be *both* significant and prolonged. Thus, either a significant or a prolonged decline is sufficient to require the recognition of an impairment loss;
- The standard requires an entity to recognise an impairment loss if there is objective evidence of impairment. It states that a significant or prolonged decline in the fair value of an investment in an equity instrument below its cost is also objective evidence of impairment. The IFRIC concluded that when such a decline exists, recognition of an impairment loss is required;
- The existence of a significant or prolonged decline cannot be refuted by forecasts of an expected recovery in market values, regardless of the expected timing of recovery.

The IFRIC also noted that determining what constitutes a significant or prolonged decline is a matter of fact which requires judgement. The IFRIC further noted that an entity should disclose in the notes the judgements upon which its assumption of objective evidence is based.

The importance of providing information on the criteria used in the notes was stressed by the AMF in its *Recommendations Regarding Financial Statements for 2008*. This general point was also made by the regulators (CESR and IOSCO) in their comments to the IFRIC. The AMF wishes to stress the importance of providing this information in 2009 financial statements.

The persistence of certain inappropriate practices (as attested by the CESR's publication of three decisions on this issue on 26 August 2009), leads the AMF to remind companies that – as the IFRIC noted in July 2009 – the notion of prolonged decline should be assessed in relation to the historical cost of the instrument. For example, the AMF considers that the practice of combining a time criterion with a decline expressed as a percentage of historical cost (i.e., the use of criteria in the form: “a decline of X% or a prolonged decline over Y months during which the decline was at least Z%”) is not consistent with IAS 39.61. This approach, when applied to a material investment on which an unrealised loss has been observed over a long period of time, would not ensure that a small decline – that nevertheless results in a material unrealised loss for the issuer – would result in a write-down.

As noted in the CESR comment letter cited above, determining the criteria for recognising a write-down requires the exercise of judgement. The AMF considers that these criteria may, under some circumstances, be permitted to change over time to reflect changes in the environment in which that judgement is exercised. The reasons for any such change should be disclosed. Judgement should also be brought to bear on exceptional cases, such as a sudden and abnormal drop in the stock price on the balance sheet date which does not reflect the normal behaviour of the security, and which may therefore

not call for a write-down. But in no case should the judgement seriously call into question the results obtained from applying the criteria.

In accordance with the principle of materiality defined in IAS 8.8, a prolonged decline does not require the recognition of impairment unless the loss is material in relation to the financial statements.

Other related disclosures in the notes should not be neglected, including:

- a description of the accounting policies applied (IFRS 7.21 and IAS 1.117);
- the reasoning, including the underlying assumptions, on which the company has based its judgement as to whether impairment exists (IAS 1.122-123);
- details of the quantitative criteria used (significant decline in value, prolonged decline in value) to ensure that no impairment is ignored (IAS 1.122-123).

1.2. IAS 39 – Debt restructurings

Some companies have to restructure their debt. Experience has shown that the lack of clear guidance from IAS 39 in this area can cause problems in applying the standard. The AMF wishes to draw the attention of issuers to two specific points.

1.2.1. Accounting treatment of the extinction of debt through the issuance of shares

Renegotiations of financial debt frequently involve the cancellation of some or all of the debt in exchange for shares. Such exchanges are currently not treated clearly by IAS 39. This lack of clarity can result in divergent practices, for example regarding:

- the measurement of equity instruments provided in exchange for debt securities (should they be valued at fair value or not? How should fair value be determined when both the equity securities and the debt securities are quoted?);
- potential differences between the measurement of the equity instruments and the carrying amount of the extinguished debt (should such differences be recognised in profit and loss for the period, or in equity?).

Draft interpretation IFRIC D25 suggests valuing the equity securities issued in exchange for debt at their fair value or at the fair value of the liability extinguished, whichever is more reliably determinable. The IFRIC also proposes that the difference between the measurement of the equity securities and the carrying amount of the extinguished debt should be recognised in profit or loss. It is unlikely, however, that this interpretation could be adopted by the European Union even if it is finalised before the end of the year. Consequently, the AMF wishes to remind issuers of the need to provide information in the notes that will permit the reader to fully understand the approach used, along with an indication (if Interpretation D25 is finalised before the end of the year) of the effect that the accounting treatment adopted by the IFRIC would have had.

1.2.2. Accounting treatment of stock warrants that are redeemable for a variable number of shares

Stock warrants (*Bons de Souscription d'Actions* – BSA) are often issued in connection with debt restructurings to encourage shareholders to accept the terms of the restructuring. This type of structure generally involves terms of exercise that depend on the future performance of the issuer. When the warrants give rise to a fixed number of treasury shares for a fixed amount of shares in cash, they are considered to be equity instruments. However, in accordance with IAS 32.11, when the number of shares for which the warrants are redeemable is variable, they are considered as financial liabilities. There are also structures which provide that each warrant is redeemable for a fixed number of shares (the exercise price of each warrant is fixed), but which make the exercisability of the warrants conditional on achieving predefined objectives. In these cases, the structures should be analysed to determine whether the instrument for which the warrant is redeemed should be recognised as a derivative. The definition of derivatives in IAS 39.9 states that they are instruments whose value changes in response to the change in a specified underlying variable (interest rate, commodity price, financial instrument price, etc.), which may or may not be a financial variable. When the variable is not financial, IAS 39.9 requires, in order for the instrument to be considered a derivative, that this variable not be specific to a party to the contract.

The IFRIC was asked to provide guidance on whether EBITDA should be considered a financial variable when it serves as the basis for determining the number of warrants that can be exercised. The IFRIC noted in January 2007 that opinion on this question was divided, and observed that it was difficult to establish a consensus based on the standards in their current form. It seems likely that companies apply a range of practices. The AMF recommends that issuers disclose how stock warrants are treated with respect to IAS 39. This information is indispensable for understanding the accounting treatment adopted. If the operation is material, the accounting treatment should be disclosed in the notes, along with an assessment of its impact on the financial statements. If the operation has the potential to significantly increase the number of shares, those disclosures should be accompanied by information on the number of warrants in circulation, their terms of exercise, and the maximum dilutive impact they could have.

1.3. Reclassification of financial instruments

In October 2008, the IASB published an amendment to IAS 39 and IFRS 7 which permits certain reclassifications between categories of financial instruments when, at the date of reclassification, it is determined that the market in the instrument has become illiquid. This decision was taken in the light of exceptional circumstances observed during the course of 2008 which resulted in an absence in liquidity in certain financial instruments. In exchange for the ability to make changes in accounting categories, the IASB called for disclosures that would permit financial statement users to understand the scope of the operations involved and the consequences of the reclassifications.

A number of studies, including one by the CESR, have been conducted on the quality of the information provided on such changes in accounting categories. Compared with their European peers, French groups frequently neglected to indicate the amounts recognised through profit and loss for the reclassified instruments in the previous accounting period. French groups can also be distinguished from other European institutions by the fact that they disclosed aggregate information (i.e., a single disclosure consisting of combined information from the various types of reclassifications made¹) rather than providing a breakdown by type of reclassification.

Although French groups' disclosures complied with the standard, they are less transparent and less comprehensive than those furnished by other comparable major financial institutions.

The amendment to IFRS 7 requires the entities concerned to provide these disclosures as long as the instruments that were reclassified remain on the balance sheet. This should be kept in mind when preparing the 2009 financial statements.

The amendment also introduces the possibility of a reclassification based on a change in the issuer's intention to hold the asset (IAS 39.50D and 39.50E). Thus, if financial assets classified in the trading book or as available for sale are no longer quoted on an active market and have the characteristics of loans and receivables (fixed or determinable payments/not quoted on an active market), provided the entity has both the intention and ability to hold them for the foreseeable future or until maturity they may be reclassified in 'loans and receivables'. When a group decides to reclassify assets due to the illiquidity of the market, this should be clearly mentioned in the notes in order to provide the reader with a full understanding of the financial statements. In view of the unusual nature of the market circumstances that lead to such reclassifications, the AMF considers that it would be useful to disclose the following information:

- the asset (or assets, by major category) for which the market(s) is (are) judged to be illiquid;
- the reasons leading to the conclusion that the market has become illiquid;
- the period during which the absence of liquidity has been observed;
- the date as of which the reclassification between categories of financial instruments takes place;
- any other information required by IFRS 7 in the event of a reclassification between categories of financial instruments.

¹ The major French banking groups reclassified financial assets from "fair value through profit or loss" to "loans and receivables", from "available-for-sale securities" to "loans and receivables", and from "fair value through profit or loss" to "available-for-sale securities".

The AMF recommends providing more detailed disclosures, distinguishing by type of reclassification, to be consistent with best practices in Europe. This recommendation applies to reclassifications which were made in 2008 and whose effects are still reflected in the 2009 financial statements, as well as to new reclassifications.

1.4. IFRS 7

The AMF has already stressed several important elements of IFRS 7. Our review of the 2008 financial statements leads us to formulate four additional recommendations.

1.4.1. IFRS 7 prior to the March 2009 amendment – Fair value measurement

Several improvements could be made in the disclosures provided by issuers on their methods for measuring at fair value:

- According to IFRS 7.27(a)², the methods used (as well as the assumptions applied when a valuation technique is used) should be disclosed in the notes. The AMF observes that this has not always been the case;
- According to IFRS 7.28(a), issuers concerned by the recognition of 'day-one profit' should disclose, for each class of financial instrument, the accounting method used to record day-one profits. This level of detail is rarely provided. IAS 39 does not specify how gains or losses beyond 'day one' should be recognised. The AMF believes that it is important for the notes to include a more detailed explanation and justification of the accounting method used.

The IASB's Expert Advisory Panel recommended in October 2008 that valuation models be calibrated periodically in relation to observable market information. The AMF considers that it would be good practice to disclose the frequency with which models are calibrated in this fashion, along with the methods used. Similarly, any recourse to third-party pricing services could be disclosed.

1.4.2. Special purpose entities

The disclosure requirements concerning special purpose entities are spread across several standards dealing with the presentation of financial statements, consolidation, and financial instruments. In general, it is difficult to gauge the exposure of listed companies to this type of entity from their financial statements.

This difficulty is related to the scope of consolidation:

- If the special purpose entity is consolidated, IAS 27.40(c) requires that the consolidated financial statements disclose the nature of the relationship between the parent and the special purpose entity if the parent holds less than half of the special purpose entity. This requirement is consistent with the principle established by IAS 1.122, which requires disclosure in the notes of the judgements that have the most significant effect on the amounts recognised in the financial statements. This principle is also mentioned in IAS 1.123(d);
- IAS 1.123(b) notes that if a special purpose entity is not consolidated, and financial assets or lease assets have been transferred to it, this places the parent in a situation that requires it to make judgements which can materially affect the amounts it recognises in its financial statements. In these circumstances, it is important to disclose the judgements made by management (IAS 1.122). In practice, however, when such disclosures are made they are often very general, and do not identify the judgements that have the greatest impact on determining whether the entity is included in the scope of consolidation. The AMF therefore recommends that when special purpose entities are likely to have a significant impact on the financial statements, they should be identified in the notes in accordance with IAS 1.122, and the accounting treatment of each entity should be disclosed along with the elements justifying that treatment. The disclosures should reflect the principle of materiality defined in IAS 8.8. Groups with a large number of entities of this type should adapt their disclosures, for example by organising information by type of entity, so that the information remains relevant.

² This sub-paragraph became paragraph 27 in the version adopted by the IASB on 5 March 2009.

The AMF also reminds companies that IAS 27.40(f) requires disclosure of the nature and extent of any restrictions on the ability of subsidiaries to transfer funds to the parent. This situation could concern special purpose entities.

1.4.3. IFRS 7 after the March 2009 amendment – Fair value measurement

On 5 March 2009, the IASB issued an amendment to IFRS 7 adopting a number of improvements to address the financial crisis. The most notable of these improvements established a new fair value hierarchy inspired by SFAS 157. The amendment defines three levels of fair value disclosures, depending on whether the instrument is quoted on an active market (level 1), its fair value depends on valuation techniques which are based on observable inputs other than quoted prices (level 2), or its fair value is not based on observable inputs (level 3).

At its 16 July meeting, the Accounting Regulatory Committee voted in favour of a draft European Commission Regulation endorsing this amendment. It appears likely that this text will be adopted before the end of the year and that its application will be mandatory for companies that close their books on 31 December.

Whatever the outcome of the EU's deliberations, however, the AMF considers that the definition of three levels for presenting financial instruments at fair value is compatible with IFRS 7 as it existed prior to the amendment. We therefore believe that this type of presentation can and should be used, even if it has not been formally adopted by the European Union by year-end. The AMF calls the attention of issuers to the need to comply with the new disclosure requirements on fair value when they become applicable in the European Union.

IFRS 7.27B requires the following disclosures:

- any significant transfers between level 1 and level 2 (IFRS 7.27B(b));
- any transfers into or out of level 3 and the reasons for those transfers (IFRS 7.27B(c));
- for level 3, a reconciliation between opening and closing balances, disclosing separately total gains or losses for the period recognised in profit or loss or in other comprehensive income; purchases, sales, issues and settlements during the period; and transfers into or out of level 3 (IFRS 7.27B(c));
- an indication of the sensitivity of level 3 values to the unobservable inputs used, if changing one or more of the inputs would change fair value significantly (IFRS 7.27B(e))³.

1.4.4. IFRS 7 after the March 2009 amendment – Disclosures relating to the liquidity risk associated with financial liabilities

The amended version of IFRS 7 strengthens the disclosure requirements for financial liabilities. The amended definition of liquidity risk clarifies that this risk arises from the obligation to deliver cash or other financial assets to a third party. IFRS 7.39 refines the requirement to provide a maturity analysis, specifying that separate maturity analyses shall be required for derivative and non-derivative financial liabilities⁴.

The amended standard specifies that the analysis of the contractual maturity of non-derivative financial liabilities shall include financial guarantee contracts issued by the entity (IFRS 7.39(a)), and that the analysis of the contractual maturity of derivative instruments shall include derivative contracts whose contractual maturities are essential for understanding the timing of future cash flows (IFRS 7.39(b))⁵.

2. IFRS 4 – Insurance contracts – Deferred profit sharing assets

³ Similar disclosures were already required by IFRS 7.27(c) for financial instruments whose valuation relies on assumptions that are not based directly on market transactions.

⁴ This requirement already existed in IFRS 7.B15, which called for these disclosures when appropriate.

⁵ This requirement already existed in paragraph B15 of the IFRS 7 application guidance, which called for these disclosures when appropriate.

The year 2008 was the first time that a large proportion of companies in the life insurance business were observed to book so-called deferred participation assets (*Participation aux Bénéfices Différée Active*, PBDA). Deferred participations are used only in life insurance contracts and financial contracts containing a 'discretionary participation' clause. Deferred participation refers to the right of the policyholder to a share of a future unrealised gain or loss allocated to the policyholder's contract. This participation is referred to as a "liability" in the case of an unrealised gain and an "asset" in the case of an unrealised loss. The accounting treatment of deferred participation assets is based on French regulation CRC 2000-05, which applies as transitional provisions of IFRS 4, and on an analogy with the application of the accounting principles for deferred tax assets and liabilities under IAS 12.

On 19 December 2008 the French National Accounting Board (*Conseil National de la Comptabilité – CNC*) published a recommendation on "the methods for recognising deferred participation assets in the consolidated or combined financial statements of insurance companies that apply the principles of current French accounting standards to the publication of consolidated financial statements under IFRS". The CNC recommendation sought to clarify, in the light of recent market conditions, how insurance companies that use French accounting principles for recognising insurance contracts in their 2008 consolidated financial statements should interpret the notion contained in Article 3112 of Regulation CRC 2000-05 that a deferred participation asset is "highly likely" to be allocated to future participation (actual or potential). The recommendation specified the methods for recognising a deferred participation asset, the analysis that should be conducted on the recoverability of this asset, and the disclosures to be made in the notes that would permit users to understand the nature, accounting methods, and risks arising from the principal uncertainties in the estimates of the deferred participation asset.

On this last point, the CNC recommended that issuers disclose:

- the nature of deferred participation recorded in assets and resulting from the effect of unrealised investment losses on the rights of policyholders under contractual and regulatory with-profit clauses;
- the accounting method applied;
- the procedure used to set the assumptions that have the greatest impact on the amounts booked;
- trends in the amounts of the deferred participation assets booked, specifying the items that materially affect the amounts recognised in comparison with the previous accounting period, and distinguishing items related to:
 - o the realisation of gains or losses on the investments,
 - o variations in unrealised gains and losses resulting from market movements,
 - o changes in the assumptions regarding the insurer's ability and intention to allocate unrealised losses to policyholders;
- information on the sensitivity to insurance risk (for deferred participation assets booked);
- assumptions and estimates regarding the behaviour of policyholders (trends in policy surrenders and inflows), which form the basis for the calculation, as well as the sensitivity of these figures and the reasons for the sensitivity.

A review of the disclosures made by the principal institutions concerned at year-end 2008 reveals widely diverging practices as regards the amount of information provided in the notes on the methods for recognising this type of asset. Generally speaking, the disclosures did not comply satisfactorily with the CNC recommendation, as little information was provided on the methods for recognising this asset. This was particularly the case for insurance companies as opposed to banking groups. While insurers reported the amount of deferred participation assets on a separate line on the balance sheet⁶, the information they provided in the notes was not sufficient to permit the user to understand how they justified the recoverability of these assets. The allocation against future participation rights was not clearly explained.

The AMF therefore recommends that the issuers concerned apply the CNC recommendation in this area. Specifically, they should:

- provide specific information on the methodology used to justify the recoverability of deferred participation assets;
- indicate the assumptions made and the tests applied;

⁶ This is something that banking groups which conduct insurance business should also do if they apply recommendation CNC 2009 R-04 (item 13 on the balance sheet).

- indicate the sensitivity to the principal assumptions;
- provide information on trends in the amounts of deferred participation assets.

3. Business combinations and consolidation

3.1. Early application of IFRS 3R – Business combinations

The revised standard on business combinations was approved by the European Commission on 3 June 2009. This standard is mandatory for accounting periods beginning on or after 1 July 2009, which means that many French issuers will not be required to apply it before 2010. However, early application is permitted.

Under the terms of the Commission's decision, it is possible to apply the revised standard to the 2009 accounting period. IFRS 3R.64 states, however, that if an entity opts for early application of the revised standard, it must apply the revised standard to the entire accounting period. Thus, a business whose balance sheet date is 31 December that wishes to use this option after the publication of its accounts for the first quarter or first half of 2009, will need to restate all business combinations recognised under the previous standard in the interim period. In light of IAS 8.15, it seems that entities cannot apply the previous standard to one part of the accounting period (e.g., the first quarter or half-year) and the revised standard to the rest of the accounting period.

This interpretation is supported by the decision of the IFRIC in July 2009 to reject a request for an interpretation on this issue on the grounds that IFRS 3R and IAS 8 are sufficiently explicit on this point.

3.2. Absence of early application of IFRS 3R for 2009

Issuers that choose not to apply IFRS 3R to their 2009 financial statements are reminded that IAS 8.30(a) requires them to mention in the notes that the entity does not apply a standard which has been issued but which is not yet effective.

In addition, IAS 8.30(b) requires them to disclose known or reasonably estimable information relevant to assessing the possible impact that application of the new IFRS could have on the entity's financial statements in the period of initial application.

In view of:

- the prospective (as opposed to retrospective) nature of the initial application of IFRS 3R,
- and the obvious difficulties that issuers would have in making disclosures concerning business combinations planned for the following accounting period (2010),

the AMF is of the view that no detailed disclosures beyond those provided under IAS 8.30(a) is necessary.

3.3. Acquisitions prior to the effective date of IFRS 3R

IFRS 3R.65 does not require entities to restate the value of assets and liabilities arising from business combinations for which the acquisition of control predates the initial application of IFRS 3R⁷. Given the changes in the treatment of assets and liabilities of the acquired entity introduced by the revised standard, this provision has the effect of retaining on the balance sheet certain previously booked items such as contingent liabilities, even if they do not conform to the new standard.

Concerning deferred taxes acquired in a business combination, in accordance with IAS 12.68, a change in the value of a deferred tax asset during the goodwill allocation period should be recorded against goodwill if it is due to new information concerning the situation which existed at the time control was acquired. Since this concerns retrospective application, it could lead to a change in the comparative accounts. In all other cases, such a change will result in the recognition of a gain or loss in the income statement.

⁷ There is one exception: IFRS 3R.67 provides that value adjustments to deferred tax assets are recorded in profit and loss, to reflect the revision of IAS 12.68.

3.4. Put options on minority interests recorded prior to the effective date of IFRS 3R and IAS 27R using the ‘partial goodwill’ method

The ‘partial goodwill’ method, which is one of the methods considered acceptable given the lack of guidance in the current standards, results in recording a liability for the put options issued, the counterpart of this liability being:

- the elimination of the carrying amount of the corresponding minority interests, and
- the recognition of partial goodwill.

As mentioned earlier, IFRS 3R.65 does not require assets and liabilities arising from a previous business combination to be restated on first-time application of the new standard.

The formulation adopted by the IASB raises at least two questions:

- what should be the treatment of a put option issued between the date that control was acquired and the date of initial application of IFRS 3R? Could a put option issued after the date that control was acquired be treated as unrelated to the business combination, and therefore excluded from the scope of application of IFRS 3R.65?
- to the extent that IFRS 3R.65 deals only with the initial accounting on first-time application of the revised standard, could an entity continue to apply its previous accounting methods to business combinations that occurred before the first-time application of IFRS 3R (and thus continue to use several different accounting methods for business combinations)?

Regarding the first question, the AMF considers that the lack of guidance in the standard means that several different accounting treatments are permitted⁸:

- a group could apply the principles of IFRS 3R to a put option issued between the date that control was acquired and the date of first-time application of the new standard;
- it could also, consistent with the accounting method used up to the date of first-time application of IFRS 3R, record the put option using the partial goodwill method (and therefore recognise partial goodwill on the put).

Regarding the second question, IFRS 3R.64 limits the application of the principles established by the new standard to new business combinations that occur after the beginning of the accounting period for which the revised standard is adopted. In the absence of more detailed guidance from the IASB on this point, it seems to us that goodwill recorded previously in connection with the recognition of the put options could be retained. This would result in earlier and later business combinations being treated differently. The AMF recommends in this case that issuers distinguish clearly in their notes the treatment applied to earlier business combinations (particularly those involving put options on minority interests).

3.5. Put options on minority interests issued after the effective date of IFRS 3R and IAS 27R: subsequent changes in debt

IAS 27R.30 (and BC41) provides that transactions between the controlling shareholder and minority interests which involve equity instruments but which have no effect on control, should henceforth be recorded as reclassifications within equity. These transactions therefore have no effect on the income statement.

However, as noted in past AMF recommendations, a put option on minority interests constitutes a financial liability within the meaning of IAS 39. According to IAS 39.AG8, any subsequent change in the fair value of a financial liability resulting from revisions to estimated future cash flows must be recognised in the income statement.

⁸ It seems to us, however, that when this issue concerns several put options on minority interests, the issuer should apply the same approach to all of the put options, based either on the accounting method used prior to the application of the revised standard, or on the revised standard.

A put option whose exercise price corresponds to the fair value of the instrument sold does not transfer to the issuer of the put option the risks and rewards associated with control. Recording changes in fair value in profit or loss within the accounts of the issuer would be equivalent, in a sense, to considering that the issuer of the put bears the risks and rewards associated with control.

IAS 27R therefore appears to raise two inconsistencies:

- between two IASB standards (IAS 39 and IAS 27R); and
- in relation to the logic applied to the control of consolidated entities.

Given that IAS 27R is more recent than IAS 39 and more accurately reflects the principles espoused by the IASB, and also that IAS 27R better reflects the economic reality of this type of transaction, the AMF considers that subsequent changes in the fair value of this type of liability should not affect the income statement. Nevertheless, since an alternative treatment is implicitly permitted by the existence of two standards, either of which might be applied, the issuers concerned should include in the notes an explanation of the accounting method used.

3.6. Accounting treatment of acquisition costs

A major difference between the revised version of IFRS 3 and the version adopted in 2004 concerns the accounting treatment of acquisition costs. While the original standard required that these costs be recorded as part of the cost of the transaction, under the revised standard they should be recorded in the income statement as it does not consider them to be part of the transaction between the acquirer and the seller.

However, given the lengthy period of time that may be needed to complete a business combination, some issuers may have conducted transactions and incurred certain acquisition costs while the 2004 standard still applied and certain costs that should be recognised under the revised standard. When the IFRIC was asked to clarify the treatment of these costs, it recognised that various interpretations were possible. However, in view of the short period of time during which divergent practices could exist, the IFRIC decided in July 2009 not to address this question. The AMF concurs with the IFRIC in recommending that issuers confronted with this situation provide a detailed description of their accounting policies in this area, and clearly identify the amounts recorded for acquisition costs.

The AMF would like to note, however, that it does not consider all of the practices that were mentioned by the IFRIC technical staff in the staff paper for the meeting (but which were not reproduced in the official publication) to be reasonable. One of the treatments envisaged would consist of capitalising the cost of a business combination in 2009, as permitted by the original IFRS 3, and then eliminating these costs in 2010 through adjustments to equity. Such a treatment does not seem to us to be consistent with the standards, since it would amount to applying a change in accounting method retrospectively, whereas the revised standard is to be applied prospectively.

4. IAS 36 – Impairment of assets

The issue of asset impairment is critically important in light of the ratio of intangible assets to equity. At the end of 2008 the ratio for industrial and commercial firms in the CAC 40 was a significant 75%, compared with 77% the previous year.

In its past recommendations, the AMF has discussed at length the disclosures to be made for impairment testing and its impact on financial statements. The AMF carried out a broad-ranging study on IAS 36 disclosures made by the 60 largest issuers listed on the Paris stock market. Based on this analysis of financial statements for 2008, we identified a number of areas where financial reporting could be improved.

4.1. Disclosures required by paragraphs 134 and 135 of IAS 36

Paragraphs 134 and 135 of IAS 36 set out the disclosures required by the IASB for cash-generating units (CGUs) containing goodwill or intangible assets with indefinite useful lives. In addition to the points emphasised in its recommendation 2006-22 for 2006 financial statements, the AMF wishes to draw issuers' attention to a number of these requirements.

Specifically, the AMF draws attention to points (a) to (f) of paragraph 134, which describe the disclosures required for each cash-generating unit (group of units) for which the carrying amount of goodwill or intangible assets with indefinite useful lives allocated to that unit is significant in comparison with the entity's total carrying amount of goodwill or intangible assets with indefinite useful lives:

- In accordance with points (a) and (b), issuers should indicate the carrying amount of goodwill and intangible assets with indefinite useful lives allocated to the unit (group of units). In practice, we found that issuers often failed to provide this information.

The AMF reminds users that in accordance with IAS 36.80, each unit or group of units to which the goodwill is allocated shall (a) represent the lowest level within the entity at which the goodwill is monitored for internal management purposes; and (b) not be larger than an operating segment as determined in accordance with IFRS 8 – Operating segments. Entities must therefore be able to justify the allocation of goodwill to a group of units or even to an operating segment by their internal goodwill reporting procedures.

Furthermore, the information provided about the methods used to define CGUs is unsatisfactory. Many issuers merely repeat the definition⁹ included in IAS 36.6. However, this information does not give financial statement users a clear idea of the way in which issuers identify CGUs. However, depending on the sector, it is useful to describe the approach adopted. In some industrial firms, for example, CGUs consist of major programmes or models, while in others, CGUs comprise plants. In the retail sector, a description of how CGUs are identified at the level of distribution networks rather than stores is in itself useful information for investors.

- If the unit's (group of units') recoverable amount is based on value in use, the AMF draws issuers' attention to the following disclosures required by IAS 36.134(d):
 - (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/forecasts. Key assumptions are those to which the unit's (group of units') recoverable amount is most sensitive, for example a given sales growth percentage, the price of a barrel of crude, or a country's GDP;
 - (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 (group of units), an explanation of why that longer period is justified. Our analysis showed that issuers often failed to provide this information;
 - (iv) the growth rate used to extrapolate cash flow projections beyond the period covered by the most recent budgets/forecasts, 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 (group of units) is dedicated;
 - (v) the discount rate(s) applied to the cash flow projections. In its review, the AMF found that information provided by issuers was not always satisfactory, and that the disclosures made in the notes regarding the discount rate(s) used were too vague. The AMF considers that entities should not, in theory, disclose a single discount rate for all impairment-tested units (group of units) to which a significant amount of goodwill has been allocated. As paragraph 134 of the standard in fact applies to each unit (group of units), issuers should disclose the discount rate per unit, unless the same rate is used for all of its impairment tests, in which

⁹ "A cash-generating unit is the smallest identifiable group of assets that generates cash inflows that are largely independent of the cash inflows from other assets or group of assets". (IAS 36.6)

case this should be justified in the notes. However, if goodwill is allocated to many different units, the AMF allows issuers to disclose, for example, the discount rate or range of discount rates per geographic area. It should also be noted that while IAS 36 also requires entities to indicate the discount rate used in previous reporting periods, this information is rarely provided.

- Our analysis showed that issuers often provide incomplete information when a unit's (group of units') recoverable amount is based on fair value less costs to sell. The AMF reminds issuers that the application of points (i) and (ii) of IAS 36. 134(e), regarding the description of key assumptions on which fair value less costs to sell is based, allows financial statement users to understand how the fair value of each CGU has been calculated. If the issuer has chosen to determine the fair value of its CGUs using the comparable companies method, it should clearly indicate how the samples have been compiled, what multiple was used and how it was estimated, and whether it is observable on a market.
- The AMF also wishes to recall the provisions of point (f) on the sensitivity of impairment tests to a change in one or more of the criteria used to compute the recoverable amount of CGUs. In accordance with IAS 36.134(f), "if a reasonably possible change in a key assumption on which management has based its determination of the unit's (group of units') recoverable amount would cause the unit's (groups of units') carrying amount to exceed its recoverable amount", the issuer should provide the following information:
 - (i) "the amount by which the unit's (group of units') recoverable amount exceeds its carrying amount;
 - (ii) the value¹⁰ 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 (group of units') recoverable amount to be equal to its carrying amount."

The issuer uses its own judgement to assess whether or not a change in assumption is reasonably possible and to identify key assumptions.

In practice, we found that issuers often failed to provide this information. Most disclosed only the impact that a change in a key assumption would have on the recoverable amount. The disclosure would typically be expressed as "a y change in the discount rate would have an x impact on the calculation of the recoverable amount". However in this specific case, this information alone does not allow financial statement users to gauge the sensitivity of the impairment test to the discount rate used because it does not identify the change that would cause the recoverable amount to fall below the carrying amount. Note that the discount rate is not necessarily the only key assumption covered by the paragraph mentioned above.

4.2. Reallocation of goodwill in the initial application of IFRS 8

IFRS 8 came into force on 1 January 2009. It must initially be applied retrospectively as a change in accounting policy if this affects the definition of operating segments and changes the allocation of goodwill to cash-generating units. In this case, any value adjustments to goodwill resulting from these changes are not included in profit or loss for the period.

Given the potential impact of the revised goodwill allocation on the measurement of future (or in some cases, past) impairment losses, the AMF recalls the recommendation published at the end of 2008¹¹ encouraging issuers in this situation to provide explanations in the notes on how goodwill or portions of goodwill have been reallocated.

4.3. Amendment to IAS 36 published in April 2009

¹⁰ This criterion aims to quantify this assumption.

¹¹ Section 3.3, *Reallocation of goodwill in the initial application of IFRS 8 – AMF Recommendation 2008-22*.

IFRS 8 allows operating segments with similar economic characteristics¹² to be aggregated so that the number of segments presented in the financial statements is less than the number of segments monitored by the chief operating decision maker.

In April 2009, the IASB published an amendment to IAS 36 specifying that cash-generating units (CGUs) or groups of cash-generating units to which goodwill is allocated cannot be larger than an operating segment before aggregation.

Based on the wording of IFRS 8 currently in force in the European Union, some groups had been able to make plans to allocate goodwill to operating segments after aggregation. They will now have to revise this allocation and, where appropriate, adjust the amounts recorded in respect of goodwill impairment losses in 2010.

Even though the April amendment will not be mandatorily effective until 1 January 2010 (prospective application), issuers are encouraged to anticipate the impact it will have as from 2009, since this period will usually represent the first period in which IFRS 8 is adopted. The amendment does not contradict IAS 36, but provides additional guidance that will help avoid widely divergent practices.

4.4. Idle assets and halted or postponed construction projects

In light of the economic difficulties affecting many industries, some issuers have been forced to temporarily shut down production lines or halt/postpone real estate construction projects.

These situations are discussed in IAS 16. 79(a) which recommends that affected entities disclose amounts relating to temporarily idle property, plant and equipment in the notes. However, the AMF concurs with the view expressed by the IFRIC in May 2009, whereby entities are required to provide this information in accordance with IAS 1.112(c) if the assets concerned are material to the entity and are relevant to an understanding of the entity's financial position at the balance sheet date.

Issuers in this situation are also encouraged to state, in accordance with paragraph 134(d)(i), that the most recent cash flow projections used in asset impairment tests reflect the fact that the assets are temporarily idle.

5. IAS 12 – Income taxes

5.1. Impact of the crisis on deferred tax assets

Under IAS 12, the criteria for recognising deferred tax assets arising from the carryforward of unused tax losses and tax credits are the same as the criteria for recognising deferred tax assets arising from deductible temporary differences. However, IAS 12 states that the existence of unused tax losses is strong evidence that future taxable profit may not be available against which the deferred tax assets can be utilised (IAS 12.35). Entities should therefore consider the following criteria in assessing the probability that taxable profit will be available against which the unused tax losses or unused tax credits can be utilised:

- whether the entity has sufficient taxable temporary differences which will result in taxable amounts in the future (IAS 12.36(a));
- whether the unused tax losses result from identifiable causes which are unlikely to recur (IAS 12.36(c));
- whether tax planning opportunities are available to the entity that will create taxable profit in the period in which the unused tax losses or unused tax credits can be utilised (IAS 12.36(d)).

These criteria are to be considered along with the principle set out in paragraph 36(b): whether it is probable that the entity will have taxable profits before the unused tax losses or unused tax credits expire.

¹² See the five criteria for determining whether operating segments have similar economic characteristics set out in paragraph 12 of IFRS 8.

This requires entities to use their own judgement, since losses can be carried forward indefinitely and business plans are often based on a variety of assumptions. When significant uncertainties exist as to the economic outlook, the risk that these assumptions will not materialise increases. The probable nature of the forecasts is therefore more difficult to establish. As a result, the AMF recommends that the issuers concerned base their approach on recent business forecasts (drawn up as close as possible to year-end) in order to limit the risk that the assumptions will no longer be valid. It also recommends that these issuers' note disclosures should include details of the main assumptions used (including the timeframe for estimating future profits), uncertainties relating to the forecasting process (see also IAS 1.125), and the date on which the forecasts and assumptions were last reviewed.

These recommendations apply both to deferred tax assets arising on tax losses incurred in the current period and to impairment tests to be performed on deferred tax assets arising on tax losses carried forward from prior periods.

5.2. Potential impact of the crisis on deferred tax liabilities

IAS 12.39 states that a parent company should not recognise deferred tax liabilities on temporary differences relating to group entities when it is able to control the timing of the reversal of the temporary differences and it is probable that the temporary differences will not reverse in the foreseeable future. Accordingly, no deferred taxes are generally recognised on subsidiaries and consolidated undertakings in respect of translation differences and retained earnings.

The financial crisis and tight lending conditions could change this practice, and it may be necessary for parent companies to obtain dividends from their foreign subsidiaries. In this case, if dividends are taxed in the country in which the subsidiary is based, a deferred tax liability should be recognised on the planned dividend payout. Similarly, if an entity is planning to sell a foreign operation, the criteria set out in IAS 12.39 should be considered to determine whether deferred taxes should be recognised on translation differences and retained earnings carried in reserves.

6. IAS 2 – Inventories

6.1. Accounting for low production levels

IAS 2.13 indicates that the production cost of inventories is based on the normal capacity of production facilities. This paragraph also states that the amount of fixed overhead allocated to each unit of production is not increased as a consequence of low production or idle plant. Unallocated overheads are recognised as an expense in the period in which they are incurred. Paragraph 16 of the same standard states that "abnormal amounts of wasted materials, labour or other production costs" must be excluded from the cost of inventories.

Given the sharp decline in production for certain sectors in 2009, issuers confronted with this problem are expected to provide details of the measurement bases used in preparing the financial statements (IAS 1.117) in order to explain how these low production levels were accounted for (i.e. excluded from the cost of inventories).

6.2. Adapting impairment tests to the economic slowdown observed in certain sectors

Some sectors have seen a significant drop in activity over recent months and inventory levels are down sharply in certain firms. These entities have sometimes chosen to halt production in order to stem the cash burn, while others have opted to continue production in a reduced capacity to prepare for an upturn in business over the coming months.

In the current climate of economic uncertainty, inventory impairment tests at year-end 2009 will be critical for some entities in preparing their financial statements. The AMF considers that the issuers concerned should pay particular attention to these tests and to the underlying assumptions. These assumptions may

have to be adjusted to reflect changes in market conditions that had not been anticipated at the end of 2008 or the longer period that may be required to run down inventories compared with 12 months earlier.

In accordance with IAS 1.125, the AMF recommends that these issuers provide detailed information on the risks associated with key assumptions, in particular:

- the nature of the assets and liabilities to which the risks relate (IAS 1.125(a));
- their carrying amounts at the end of the reporting period.

7. IAS 1 and IAS 7 – Presentation of financial statements and cash flow statements

7.1. Revision of IAS 1 – Presentation of financial statements – effective as of 1 January 2009

The revised version of IAS 1 is effective for reporting periods beginning on or after 1 January 2009. The main changes introduced by the revised standard require entities to present:

- a statement of comprehensive income for the period (IAS 1R.10.b);
- a statement of financial position (or balance sheet) as at the beginning of the earliest comparative period when an entity applies an accounting policy retrospectively or makes a retrospective restatement of items in its financial statements (IAS 1R.10.f);
- the amount of income tax relating to each component of other comprehensive income, either in the statement of comprehensive income or in the notes (IAS 1R.90);
- reclassification adjustments relating to components of other comprehensive income (IAS 1R. 92).

The statement of comprehensive income should include the components of profit or loss (recognised income and expenses) as well as the components of other comprehensive income. Entities may present either a single statement or two statements, in which case the second statement is to be presented immediately after the first. The components of other comprehensive income are:

- changes in the revaluation surplus (IAS 16 et IAS 38);
- actuarial gains and losses, where appropriate (IAS 19);
- gains and losses arising from translating the financial statements of a foreign operation (IAS 21);
- the share of changes in comprehensive income from associates accounted for using the equity method (IAS 28 and IAS 31);
- gains and losses on remeasuring available-for-sale financial assets (IAS 39);
- the effective portion of gains and losses on hedging instruments (IAS 39).

The AMF draws issuers' attention to the following CNC publications dated 2 July 2009:

- Recommendation 2009-R-03 on the format of financial statements for entities applying international accounting standards (excluding banks and insurance companies), which replaces Recommendation 2004-R-02 of 27 October 2004;
- Recommendation 2009-R-04 on the format of financial statements for credit institutions and investment firms applying international accounting standards, which replaces Recommendation 2004-R-03 of 27 October 2004;
- Recommendation 2009-R-05 on the format of financial statements for insurance firms applying international accounting standards, which replaces Recommendation 2006-R-01 of 30 June 2006 and Recommendation 2005-R-01 of 24 March 2005.

These three recommendations reflect and explain the new requirements of IAS 1.

7.2. Presentation of the income statement: other income and expenses, finance costs

The AMF draws issuers' attention to IAS 1.86, according to which income and expenses may not be offset in the statement of comprehensive income unless they meet the conditions set out in paragraph 32 of the standard (i.e. offsetting is explicitly required or permitted by another standard). As a result, IAS 1 does not allow any line showing "other income and expenses" in the statement of comprehensive income. These items should therefore be presented separately. In accordance with IAS 1.85, if any component of "other income" or "other expenses" is material, it should be disclosed to users on a separate line of the financial statements.

Issuers should also note that IAS 1.82 requires separate presentation of “finance costs” in the statement of comprehensive income. Entities are not however prevented from including a sub-total reflecting net costs of debt whenever income and expenses are presented separately.

As indicated in paragraph 72 of the IFRS conceptual framework, issuers tend to distinguish between operating and non-operating income and expenses. As permitted by IAS 1.85, many issuers present an intermediate line within the statement of comprehensive income showing “net operating income”. This provides a clearer picture of income and expenses generated by operating activities. The AMF wishes to remind issuers that all the operating income and expenses (including goodwill impairment losses) are to be included within net operating income.

7.3. Repayment clauses

In its *Recommendations Regarding Financial Statements For 2008*, the AMF drew issuers’ attention to the consequences of repayment clauses triggered by a failure to respect financial ratios in covenants¹³. The AMF stated that failure to comply with a covenant could require issuers to reclassify the related debt within current liabilities. Accordingly, those issuers concerned were encouraged to analyse their situation several months before the balance sheet date in order to identify clauses that could lead to a risk of default. This would allow them to take preventive action, as necessary, in order to eliminate the risk at year-end. These recommendations continue to apply in the current economic climate.

The AMF recommends that issuers observe existing best practices in this field.

Given the difficulties encountered in accessing financing, confirmation that no such clauses exist should be provided. Around one-third of listed French companies provide this information.

As the aim of disclosure is to enable financial statement users to evaluate the nature and extent of risks arising from financial instruments (IFRS 7.31), the AMF believes that issuers should provide:

- an indication of the type of contractual clauses that could trigger early repayment (failure to comply with covenants, change of control, etc.);
- a description of the covenants to be met (including the frequency with which compliance will be assessed);
- details of the consequences resulting from a failure to comply with one or more contractual clauses.

7.4. IAS 7 – Cash flow statements

The AMF reviewed a cross-section of information provided by CAC 40 companies on the cash flow statement.

It found that on the whole, issuers presented a detailed breakdown of the different cash flows (from operating, investing and financing activities).

In accordance with IAS 7, entities using the indirect method to present their cash flow statements are required to adjust profit or loss for the effects of transactions of a non-cash nature but without specifying at what level of profit or loss the adjustment has been made. In practice, entities that do not show consolidated profit as the first line of their cash flow statement describe the indicator used and its position within the income statement.

Pursuant to IAS 1.113, issuers should nevertheless endeavour to make the following improvements:

- the main items in the cash flow statement should be cross-referenced with the corresponding notes. For example, a breakdown of the various components comprising changes in working capital (trade receivables, inventories, trade payables) is not always provided;
- similarly, comments should be provided explaining the main movements in cash flows (IAS 1.114(c)).

¹³ Section 5, *Classification of debts as current or non-current liabilities*.

We also found that in practice, the contents of the “cash and cash equivalents” line vary widely. IAS 7 defines cash as cash on hand and demand deposits (IAS 7.6), while cash and cash equivalents are defined as short-term, highly-liquid investments that are readily convertible to known amounts of cash and which are subject to an insignificant risk of changes in value. However, IAS 7.8 indicates that in some countries, bank overdrafts which are repayable on demand form an integral part of an entity’s cash management and that in these circumstances, they are included as a component of “cash and cash equivalents”. Both practices are used by issuers in France.

Over the past few months, investors have placed greater emphasis on cash at hand. We therefore believe that a description should be provided in the notes of the components of cash. Issuers including bank overdrafts in “cash and cash equivalents” must provide detailed disclosures in the notes to allow financial statement users to draw comparisons with other companies. Similarly, issuers including bank overdrafts within cash flows from financing activities should take care to separate overdrafts whenever they are material.

8. IAS 19 – Employee benefits

Accounting for employee benefits, like the treatment applied to financial instruments, involves the use of valuation techniques that rely on numerous assumptions as well as judgement on the part of management. Accordingly, IAS 19 calls for detailed disclosures on retirement benefits, post-employment medical benefits and other long-term employee benefits. When market conditions are difficult, creating greater uncertainty about certain aspects of valuation, it is important to have information¹⁴ about methods and assumptions, particularly if funded commitments are highly sensitive to small changes in parameters.

For this reason, the AMF carried out a cross-cutting review of disclosures by the 60 largest companies listed in Paris. The study revealed that the following areas were most in need of improvement:

8.1. Information about discount rates

If issuers are present in countries where they have material post-employment liabilities, we would like more precise information on individual geographical regions. Approximately one-third of the companies in our sample supplied an overall discount rate, without providing a breakdown by geographical region. However, such information would be valuable given that large listed groups conduct much of their business abroad.

Where issuers did provide details about discount rates for specific geographical areas, the information was expressed as:

- a single rate per country in virtually all cases;
- a range of rates in about half of all cases where the region in question consists of an entire continent (Europe, euro area, North America, etc.);
- wide ranges for "other" regions (e.g. 4%-8.68%, 1.9%-7.7% or 6.21%-10.24%).

The AMF wishes to draw issuers' attention to IAS 19.120A(n), which states that the actuarial assumptions provided in the notes should not be expressed as ranges. In many cases a range is understandably used as a way to address practical constraints, but if this results in the disclosure of a very wide range, the information provided will no longer be IAS 19 compliant. In such instances, if the information is material and relevant, the AMF recommends that issuers refine the level of detail provided for each geographical region or supply assumptions for a single country if the other countries in the region make non-material contributions.

¹⁴ Some plans involve the allocation of shares and are treated according to paragraph 15 of IFRS 2. In this case, recognition of the expense is spread over the period during which services are rendered. The issuer is required to recognise an expense even if it is highly unlikely that the options will be exercised (for example because the issuer's share price has fallen). It may therefore be useful for the issuer to draw attention to the P&L impact of plans that are well out of the money.

IAS 19.78 states that the rate used to discount post-employment benefit obligations should be determined by reference to market yields on high-quality corporate bonds. In our sample, issuers generally explained which yield they used to determine the discount rate. In many cases, however, they gave a very general indication, such as "the yield on prime corporate bonds". In the AMF's view, it would be good practice to tell users what level of quality was deemed to meet IAS 19 requirements, for example by indicating a rating based on the scale employed by one of the main rating agencies.

Furthermore, we believe that groups whose activities generate material foreign liabilities should break down this information by geographical region.

When issuers determine discount rates by reference to French government bonds, this choice should be disclosed and justified in the notes. Having observed different practices in this area and considering that it is always possible to estimate the yield on high-quality corporate bonds, the IASB published an exposure draft in August 2009 that is intended to prohibit issuers from using government bond yields. The IASB may publish this amendment before the end of the year. If it does, pursuant to IAS 8.30, affected issuers would have to provide the following note disclosures:

- a precise description of and justification for the reference yield and the spread used to estimate the market yield on corporate bonds (along with a description of any other assumptions that can aid understanding of the choice of yield);
- the quantified impact of the new yield on the financial statements.

8.2. Information on the basis used to determine the expected return on plan assets

The vast majority of issuers in the sample provided a breakdown of plan assets by investment medium (equities, property, bonds, etc.). But less than half of companies supplied information about the basis used to estimate the future rate of return on these assets (IAS 19.120A(l)). Only a handful of issuers provided detailed information in this area with a breakdown by investment medium.

8.3. Sensitivity analysis for parameters used to calculate liabilities

Around one-half of issuers in the sample provided a sensitivity analysis for the parameters used to calculate liabilities. IAS 19.120 requires issuers to provide information that can be used to evaluate the nature of their liabilities and the effects of those liabilities during the period. In this regard, information about the main sources of uncertainty surrounding estimates, notably the choice of discount rate, the estimated future rate of return on plan assets, or the forecast increase in payroll over the remaining life of the plan, is generally useful, particularly when markets are extremely volatile.

The study found that in most cases the discount rate was the only source of uncertainty for which issuers felt it necessary to provide a sensitivity analysis. Given the high levels of volatility on stock markets as well as property markets, it could be useful to supplement this information with an analysis of sensitivity to the rate of return on assets.

8.4. Retrospective information concerning post-employment benefits

8.4.1. General information about plans

Entities are asked to provide information on the present value of obligations, the fair value of plan assets, as well as the surplus or deficit in the plan for the current period and the previous four annual periods (IAS 19.120A(p)(i)). In practice, a small minority of issuers proceeded with early application of this amendment, which was introduced in 2006, and thus supplied information on the required five years.

8.4.2. Information about experience adjustments

Only one-half of the companies in the sample gave information about experience adjustments arising on plan liabilities and assets (IAS 19.120A(p)(ii)). The vast majority of companies that provided this information expressed it as an amount. Only a few companies provided both an amount and a percentage

(which we view as the way to provide the most relevant information). Moreover, just one-third of the companies that did disclose this information included information on the previous four annual periods, for the reason mentioned in the previous paragraph.

9. New standards and interpretations

9.1. Amendment to IAS 23 – Borrowing costs

The main change introduced by the adoption of the revised version of IAS 23 is that a single accounting treatment¹⁵ – capitalisation of borrowing costs – now applies to qualifying assets, i.e. those that necessarily take a long time to construct or produce. Because in practice few French issuers have opted to capitalise borrowing costs, the AMF wishes to draw attention to the procedures for first-time application of the revised standard.

The transitional provisions for first-time application include two options:

- revised IAS 23 is applied to borrowing costs relating to qualifying assets for which the commencement date for capitalisation is on or after the date on which the standard came into effect, i.e. 1 January 2009; or
- the issuer selects a date before the entry into force of the standard from which borrowing costs relating to all new qualifying assets must be capitalised.

In accordance with IAS 23.29, entities should specify which method is used to make the transition.

9.2. IFRS 8 – Operating segments

Application of IFRS 8 – *Operating segments* is mandatory for periods beginning on or after 1 January 2009. Although early application was allowed, in practice relatively few French issuers made use of the option. We feel it is therefore worth recalling that under IFRS 8.36 comparative information must be provided in respect of the previous period when the standard is applied for the first time.

Furthermore, although not many issuers apply this standard yet, a number of application-related issues have been identified and warrant particular attention. One key question concerns the definition and scope of sectors, which could change materially in the switch from the old to the new standard. Another noteworthy change is the option of using different accounting methods from those used in the IFRS accounting framework to present the performance of operating segments. The AMF included solutions in its recommendations regarding the 2008 financial statements that issuers can use to address these issues when applying the standard for the first time in 2009.

Some issuers indicated in disclosures published at 31 December 2008 or in connection with their 2009 interim statements that application of IFRS 8 had resulted in changes to operating segments. As a rule, however, because the explanations provided were often couched in very general terms, it was impossible to tell what these changes were. Under IFRS 8.36, a comparison based on restated 2008 data per operating segment is required. If, as IFRS 8.36 states, the necessary information is unavailable or would be too costly to prepare, the AMF feels that a detailed explanation about changes to sectors between 2008 and 2009 should be provided (see also paragraph 4.2 above concerning the reallocation of goodwill).

9.3. IFRIC 12 – Service concession agreements

On 25 March 2009 the European Commission endorsed interpretation IFRIC 12 – *Service concession agreements*. Because of the delay in adopting the interpretation, the mandatory application date for the standard adopted by the European Union (financial periods beginning on or after 29 March 2009) comes after that set by the IASB (financial periods beginning on or after 1 January 2008). This means that groups

¹⁵ The old version of IAS 23 left open the choice between capitalising and expensing costs.



whose financial year follows the calendar year will not apply IFRIC 12 until 2010. However, the European Union does allow early application.

The AMF reminds issuers that do not opt for early application that under IAS 8.30 they are required to provide information on the impact that application of IFRIC 12 would have on their financial statements, to the extent that this information is known or reasonably estimable.

10. Directive 2009/49/EC of 18 June 2009 on the obligation to draw up consolidated accounts

On 18 June 2009 the European Parliament and the Council adopted Directive 2009/49/EC, which amended the Seventh Directive (83/349/EEC) on the obligation to draw up consolidated accounts in certain circumstances. The new directive states that undertakings having only subsidiary undertakings considered as not being material, both individually and as a whole, shall be exempted from the obligation to draw up consolidated accounts.

The directive clarifies the situation of companies that are listed on a regulated market and that have one or more immaterial subsidiaries. Whereas Article 13 of the Seventh Directive exempted this type of company from drawing up consolidated accounts, Regulation (EC) 1606/2002, which requires companies listed on a regulated market to apply IFRS, did not refer to Article 13 of the Seventh Directive to say which listed companies were exempted from preparing IFRS-compliant accounts.

Once the change to the Seventh Directive is transposed into French law, the affected companies will no longer be required to draw up consolidated accounts and may, if they choose, prepare only parent-company accounts in accordance with the French accounting framework.