

AMF recommendation
2015 Financial Statements - DOC-2015-08

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

Drafting and interpreting the international financial reporting standards is the exclusive role of the IASB and the IFRS Interpretations Committee (IFRS IC).

However, the AMF, like ESMA and other European regulators, seeks to identify, before each year end, those topics which seem the most important in the given situation, in order to draw the attention of listed companies and their statutory auditors to them, thereby contributing to disclosure of good-quality accounting and financial information.

In several of the recommendations cited in the present document, the AMF asks companies to provide descriptions or explanations in the notes to their financial statements. Not all of the issues arising from particular standards will be relevant to all companies. The level of detail should be commensurate with importance of the items dealt with in the notes, so as to highlight relevant information.

The issues addressed this year are discussed below.

The importance of relevant, consistent and readable information

All the European regulators support the projects underway to restore meaning to financial disclosure and to financial statements in particular.

The AMF draws attention to its Guide to the relevance, consistency and readability of financial statements¹. The Guide is aimed at helping companies prepare their financial statements by suggesting ways of improving their relevance, consistency and readability, illustrated with excerpts from real financial statements prepared by companies that have made successful efforts to improve their financial information. The AMF believes that improving the quality of financial information is a particularly important objective and is willing to discuss the issue with companies and their statutory auditors.

ESMA has also published a *Statement*² that reiterates these same themes and emphasises their importance to the regulators.

Relationship with ESMA priorities

As in previous years, ESMA has identified common priorities for 2015 at European level³. They are the impact of market conditions on the financial statements, statement of cash flows and fair value measurement and related disclosures.

As far as the accounting impact of market conditions is concerned, the AMF recommendations discussed below are very close to ESMA recommendations. References to the ESMA document are intended to facilitate comparisons between it and AMF recommendations.

Reference is made in our recommendations and in the ESMA document to extracts from the EECS's Database of Enforcement published by ESMA. These extracts describe certain decisions made by European regulators on IFRS implementation in the context of enforcing corporate financial information.

¹<http://www.amf-france.org/Publications/Guides/Professionnels.html?docId=workspace%3A%2F%2FSpacesStore%2F867e30e0-807f-437c-af31-ee2686d81c4e>

² http://www.esma.europa.eu/system/files/2015-esma-1609_esma_public_statement_-_improving_disclosures.pdf

³ https://www.esma.europa.eu/system/files/2015-1608_esma_public_statement_-_ecep_2015.pdf

Concerning the statement of cash flows, the points raised by ESMA are consistent with AMF recommendations in previous years⁴:

- The importance of reconciliations between the cash flow statement and other parts of the financial statements (2012 recommendations, part 6.1.1)
- The classification of certain cash flows: definition of cash flows from operating activities (2014 recommendations part 4.3), classification where there is a choice of presentation (2014 AMF recommendations part 4.2)
- A reminder on transactions without an effect on cash flows and netting principles (2014 AMF recommendations part 4.1)
- The criteria for qualification as cash and cash equivalents (2011 AMF recommendations part 1.1.1)

The cash flow statement is a key element in the understanding and analysis of the company's financing and investment policy. Investors and analysts believe that the information contained in the cash flow statement can be improved, and the AMF encourages companies to continue their efforts in this regard.

As far as fair value measurement is concerned, ESMA notes the importance of maximising the use of relevant observable inputs, and particularly the use of unadjusted quoted prices where there is an active market⁵. It also calls on companies to provide detailed information on the methodology and assumptions used to determine level 2 or 3 fair value.

Working capital management

The AMF invites companies to take note of ESMA's priorities and has deemed it useful to add a specific theme on working capital management, including reverse factoring. These operations are becoming more widespread in corporate finance and offer alternative or complementary solutions to bank borrowing or the capital markets. As the principles on accounting for and presenting these operations in financial statements are not very explicit, the AMF intends to raise awareness around this matter among companies via its recommendations and invites them to describe certain choices they make in preparing their financial statements.

The AMF's review of corporate reporting

ESMA guidelines on enforcement of financial information require European market regulators to issue periodic, public reports on their national enforcement activities from 1 January 2015 onwards.

The AMF has therefore decided to publish details of its review of financial statements in its year-end recommendations, together with quantitative data on its work and the conclusions drawn from them. This presentation appears in the final part of this document. It includes information on the main themes of specific AMF recommendations to companies upon the conclusion of its reviews.

⁴<http://www.amf-france.org/Reglementation/Doctrine/Doctrine-list.html?category=I+-+Emetteurs+et+information+financi%C3%A8re>

⁵ Cf. 16th Extract from the EECS's Database of Enforcement (Decision EECS/0214-02), ESMA, 18 November 2014; 17th Extract from the EECS's Database of Enforcement (Decision ref EECS/0115-03), ESMA, 21 July 2015

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1 Accounting impacts caused by the economic environment

[Adapting information presented in the financial statements to economic conditions, in particular, and the link with items concerning financial communications relates to strong demand from analysts and investors]

IAS 1.9 states that “The objective of financial statements is to provide information about the financial position, financial performance and cash flows of an entity that is useful to a wide range of users in making economic decisions. »

For some companies, general volatility and/or the low level of certain economic assets (interest rates, oil, etc.) can lead to a deterioration or an improvement in their performance and financial position. These effects vary according to the company and its particular characteristics.

The AMF notes that in accordance with IAS 1.125, companies must explain in the notes to their financial statements the judgements made and key assumptions used, together with sensitivity analyses when their impact on the financial statements is material over the period (e.g. asset depreciation or increases in liabilities).

cf. ESMA page 2, “Impact of the financial markets conditions in the financial statements”, paragraph 2

Recommendation

When a company has material exposure to volatile underlying economic assets (commodities, currencies) or to countries facing various uncertainties, the AMF recommends that all information provided in the financial statements relating to exposures and their associated risks be grouped within a single note or that references are made to them within the financial statements to make reading and understanding them easier.

cf. ESMA page 2, “Impacts of the financial markets conditions in the financial statements”, paragraph 1

Readers of financial statements are sometimes taken aback by the lack of any explanation in the notes of an exposure to a specific underlying asset (country, a commodity price, exchange rates, etc.) when prior corporate communications led them to believe that the exposure was material. The AMF emphasises that confirmation that a particular factor has not had a material financial impact could be helpful in this situation, and invites companies to consider this sort of text where appropriate.

1.1 Interest rates environment

The present economic environment features low but volatile interest rates. In the euro area, for example, the decline in interest rates observed in 2014 generally continued at the beginning of the first quarter of 2015⁶. In some countries, short-term interest rates even turned negative in certain maturities.

While low rates can reduce the cost of corporate debt and capital, they also automatically increase long-term commitments that are discounted to present value (defined benefit plans, decommissioning provisions etc.) and could influence value in use in impairment reviews.

The present interest-rate environment has to be taken into account in such matters as the determination of the fair value of financial and non-financial assets and liabilities, the recoverable amount used in goodwill impairment tests and the discount rate used for pension commitments and long-term provisions.

The AMF notes that according to IAS 19.145 and IAS 36.134(f), IFRS require the presentation of key assumptions, including the discount rate used and the sensitivity to those assumptions, for defined benefit plans liabilities and for impairment tests when a reasonably possible change in a key operational hypothesis (e.g. revenue, margin or long-term growth rate) or financial hypothesis (e.g. discount rate) could lead the carrying value of the CGU or group of CGU to exceed its recoverable amount.

cf. ESMA page 2, "Interest rate environment", paragraph 3

Recommendation

The AMF recommends that companies with material long-term provisions describe their key assumptions, including the discount rate, together with reasoned justification, as well as a sensitivity of valuation obtained from a change in this rate.

cf. ESMA page 3, "Interest rate environment", paragraph 1

The mean variation in euro area risk-free rates in the 10-year maturity was around 80 basis points in 2013 and 180 basis points in 2014. Yet impairment test sensitivity analyses for almost 40% of CAC 40 companies used a change in the discount rate of +/- 25 basis points or less.

Similarly, and for pension liabilities, the magnitude of the change in the Corporate iBoxx AA 10+ index was almost 75 basis points in 2013 and 170 basis points in 2014. Around 40% of CAC 40 companies provided a sensitivity to a change in the discount rate used of +/-50 basis points or less in 2014.

Recommendation

The AMF invites companies to adapt the sensitivity analysis to the specific context of the end of the accounting period when they determine the reasonably possible variation used in presenting sensitivity to the discount rate. They should also ensure that the reasonably possible variation is consistent with observed historical variability.

cf. ESMA pages 2 and 3, "Interest rate environment", paragraphs 3 and 2

Concerning defined-benefit plans, paragraphs 75 and 78 of IAS 19 indicate that actuarial assumptions shall be unbiased and mutually compatible.

cf. ESMA page 3, "Interest rate environment", paragraph 2

In their 2014 accounts, a third of CAC 40 companies provided information on the geographical area inflation rates used for the wage growth rate.

⁶ For example, the French 10-year government bond yield varied as follows: 1.70% at 30 June 2014, 0.84% at 31 December 2014 and 1.19% at 30 June 2015 (with a trough at 0.36% in mid-April 2015).

Recommendation

For material defined-benefit plans, and when the rate of increase in pay retained is significantly lower than the long-term inflation objective of the geographical area concerned, the AMF recommends describing the methodology used for determining the wage growth rate.

1.2 Commodity prices

Current and future prices of commodities (oil, natural gas, iron ore, etc.) are key variables in the valuation of the assets of some companies.

In a context of low oil prices⁷, analysts need precise information on the impacts on these companies.

Moreover, investment projects can be mothballed or abandoned in expectation of better market conditions, which has depreciation and valuation implications (goodwill, tangible assets, inventories, etc.).

Recommendation

When the impact of changes in commodity prices is material to the financial statements, the AMF invites the companies concerned to provide precise information on that impact (e.g. the impact on key aggregates presented on the face of the company's primary financial statements). It would also be useful to describe the accounting implications of operational decisions taken with regard to market conditions (e.g. project abandonment or postponement).

cf. ESMA page 3, "Exposure to high volatility and low prices for commodities", paragraphs 1 and 2

When the price of a commodity is a key assumption in assessing components of the financial statements (e.g. inventories, tangible or intangible impairment tests, business combinations), the AMF considers that the nature and value of the parameter used should be indicated (e.g. spot or forward price), together with the value retained for this parameter in the business plan and the sensitivity of that assessment to a different change or trend.

cf. ESMA page 3, "Exposure to high volatility and low prices for commodities", paragraph 3

In the case of a high exposure to oil prices, for example, the price change retained could be presented with the time period in which the group expects a return to an equilibrium price and mention of what the group considers the equilibrium price to be.

The sensitivity analysis could show the impact of a slower return to what is considered to be the equilibrium price.

cf. ESMA page 3, "Exposure to high volatility and low prices for commodities", paragraph 3

1.3 Specific risks

Some countries are currently suffering from various uncertainties, including financial difficulties (e.g. Greece), marked political risk (Syria, Ukraine etc.) and currency risks (Venezuela), with exchange controls in some cases (Russia).

French companies may have material exposures to such countries via operating subsidiaries, commercial trades or financial markets.

These risks must be taken into account in the assumptions used for asset or liability valuations (impairment tests, provisions, contingent liabilities, etc.).

Moreover, IFRS 7 requires the presentation of information on credit risk and liquidity risk. Specific information is required for each of these risks, including quantified exposure and details of concentrations of risk.

⁷ Oil prices per barrel: \$114 in mid-June 2014, \$46 in mid-January 2015, \$63 in mid-June 2015.

Recommendation

In the event of material exposure to a country subject to serious economic or political difficulties, the AMF recommends a description of the nature of accounting exposures (e.g. tangible, intangible and financial assets, inventories or cash and cash equivalents), the impact on the financial statements of operational decisions taken with regard to the situation (asset depreciation, provisions for restructuring, etc.) and a description of residual uncertainties.

Where there is material exposure to a country with several exchange rates, companies are invited to describe such exposure, the exchange rate used, the analysis that determined the exchange rate to be used with regard to IAS 21.26 criteria and, where relevant, a sensitivity to the choice of another rate.

cf. ESMA page 4, "Foreign exchange rate and countries at risk", paragraph 3

Furthermore, IFRS 12 and IAS 7 require information on restrictions affecting access to assets. Thus paragraphs 13 and 22(a) of IFRS 12 indicate that companies should mention significant restrictions on the ability of the company to have access to or use the assets and settle the liabilities, with carrying amounts of the assets and liabilities to which these restrictions apply. Paragraph 48 of IAS 7 requires mention of the amount of significant cash and cash equivalents balances that the entity holds and that are not available for use by the group. The AMF has drawn attention to these obligations in the past.

The AMF notes that material restrictions on assets and liabilities must be mentioned in the financial statements.

Recommendation

The AMF recommends that companies adapt the detail of information on material restrictions on assets and liabilities to their particular importance.

cf. ESMA page 4, "Foreign exchange rate and countries at risk", paragraph 4

2 Working capital management

[Efforts to improve WCR have become more widespread in recent years. Financial analysts take them very seriously but say they lack information on steps that have been taken and their effects in financial statements]

The consequences of the 2008 financial crisis left many companies with liquidity pressures. Some now tap funding sources other than, or in addition to, bank borrowing or capital markets in order to meet short- or long-term financing or cash requirements. One common solution consists in optimising the working capital requirement.

Such management can bear on different components of the working capital requirement.

2.1 Operations concerning assets

Different measures can be taken on operating receivables, notably sales of trade or tax (e.g.CICE) receivables, factoring operations and securitisation.

Paragraphs 15 to 37 of IAS 39 explain the analysis needed for the derecognition of transferred receivables; a decision flow chart is given in paragraph AG36.

When this type of management involves *ad hoc* vehicles, analysis of control in the terms of IFRS 10 is primordial. As in its 2013 recommendations, the AMF therefore draws attention to the importance of detailed analysis of the operation's characteristics, particularly when it involves securitisation funds and structures. All relevant factors should be taken into account.

The AMF notes that all of the risks and advantages of a receivables sale must be analysed (credit risk, dilution risk, guarantees, late payment, currency risk, etc.) in order to determine whether these receivables can be derecognised or not.

These observations apply by analogy to tax receivables.

In addition, IFRS 7 requires qualitative and quantitative information to be provided on the way the entity manages its liquidity risk (the nature of different funding sources, the concentration of risk, seasonality where applicable) and asset transfers⁸. When transfers result in the derecognition of the financial assets transferred and are not spread evenly over the accounting period but are concentrated in a specific time of year (close to year-end, for example), IFRS 7.42G requires additional information on the transfer timetable and its impact on the financial statements (amounts of receivables sold and cash receipts, profit generated by the transfers in question, etc.).

Recommendation

In the event of material derecognition, the AMF recommends explaining the main features of the operation, key features and significant judgements made in determining the accounting treatment.

When the effects of transfers of financial assets are material, information on these effects is also required irrespective of whether the operations gave rise to the derecognition of receivables or not (amount of receivables transferred in programmes, amount of derecognised receivables, impact on profit, etc.). Particular attention shall be paid to the additional information required when these transfers are not spread evenly throughout the accounting period.

⁸ cf. 2012 AMF recommendations, part 4.4 (transfers of financial assets).

2.2 Operations concerning liabilities

Operations concerning assets are increasingly complemented with operations involving liabilities, for example with new forms of factoring, including reverse factoring for operating liabilities. This type of operation is initiated not by the supplier but by the customer, which organises the sale of its supplier's trade receivables and confirms its authorisation of repayment of debts on its balance sheet on the maturity date. Following this operation, the operating liabilities due from the customer to its supplier become payable to the financial institution.

The objectives of such arrangements can vary, but include easing funding for the supplier network, better factoring terms for the supplier by virtue of the intervention of a customer with a better credit rating and simplifying the processing of supplier invoices for the customer.

A question arises over the presentation and classification of this type of operations in the cash flow statement and balance sheet. It is a matter of determining whether the customer's debt vis-à-vis its suppliers that is sold to the banking institution should be classified as bank debt or trade payables, and how that operation should be presented in the cash flow statement.

Although IFRS do not define operating debt or trade payables, and while IAS 39 includes operating liabilities within financial liabilities, IAS 1.70 states that « some current liabilities, such as trade payables, (...) are part of the working capital used in the entity's normal operating cycle. », itself defined in paragraph 68 of IAS 1. IAS 1 adds in its paragraph 15 that « financial statements shall present fairly the financial position, financial performance and cash flows of an entity. Fair presentation requires the faithful representation of the effects of transactions (...). The application of IFRS, with additional disclosure when necessary, is presumed to result in financial statements that achieve a fair presentation ».

Recommendation

The AMF recommends detailed analysis of reverse factoring in order to determine their presentation in the financial statements. This analysis shall take account of the terms of contracts as well as the facts and circumstances specific to the transactions. It is therefore important to enquire into the substance of operations.

cf. ESMA page 5, "Classification of cash flows", paragraph 4

AMF invites companies to analyse the operation's objectives and differences between the characteristics of debt vis-à-vis the financial institution and trade payables not set up in the factoring arrangement (payment deadlines, invoiced interest, guarantees etc.)

Quantitative and qualitative information on these operations in the notes, when they are material, would help investors obtain a good understanding of the company's financial and cash position. The accounting treatment of these financing operations can make a substantial difference to the company's main financial indicators (debt ratios, performance indicators and the aggregate WCR itself) and calls for relevant judgement analysis.

Recommendation

In accordance with IAS 1.117 and 122 and 125-127, the AMF recommends the provision of information in the notes to the financial statement of the main characteristics of any material reverse factoring transactions, together with the accounting analysis used for presentation and the significant judgements made in that analysis.

Information on the financial effects of these transactions on the financial statements (balance sheet and cash flow statement) is also recommended (identification of the amounts involved, for example), to improve understanding of the company's financial and liquidity position.

cf. ESMA page 5, "Classification of cash flows", paragraph 4

2.3 Centralised treasury management operations

Groups with a large number of operating subsidiaries use centralised management arrangements to optimise their treasury operations, for example through cash pooling at a bank.

IAS 32.42 describes the criteria for netting financial assets and liabilities: the company « currently has a legally enforceable right to set off the recognised amounts and intends either to settle on a net basis, or to realise the asset and settle the liability simultaneously. »

Apart from a legal right to net receivables and payables, which must not be conditional, the application of netting rules can raise particular difficulties around the intention to settle on a net basis or to realise the asset and settle the liability simultaneously, notably in the case of notional cash pooling. This question has been passed to the IFRS IC.

Recommendation

Given the diversity of centralised treasury management contracts and their operational features, in-depth analysis of all the IAS 32 netting criteria is warranted, and notably the question of intention, in order to determine whether credit and debit cash positions vis-à-vis a single bank counterparty should be presented on a net or gross basis.

In the case of material amounts and analysis that requires the exercise of judgement, the AMF recommends detailing the features of the operation, the analysis carried out and its effects in the financial statement in the notes.

The AMF also draws attention to the fact that apart from the information required by IFRS 7.13A on set off financial assets and liabilities (i.e. gross and net amounts), IAS 32.47 requires specific information when an entity has a right of set-off, but does not intend to exercise it. This requirement is intended to inform readers of financial statements of the effect of this right on the entity's credit risk exposure.

3 New standards published but not yet applied (IFRS 9 and IFRS 15)

Where new standards have been published but are not yet applied, paragraphs 30 and 31 of IAS 8 ask for a description of the expected impact when the standard is first applied, when that impact is known or can be reasonably estimated.

IFRS 15 - *Revenue from contracts with customers* and IFRS 9 – *Financial instruments* were published in May and July 2014 and are due to come into force on 1 January 2018.

Although the European Union has not yet adopted these standards, companies are encouraged to start work on identifying problems that could arise on implementing them, given their potential complexity, in order to guarantee the quality of the financial information that will be produced when they come into force. Changes to IT and/or reporting systems may be necessary.

cf. ESMA page 7, “New IFRS requirements”, paragraph 2

IASB has set up temporary working groups to examine difficulties arising from the implementation of IFRS 15 (a joint group with FASB) and IFRS 9 in relation to the depreciation of financial assets. All interested parties can make these groups aware of any problems they have identified in implementing the standards. In France, ANC has established a working group for IFRS 15 that discusses difficulties in implementing the standard.

Recommendation

With reference to 2015, companies are asked to report on preparations for implementation and, where available, to provide qualitative information on the accounting policies that may be modified once IFRS 15 and IFRS 9 come into force. Companies that plan to early-adopt should make a disclosure to that effect.

cf. ESMA page 7, “New IFRS requirements”, paragraph 3

The application of IFRS 9 and IFRS 15 will necessitate explanation of the main differences relative to current practice. This means that companies may need to provide far more detail on the way in which revenue or financial instruments are currently treated.

The importance of improving the presentation of accounting principles on revenue recognition is also highlighted in the Guide to the relevance, consistency and readability of financial statements.

Recommendation

The AMF recommends that companies provide a sufficiently clear and detailed description of the accounting principles applied at the 2015 year-end in revenue recognition (transfer of risks and rewards, completion method, etc.).

4 Review of financial statements

ESMA guidelines⁹ on the enforcement of financial information require European market regulators to issue periodic and public reports on their national enforcement activities from 1 January 2015 onwards.

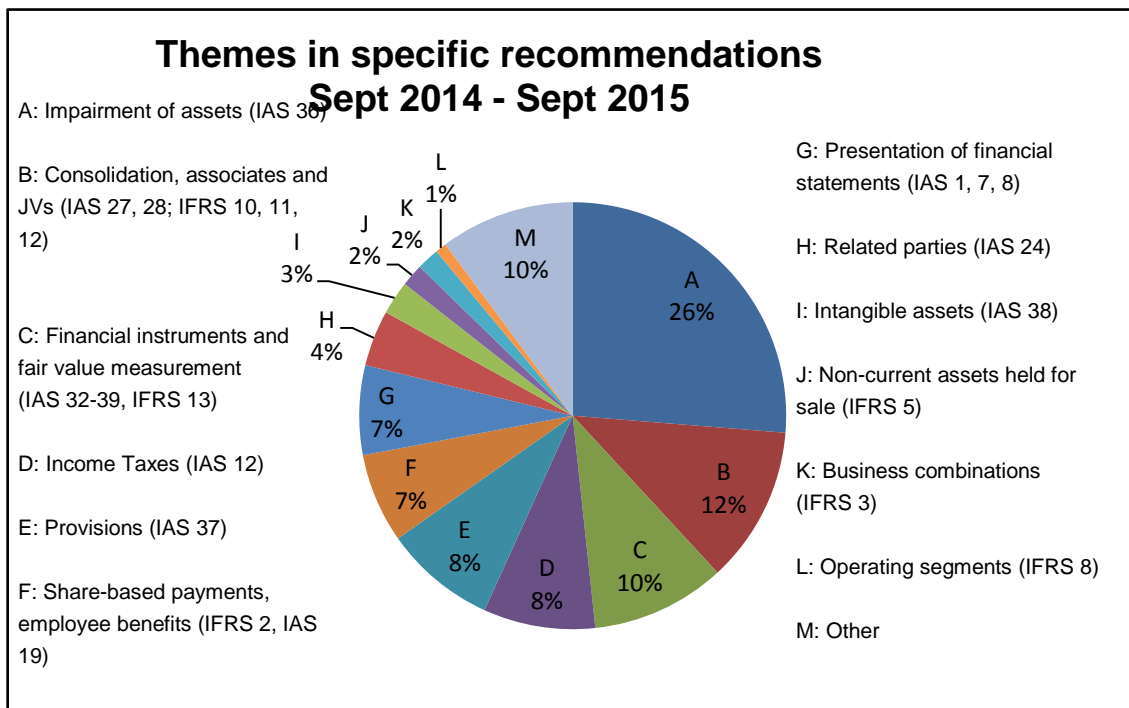
Quantitative information gathered from reviews in 2014-15 is given below, bearing on the main themes of AMF workstreams and commentary. There is a continuum between reviews of financial statements carried out by the securities regulator, which identifies difficulties in applying accounting standards, the choice of topics for AMF recommendations on financial statements and the direction that is given to future reviews.

4.1 Ex post review

Concerning reviews of the accounting aspects finalised by AMF staff between September 2014 and September 2015, no changes to financial statements were requested but recommendations for the next set of financial statements were sent to 54% of companies. 46% of reviews did not give rise to any specific action¹⁰. When recommendations or the subjects requiring follow-up are identified by the AMF staff, they systematically undertake a targeted review at the close of the following accounting period.

To recap, the AMF finalises its review with a letter confirming its conclusion addressed to the company. AMF commentary can be split between specific recommendations (concerning both the accounting method and the information contained in the notes), which the AMF expects to be taken into account in the next set of financial statements, and comments that it wants to bring to the company's attention. If the information shown in the company's financial statements appears to comply with accounting principles and the level of detail seems adequate, the AMF does not comment.

The breakdown of themes among companies that received specific recommendations for their next set of accounts is as follows:



⁹ <https://www.esma.europa.eu/content/ESMA-Guidelines-enforcement-financial-information>

¹⁰ ESMA enforcement guidelines provide that when an error is identified by an authority charged with the corporate reporting review it can act as follows, depending on the gravity of the error:

- demand the publication of new financial statements,
- ask for a correction to the financial statements,
- demand that the error is corrected in the next set of financial statements.

4.2 Pre-clearance

11 companies asked the AMF for its opinion on an accounting analysis before they published their 2014 financial statements, notably on the treatment of complex financial instruments or applying IFRS 5. For 2015 financial statements, three companies have asked the AMF for a pre-clearance on an accounting analysis as of end-September.

Every year the AMF organises meetings with a number of Segment A companies. The main purpose of these meetings is to discuss structural accounting issues (material operations, implementing new accounting standards, etc.).

4.3 Accounting review included in an IPO prospectus

In the context of IPO prospectuses, between September 2014 and September 2015, the AMF reviewed the financial statements of 38 companies, 12 under French accounting standards and 26 under IFRS.

Among the companies presenting financial statements under IFRS, the AMF asked 11 for changes. It also asked for the addition of further notes before the IPO in three cases, and recommendations for the next set of accounts in six cases.

The main themes giving rise to changes in financial statements or notes before an IPO were revenue recognition, the cash flow statement and the accounting treatment of certain intangible assets.

Among the companies presenting financial statements under French accounting standards, the AMF asked one company for changes to financial statements and made recommendations for the next set of financial statements in four cases.