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AMF RECOMMENDATIONS REGARDING FINANCIAL STATEMENTS FOR 2008

For many publicly traded companies, the financial crisis of the past fifteen months is one of the key events of 2008. It is likely to have a major impact on financial statements, not just for financial institutions but also for industrial and commercial firms. It raises particularly important issues regarding the fair value measurement of certain instruments (IAS 39 – Financial Instruments: recognition and measurement), valuations (IAS 36 – Impairment of Assets, IAS 19 – Employee Benefits), the classification of financial debts that include covenants, and the impairment of tangible and intangible assets.

Since the beginning of 2008, a number of initiatives have been taken by governments (through the G7 and ECOFIN) and regulators to deal with the financial crisis. In April, the Financial Stability Forum (FSF) published a report containing 67 recommendations, including three calling for action on the part of the international accounting standards setter; and the G7 issued a statement calling for greater transparency in financial statements starting with the 2008 mid-year reporting cycle. These proposals are aimed at measuring fair value in illiquid markets, improving the rules for consolidating special-purpose entities, and improving public disclosures concerning financial instruments. These proposals led the IASB to form an Expert Advisory Panel, charged with rapidly formulating proposals to address the problems of valuation and related disclosures. Regulators have contributed to the work, taking part in the IASB initiatives and offering their analysis of the issues (see IOSCO's report on market turmoil [1] and CESR's statement on fair value measurement and related disclosures of financial instruments in illiquid markets [2]).

As the publication of year-end financial statements approaches, the AMF wishes to stress one of its previous recommendations that still appears timely. This is the recommendation concerning disclosures on capital (IAS 1), and in particular on the distinction between the liability and equity components of instruments, external restrictions affecting capital, the presentation of material estimates, and adapting the description of accounting methods to the specific characteristics of the issuer's business.

In addition, the AMF published recommendations on 7 October 2008 concerning leveraged company investment funds that includes a section on the periodic disclosures to be provided by issuers.

Finally, in view of regular complaints about the excessive length of financial statement notes, the AMF urges issuers, once again this year, to focus on the relevance of disclosures rather than their volume. As it

[1] The final report, "Report on the subprime crisis", published on 29 May 2008, is available at http://www.iosco.org/library/pubdocs/pdf/IOSCOPD273.pdf

[2] Report published on 3 October 2008, available at http://www.cesr.eu/popup2.php?id=5285

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did in 2007, the AMF reminds issuers that, in accordance with the concept of materiality referred to in IAS 1.29-31[3], specific disclosure provisions need not apply to information that is not material.

Having made these reminders, we present below our recommendations for the preparation of 2008 financial statements. The principal themes are:

- the consequences of the financial crisis (both for financial instruments and for the valuation of other significant balance sheet items)
- structural transactions (consolidations, acquisitions, and de-consolidations)
- new standards and interpretations.

[3] IAS 1 – Presentation of Financial Statements – version including amendments resulting from IFRS issued through 31 December 2006, applicable to 2008 financial statements.

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1. First-time application of IFRS 7– Financial Instruments: disclosures

Because IFRS 7 was applied for the first time in 2007, the AMF decided to conduct a broad analysis of the way in which this standard has been applied. The review focused on non-financial companies in the SBF 120 index, with a sample of 90 issuers.

1.1. Improvements resulting from the application of IFRS 7

First-time application of IFRS 7 to 31 December 2007 financial statements resulted in more numerous and more detailed disclosures on exposures and financial instruments. The quality of disclosures has improved in terms of:

- The description of financial risks and the way they are managed by the company;
- Exposures to various financial risks and their quantitative impact, including:
    - credit risk, in a financial environment marked by an increase in risk-related costs at year-end 2007 and an increase in counterparty credit risk,
    - interest rate risk, in a context of rising interest rates,
    - currency risk, with persistent and significant fluctuations in the values of major currencies,
    - equity risk, in the context of a significant decline in stock market indexes creating problems with financial instrument valuation, and
    - commodity risk, in an environment of high volatility in commodity and energy prices;
- The impact of the financial crisis – and in particular the impact on financial institutions as at 30 June 2008, in line with the FSF's recommendations – with descriptions of the exposures, write-downs, and provisions recorded, and information on the methods and assumptions used.

1.2. Weaknesses identified in the application of IFRS 7 and areas for improvement in 2008

The following weaknesses were noted in the initial application of IFRS 7:

1.2.1. Fair value disclosures

IFRS 7.25 requires the disclosure of information on the fair value of financial assets and liabilities by class of instrument, including items not measured at fair value. By and large, this information is provided but cannot always be linked with the balance-sheet category concerned.

Furthermore, the methods and assumptions used to determine these fair values (IFRS 7.27) were often described only in very general terms, with no breakdown by type of technique used (i.e. direct reference to prices on an active market versus valuation techniques relying on observable or unobservable inputs). Such a quantitative analysis is not required by IFRS 7 (this requirement was introduced in the proposed amendments to IFRS 7 published in October 2008), but it could provide valuable information to users.

1.2.2. Description of risks (credit, liquidity, market)

The application of IFRS 7.33 should result in the systematic description of the risks associated with financial instruments to which the entity is exposed, as well as the way in which those risks are managed. However, the review of the 90-company sample indicates that this information is not always provided. For example:

- only 54 of the 90 companies provide information on the management of credit risk;
- only six companies provide general information on equity risk. In the current context, this lack of information is unacceptable for entities holding significant amounts of equities;
- very few groups provide information on risk concentrations (IFRS 7.34(c)).

The standard requires quantitative disclosures on each type of risk, unless it is not material (IFRS 7.34(b)).

1.2.3. Credit risk

In general, IFRS 7 is intended to allow financial statement readers to form an opinion on the hedging of credit risk at the balance sheet date and the quality of the assessments carried out by the credit risk department.

Only a minority of groups have significantly improved their qualitative disclosures on credit risk. Most continue to be satisfied with very general disclosures.

The AMF reminds institutions of the need to disclose the following information:

- for the balance sheet, an analysis of the age of financial assets (particularly receivables) that are past-due at the balance sheet date but not impaired (IFRS 7.6 and 37(a)), impaired assets (IFRS 7.37(b)), and the criteria used to determine whether impairment testing is needed (IFRS 7.B5(f));
- a reconciliation table displaying changes in impairment for each class of financial assets (IFRS7.16). It may be useful to make separate lists of additions to provisions, utilisations (i.e. recoveries for receivables that have been written off), recoveries for unused provisions (due to collections or credit risk reassessment), and other changes (for example, due to exchange rate effects);
- for the income statement, the amount of losses for each class of assets (IFRS 7.6 and 20(e)).

1.2.4. Liquidity risk

The AMF notes that:

- information on the liability maturity structure is often lacking (only 56 of the 90 sample companies provided this information) (IFRS 7.39(a));
- to a lesser degree, there is no description of the issuer's management of liquidity risk (not disclosed by 11 out of 90 issuers) (IFRS 7.39(b));

- the presentation of the maturity structure is often cursory and does not allow reconciliation to the issuer's principal liabilities (IFRS7.6);
- the liability maturity analysis focuses solely on the long term, to the detriment of the period immediately following the end of the accounting period (less than one month, one to three months, three months to one year, one to five years, following the example proposed by IFRS 7.B11). The standard indicates that this presentation calls for judgement on the part of management. A note explaining how the liability maturity structure is organised would therefore be useful (in accordance with IAS 1.113);
- the liability maturity analysis shows payment schedules that correspond to the amounts shown on the balance sheet instead of undiscounted contractual cash flows, as required by IFRS 7.B14; (undiscounted contractual cash flows should include items that are not yet recorded on the balance sheet such as undrawn loan commitments [IFRS 7.B13]; and borrowing costs). In view of the differences between the balance sheet liabilities and the figures in the maturity table, it would be good practice to provide a note describing how the table was constructed; this would help verify the consistency between the liability classes on the balance sheet and those in the notes. In addition, certain items of information, required by the standard but often omitted, seem to be essential in evaluating the reported amounts. These include the maturity assigned to instruments such as perpetual securities with no contractual maturity, the interest rate used in reporting variable-rate loans, and the exchange rate used in reporting loans in foreign currencies;
- financial derivatives are not reported separately in the liability maturity analysis (IFRS 7.B15);
- the liability maturity analysis includes derivative instruments that represent assets at the balance sheet date without identifying them separately (netting not compliant with IAS 32);
- references to and descriptions of covenants for bank loans or bond issues are all too often missing (this information is sometimes provided in the management report).

1.2.5. Sensitivity to various market risks

Disclosures about the sensitivity of the entity's performance to various market risks could be improved:

- in terms of the hedging of different types of risk (IFRS 7.40(a)). For example, only 47 of the 90 sample companies provide an indication of sensitivity to interest rate risk. Some of the companies holding fixed-rate debt consider that they are not exposed to this risk. That conclusion is questionable, since when a long-term fixed-rate financing reaches maturity, the conditions for rolling it over may be less favourable, exposing the borrower to interest rate risk. While such information is not explicitly required by the standard, in the current environment, disclosures concerning fixed-rate credit lines that will need to be renewed in the 12 months following the end of the accounting period would seem to be relevant, if they are not provided elsewhere;
- only 38 firms disclose their sensitivity to currency risk, which seems surprising since the sample companies all have extensive international business;
- in one case, the disclosures concerning the sensitivity of valuations to assumptions (required by IFRS 7.40(a)) were based not on a single scenario corresponding to the effect of a reasonably possible change in assumptions but on several scenarios, contrary to IFRS 7.B18(a). While this

approach could be relevant if there are significant threshold effects and the degree of uncertainty is considered to be high, the relevance of the disclosures can suffer if the volume of information provided is too great, there is no accompanying commentary, and the reasonably possible changes are not flagged.

In general, to ensure that the disclosures made under IFRS 7 are understandable, it is helpful to add explanations to the various figures that are disclosed.

Finally, in 2007 only a few of the groups highlighted the impact of financial instruments on the income statement (IFRS 7.20). Where these data were disclosed, it was usually very difficult – if not impossible – to reconcile them to the income statement headings and to the breakdown of interest income or expense by type of impact, which was generally disclosed in the financial statement notes.

1.3. Presentation of disclosures: possibility of cross-reference to the management report or other separate financial statements

Under IFRS 7, some disclosures (the qualitative and quantitative information required by paragraphs 31 to 42 on the nature and extent of risk exposures associated with financial instruments and the way they are managed) can be presented outside the notes. [4]

Concerning this option, the AMF recalled at the end of 2007 the requirements of IFRS 7.B6:

- this information, even if it is provided outside the notes, should be drawn up on the same timetable and under the same conditions as the consolidated financial statements and should accompany them. If this information is lacking, the consolidated financial statements will be considered incomplete[5];
- an explicit cross-reference to this audited information should be included in the notes to the consolidated financial statements.

The review of the disclosures made in 2007 shows that practices in this area vary widely:

- Information on risk exposures arising from financial instruments is often disclosed without cross-reference between the notes and the management report or risk report,
- the information disclosed in the notes sometimes does not cover all the financial risks discussed in the management report or risk report. Among the topics mentioned in the reports but not in the notes, liquidity risk figures prominently. The AMF recommends adopting a uniform approach to the materiality of exposures that are disclosed, because discrepancies in this regard can raise doubts about the exhaustiveness of the information disclosed under IFRS 7;
- in some cases, the information disclosed in the management report is duplicated in the notes. The usefulness of this repetition is questionable;

[4] IFRS 7.B6 cites the management report or risk report as separate financial statements that can contain these disclosures.

[5] Under the Transparency Directive, for the annual and semi-annual financial reports, the financial statements and the section of the management report that comments on the accounts must be produced simultaneously.

- in other cases, the description of exposures in the management report or risk report differs significantly from that provided in the notes;
- the management report or risk report often does not specify what information is being disclosed pursuant to IFRS 7;
- consequently, the reader generally does not know whether the information has been audited.

In light of the implementation problems noted by the AMF, the traceability of the information disclosed under IFRS 7 should be improved. Better traceability would make it possible to avoid duplicating some or all of the disclosures, wherever they may appear (the financial statement notes, the management report, or the risk report). The disclosures regarding the level to which the auditors have verified this information should also be improved, preferably by an explicit reference.

For the 31 December 2008 year-end, in view of the continuing financial crisis, the AMF stresses the importance of disclosures concerning exposures to financial risks, and the methodologies and assumptions underlying them. The AMF recommends users pay close attention to disclosures on the sensitivity of the principal assumptions.

IFRS 7 permits certain information (on risk exposures, methodologies, assumptions, sensitivity analysis of valuations, risks management) to be disclosed outside the financial statements. The AMF recommends that issuers choosing this option should clarify the nature of the information disclosed by taking the following steps:

- specify what information is being disclosed under IFRS 7
- include cross-references to and from the financial statements
- clarify the level of audit carried out by the statutory auditor.

2. IAS 39 – Financial instruments: recognition and measurement

2.1. Initiatives in response to the financial crisis

The financial crisis has highlighted certain problems in applying the IFRS that deal with financial instruments, particularly those concerning the valuation of financial instruments in illiquid markets.

A large number of initiatives have been launched since the beginning of 2008 to address the accounting issues raised by the crisis. In April, the FSF published a report containing 67 recommendations, including three calling for action by the international accounting standards setter:

- improving, in the very short term, the rules for consolidating off-balance-sheet entities and for disclosing them in the notes;
- forming a panel of experts charged with helping preparers of financial statements to apply fair value when markets are illiquid;
- improving note disclosures on financial instruments and financial risks.

The G7 has taken up the issue and called for some of the FSF's recommendations to be applied as of 30 June 2008, in order to improve the transparency of financial statements.

In response, the IASB has formed an Expert Advisory Panel to propose improvements in disclosures on complex financial instruments and their valuation in illiquid markets. This work has been conducted by a group of 20 participants, including international securities regulators[6]. A discussion paper was submitted to the IASB at its September meeting. It should be finalised by the end of October and published for instructional purposes, not as a standard or implementation guidance.

On 13 October, the IASB published amendments to IAS 39 that ensure convergence with the US GAAP on the issue of the reclassification of certain financial instruments. An exposure draft was also published to improve note disclosures concerning the liquidity risk and the different levels of fair value used to price financial instruments.

On 15 October the AMF, in conjunction with the national accounting standards setter (*CNC*), banking supervisor (*Commission bancaire)* and insurance supervisor (ACAM), published a "Recommendation on fair value measurement of certain financial instruments"[7]. The aim was to provide clarification for the annual and interim financial statements ending on or after 30 September 2008 of entities holding financial assets which are valued at fair value and for which there is no active market.

2.2. Disclosure of the impact of remeasurement on income and equity

The AMF recommendations regarding available-for-sale securities and cash flow hedges, published in December 2007, stated that issuers could improve their disclosures on the impact of transferring valuation adjustments previously carried in equity to the income statement. These recommendations highlight the usefulness of identifying the equity impact of this financial instrument class. As such, the recommendations simply repeat IFRS 7.20(a)(ii), which requires that gains and losses recognised directly in equity during the accounting period should be disclosed either on the face of the financial statements or in the notes. Paragraph 20(a)(ii) also requires that the amount reclassified from capital to profit or loss during the accounting period should also be disclosed in the financial statements or the notes.

In view of the steep decline of financial markets, these disclosures are particularly important for issuers that have significant portfolios of financial instruments classified as "available for sale". Indeed, because IAS 39.67 requires that cumulative losses previously recognised in equity must be recognised in profit or loss when the asset is written down, a financial statement reader who notes a large decrease in equity due to a decline in the reserve for available-for-sale financial instruments can legitimately raise questions concerning the criteria used to recognise the loss. Consequently, the AMF considers that the disclosures required by IFRS 7 should, in these situations, be accompanied, in accordance with IAS 1.113, [8] by

[6] The president of the Technical Committee of IOSCO was represented on the Expert Advisory Panel. A contribution from European regulators was produced by CESR and delivered to the IASB.

[7] Available at http://www.amf-france.org/documents/general/8477_1.pdf

[8] IAS 1 – Presentation of financial statements – version including the amendments resulting from the IFRS issued up to 31 December 2006 and applicable to 2008 financial statements.

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explanations of the judgements leading to the conclusion that there was no actual loss despite indications of a loss, if these judgements are among those that have the most significant effect on the financial statements. However, if gains and losses recognised in equity are material, they should be disclosed separately in accordance with the principle stated in IAS 1.32.

Given the difficulty of evaluating losses on available-for-sale financial instruments in the current context, it would be helpful to disclose information on unrealised losses that have not been recognised at the close of the accounting period (i.e. in the case of a negative fair value reserve in equity) by type of financial instrument (listed shares, unlisted shares, corporate bonds, French and foreign government bonds, etc.), specifying the periods during which this situation has been observed, in order to understand the impacts at the accounting close.[9]

Regarding the impact of the market decline and the recognition of losses on available-for-sale financial instruments, it should be recalled that the IFRIC discussed this question in June 2005 and gave its reasons for concluding that an interpretation on this subject would not be appropriate. The IFRIC noted that the criterion set forth in IAS 39.61 ("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") should be applied not with respect to the valuation of the instrument at the close of the most recent accounting period, but rather in relation to its original cost. It also stipulated that the prolonged nature should be assessed in terms of the total period during which the fair value of the financial instrument is below its original cost.[10] Issuers are urged to specify in the notes the criteria used and indicate that they are applied consistently in implementing this provision.

Shares that are traded continuously on an organised market (such as those making up the CAC 40 index) should, with few exceptions, be valued at the price quoted at the end of the accounting period.

3. IAS 36 – Impairment of assets

3.1. Impact of the crisis on the valuation of intangible assets and goodwill

The issue of asset impairment is critically important, given the ratio of intangible assets to equity. At year-end 2007, the ratio for the industrial and commercial firms in the CAC 40 was 75% (compared with 77% the preceding year), which is very significant.

In its past recommendations[11], the AMF has discussed at length the disclosures that must be made on impairment testing and its impact on financial statements.

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[9] A similar analysis is required by US accounting standards, in paragraph 17 of FSP.FAS115-1/124-1.

[10] According to the June 2005 IFRIC Update, the notion of "prolonged decline" must be assessed in relation to the period during which the fair value of the investment remains below the original cost of the investment.

[11] AMF recommendations regarding financial statements for 2007 (http://www.amf-france.org/documents/general/8056_1.pdf) and AMF recommendations on accounting information reported in financial statements for 2006 (http://www.amf-france.org//documents/general/7538_1.pdf).

In the context of the crisis that began in the summer of 2007, the decline in the value of listed shares is likely to be matched by similar declines in unlisted shares. This constitutes an indicator of loss and should therefore be taken into account when analysing the valuation of certain assets linked to equity investments.

Moreover, considering the importance of discount rates in determining the values in use that may explain asset values, it should be noted that Annexe A of IAS 36 mentions that when an asset-specific discount rate is not directly available from the market (IAS 36.A16):

- it should be based on the entity's weighted average cost of capital, its incremental borrowing rate, and other market borrowing rates (IAS 36.A17);
- these items should be adjusted to reflect how the market would assess the risks associated to the estimated cash flows generated by the asset (IAS 36.A18).

In periods of high volatility in the risk premiums demanded by the market, this approach can be difficult to apply. It seems to us that, following the recommendation of the CNC, the *Commission bancaire*, the ACAM, and the AMF (see above), a reasonable and consistent approach using historical data available to the entity can be implemented to correct for market distortions in the risk premium. When such an approach is used, the entity should provide a detailed description of the elements used to set the discount rate, along with an explanation of any material changes relative to previous financial statements.

3.2. Market cash flows

As noted in the AMF's December 2007 recommendations, when an issuer is unable to measure the recoverable value of an asset based on its fair value less costs of disposal using a 'comparables' method, [12] it may estimate fair value using discounted future cash flows estimated on the basis of market value.

The AMF has noted that, when this method is used, the notes should mention this choice, explain the reasons for not using a 'comparables' method, describe key assumptions, note changes in key assumptions since the previous report, mention the sources used, and provide sensitivity analyses when appropriate (IAS 36.134(f) and IAS 1.120).

This controversial aspect of the application of IAS 36 was recognised officially ex post (in May 2008) by an amendment to IAS 36.[13] Paragraph 134 henceforth requires that the estimation of fair value less costs to sell may be based on the cash flows generated by the asset. The amended standard requires entities using this approach to provide details on the period covered by the cash flow projections made by

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[12] IAS 36 provides that, as a last resort, reference can be made to the "best available information" that can be obtained from "recent transactions for similar assets within the same industry" (IAS 36.27), that is, using a 'comparables' method. In practice, it can sometimes be difficult to identify companies (listed or unlisted) and transactions that are truly comparable to the asset or group of assets being valued, and to obtain access to detailed information.

[13] This amendment applies to accounting periods that begin on or after 1 January 2009. Entities are authorised to apply it to earlier periods.

management, the growth rate used to extrapolate the cash flows, and the discount rate applied to the cash flows.

In the context of the financial crisis that has been affecting the markets since 2007, this method will probably prove more difficult to use, since an entity must be able to justify the market dynamic – that is, to link the underlying forecasts with market parameters (sector trends, average profitability, analysts' expectations). This is likely to be difficult because of the uncertainty in the economic outlook. In any event, considering the sensitivity of income to the assumptions used in the valuations, it seems vital to achieve total transparency by disclosing the new information required by IAS 36, along with the additional disclosures that we recommended in 2007, in the notes to the financial statements.

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

If an issuer opts for early application of IFRS 8, "Operating segments" (see also point 8, below), and this decision results in a change in the allocation of goodwill to reflect changes to groups of cash-generating units (CGU), this will raise the question of how the reallocation of goodwill should impact on impairment tests.

IAS 36.96 states that impairment testing of a CGU to which goodwill has been allocated should be conducted every year. Paragraph 99 indicates that the most recent calculations that have been used to verify the recoverable value of a CGU to which goodwill has been allocated can be reused for the current period providing (see in particular IAS 36.99(a)) that the CGU's assets and liabilities have not materially changed since the last testing date.

This criterion, by definition, is not satisfied when goodwill is reallocated to new group of CGU. Consequently, the AMF expects the issuers concerned to conduct new impairment tests after changing the structure of their groups of CGU, even when annual tests of goodwill valuation were conducted prior to the application of IFRS 8.

Considering the potential impact of such reallocations when measuring losses, the AMF wants issuers confronted by this situation to provide explanations in the notes on how goodwill or quotas of goodwill have been reallocated.

4. IAS 19 – Employee benefits

4.1. Impact of the crisis on post-employment benefits

The severe deterioration in financial markets since 2007 has probably, in some cases, had an appreciable effect on net long-term obligations (in particular pensions). Any material decline in the return on plan assets raises questions about the forecast return on these assets ('experience adjustments'). A decrease in the returns expected in a financial year results in an increase in the cost of services in the following

year and hence a decline in the performance of the business in that year. The decline in the value of the plan assets results in an increase in net benefit obligations and, once again, a decline in the performance of the business. This decline is immediate if actuarial gains and losses are recorded immediately in income or equity. It can be delayed if the issuer uses the so-called 'corridor' approach. As a general rule, this question is not neutral, particularly considering the large foreign establishments of some groups traded in Paris.

While IAS 19.120A(o) requires the disclosure of the sensitivity of assumptions only in the case of obligations for medical benefits, IAS 1.120 requires sensitivity analyses for all of the principal sources of uncertainty in estimates. Consequently, once an issuer has identified post-employment benefit obligations as one of the principal sources of uncertainty, these disclosures become mandatory.

This recommendation also applies to plan assets. If they are material, a sensitivity analysis should be provided, covering both the returns expected in the following accounting period and the assumptions used to estimate them on the balance sheet date.

It is also useful to recall the other requirements of IAS 19 that help clarify the way actuarial estimates of these obligations have been generated. For example, the standard requires disclosure of experience adjustments to plan assets. This information should be accompanied by detailed information on the relative shares of the major categories of plan assets (stocks, bonds, real estate - IAS 19.120A(j)) and a narrative description of the basis used to determine the expected rate of return on plan assets (covering the major asset categories – IAS 19.120A(l)).

4.2. Reference rates for discount rates used in estimating liabilities

In reading the financial statements, it is not always easy to identify which reference rate (the rate required for issuers of corporate bonds or the rate for French government bonds) is used by issuers to determine the discount rate for valuing the liabilities associated with post-employment benefits. While this information is not explicitly required by IAS 19.120A, the AMF encourages issuers to disclose the reference rate, in addition to the discount rate, if liabilities are significantly sensitive to the discount rate.

On the assumption that an issuer has until now used the interest rate on high-grade corporate bonds as the reference rate (IAS 19.78), the analysis of market conditions at year-end 2008 could, in some cases, lead to the conclusion that:

- the market is too shallow to continue using this reference as a basis for valuing the commitments;
- the index used as reference rate includes a large proportion of financial institutions whose borrowing terms have deteriorated very sharply during 2008.

In these circumstances, an issuer should either adjust the index and provide detailed disclosures in the notes, or look for an alternative index that satisfies the qualitative criteria set forth in IAS 19.78 and that could replace the reference rate used until then. In either case, it is important for the issuer to indicate

what index it had been using up to that point and to explain why that index is no longer appropriate. It should also specify the new rate used and the reasons for that choice. The AMF does not regard this as a change in accounting method, only as a change in estimates.

5. IAS 1 Presentation of financial statements – classification of debts as current or non-current liabilities

IAS 1 requires that debts that have one or more of the following characteristics should be included in the current liabilities of the company (IAS 1.60)[14]:

- "(a) the entity expects to settle the liability in the course of its normal operating cycle,
- (b) the liability is held primarily for the purpose of being traded,
- (c) it is due to be settled within twelve months after the balance sheet date, or
- (d) the entity does not have an unconditional right to defer settlement of the liability for at least twelve months after the balance sheet date."

Long-term financing contracts frequently requires that the debtor commits to satisfy one or more ratios, and that a failure to satisfy one of these ratios results in accelerated repayment of the financing. In general, the borrower will seek to renegotiate the terms of the current contract rather than classify the corresponding liability as a current liability. IAS 1.65 deals precisely with these situations. It states that "when an entity breaches an undertaking […], on or before the balance sheet date with the effect that the liability becomes payable on demand, the liability is classified as current, even if the lender has agreed, after the balance sheet date and before the authorisation of the financial statements for issue, not to demand repayment as a consequence of the breach."

When the effect of the breach is not to make the liability immediately payable on demand (if, for example, the contract sets a deadline for the debtor to inform the creditor, and the creditor has an additional period in which to assess the situation before possibly accelerating the repayment of its claim), the question arises, in theory, whether the liability should be reclassified. On this point, the principle established in paragraph 60(d), and recalled in the second section of paragraph 65, according to which "the liability is classified as current because, at the balance sheet date, the entity does not have an unconditional right to defer its settlement for at least twelve months after that date." is very clear. Consequently, in such situations, the liability should be reclassified as a current liability, even if the creditor agrees, after the balance sheet date and before the decision to authorise the publication of the financial statements, to defer accelerated repayment of the liability. An additional note disclosure on the events occurring after the balance sheet date can be used to provide information on the agreement reached with the creditor.

For this reason, it is important for the issuers concerned to analyse their situation several months before the balance sheet date, in order to identify clauses that could lead to a risk of default. They can then take preventive action, as necessary, to get rid of this risk at year end.

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[14] IAS 1 – Presentation of financial statements – version including the amendments resulting from the IFRS issued up to 31 December 2006 and applicable to 2008 financial.

6. Business combinations and consolidation

The issue of business combinations addressed in IFRS 3 remains a major source of discussion between issuers and securities regulators.

6.1. Treatment of sales of minority interests

Currently applicable IFRS do not provide an accounting treatment for acquisitions and sales of non-controlling minority interests. The amendments to IFRS 3 and IAS 27 published by the IASB in January 2008 address this issue. Since minority interests are considered an integral part of capital, the effect of any acquisition or sale of a non-controlling minority interest should be booked in equity. However, these modifications to the standards have not been endorsed by the European Union and should therefore not be applied in advance.

In response to a request from an issuer faced with a sale of minority interests, the AMF agreed that the issuer could record the effect of this transaction on the income statement, since the issuer had not already specified which accounting method it would apply to sales of minority interests. However, the application of the provisions of amended IAS 27 would also have been permitted under the criteria of IAS 8 (since it is motivated by the application of a new standard).

The AMF draws the attention of issuers to this type of transaction and stresses the importance of ensuring the permanence of the accounting methods chosen. Until the amendments to IFRS 3 and IAS 27 become applicable, the choice of accounting treatment for this type of transaction must be justified in relation to the accounting methods used by the issuer and be disclosed in the notes. Any change in the accounting treatment constitutes a change in accounting policy as defined by IAS 8 and must be applied retrospectively and the impact comparative information should be assessed.

6.2. Absence of consolidated financial statements

In the course of their review of the 2007 financial statements, the AMF encountered instances in which issuers holding 20% or more of the equity of another company did not prepare consolidated financial statements.
The European Commission, it its November 2003 “Observations”, stated that when national law requires the publication of consolidated financial statements, the requirements of Regulation 1606/2002 (Application of international accounting standards) apply to them as well. The Commercial Code (Article L.233-16 IV) provides that “each year, commercial companies shall prepare and publish […] consolidated accounts […] in respect of any undertakings that they control either solely or jointly or over which they exert a significant influence as defined hereunder […].
IV. – Significant influence over the management and financial policy of a company is assumed if the company holds one fifth or more of the voting rights of the undertaking”.

The AMF therefore asked issuers whose securities were traded on a regulated market to prepare consolidated financial statements in accordance with IFRS whenever the issuer holds a significant investment in another company that gives it significant influence. With the possible exception of venture capital companies, this request implies the application of the equity method to the investments concerned.

When the presumption associated with a holding of more than 20% of the voting rights cannot be applied, it is important to determine if other factors that indicate significant influence are present (particularly if the issuer is close to the 20% threshold). These include:

- representation on the board of directors or equivalent governing body of the investee;
- participation in the policy-making process, and in particular participation in decisions about dividends or other distributions;
- material transactions between the investor and the investee;
- exchange of managerial personnel or provision of essential technical information.

The existence of a large or majority holding by another investor does not necessarily rule out the conclusion that the issuer has a significant influence.

Finally, when the significant influence is exercised by a venture capital company, it should be recalled that IAS 28 does not apply to investments by this type of company if "upon initial recognition [these investments in associated companies] are designated as at fair value through profit or loss or are classified as held for trading and accounted for in accordance with IAS 39". This paragraph means that the investments concerned should be accounted for under the equity method, unless the company chooses at the time of initial recognition to record them at fair value, with changes recognised in profit or loss.

7. IFRS 5 – *Non-current assets held for sale and discontinued operations*

The complexity of IFRS 5 has generated numerous implementation problems.

7.1. Loss of significant influence and application of IFRS 5

Does the loss of significant influence, for example when the percentage of control falls from 21 to 19%, systematically result in the application of IFRS 5? The answer to that question seems to depend on the way in which the entity loses its significant influence:

- case 1: IAS 28 provides that when an issuer commits to the sale of an investment in an associated company, IFRS 5 applies. The investment is no longer valued using the equity method, but rather at the lower of its carrying amount and fair value less costs to sell. The investment is carried on the balance sheet as an "asset available for sale" according to IFRS 5;
- case 2: if, for example, the percentage of the holding is diluted without a sale and significant influence is lost, IAS 28 (paragraphs 18 and 19) specifies that IAS 39 applies, without prejudging the manner in which the loss of influence occurred. Consequently, it seems appropriate to

reclassify the book value of the investment in the affiliate on the balance sheet in a financial instrument class in accordance with IAS 39. In the income statement, the investment's share of income is no longer recognised from that date, and changes in value are henceforth recorded on the appropriate line in income or equity, in order to reflect the financial character of the investment. Thus the valuation and disclosure rules of IFRS 5 do not apply.

7.2. Booking a loss that exceeds the amount of assets included in the scope of IFRS 5 measurement requirements

Paragraph 4 of IFRS 5 provides that a 'disposal group' can include any asset or liability of the entity, including current assets (and liabilities) such as inventoroes, as well as assets that are excluded from the measurement requirements of IFRS 5, including financial instruments to which IAS 39 applies (in paragraph 5).

Regarding the valuation of disposal groups, Paragraph 19 provides that the assets and liabilities of the group that do not fall within the scope of measurement requirements of IFRS 5 should be valued according to the IFRS that applies to them: this could be the case for inventories, which would be valued or written down according to IAS 2, and financial instruments, which would be valued or written down according to IAS 39. It is only afterwards that the group is valued at the lower of its carrying amount and fair value less costs to sell.

Any write-off that may be recorded is deducted from the book value of the group's non-current assets in the order specified in IAS 36 for cash-generating units (IAS 36.104):

- first, goodwill,
- then, other assets, for the portion of their carrying amount.

8. IFRS 8 – Operating segments

IFRS 8 – Operating segments, adopted by the European Union on 21 November 2007, must be applied for all accounting periods beginning on or after 1 January 2009.

This standard can result in major changes in the way companies disclose their activities. Contrary to IAS 14, the new standard no longer requires information to be disclosed in two dimensions (business segment and geographical segment). It requires that the information disclosed be based on the information used by management to monitor the entity's activities, and allows this information to be generated using the same rules and accounting policies and the same presentation as those used in the entity's management reporting systems.

8.1. Early application

Since the standard was adopted by the European Union at the end of 2007, several listed companies chose to apply it to their 31 December 2007 financial statements. Based on this experience, the AMF considers it useful to draw attention to the following points.

8.1.1. Definition of segments

Standards IAS 14 and IFRS 8 use different terms and concepts to organise the identification of segments of activity (e.g. reporting segments in one case and operating segments in the other).

IFRS 8 requires companies to indicate in the notes the factors used to define the different segments. It also requires specifying the types of products and services that make up each segment.

In the event of a major change in segments due to the change of standard, it is important to explain the reasons for the change in sufficient detail, identifying the effects of the application of the new standard from the effects of the change in the operating structure so that users can understand the link between the new disclosures and the descriptions of business lines, exposures, and profitability profiles.

In the event of a major change in the presentation of segments with the implementation of IFRS 8, or if the identification of segments provided in the management report does not appear to be consistent with the segment information provided with the financial statements, the AMF is authorised to conduct investigations of the issuers and their external auditors to verify the faithfulness of the disclosures.

8.1.2. Scope of segments

The AMF has found that the composition of segments is sometimes modified even though the names and the nature of the segments have not changed. In such cases, it is useful to specify what changes in scope have been made and the reasons for those changes.

8.1.3. Accounting principles applied to segments

Another important innovation introduced by this standard is the possibility of segment reporting using indicators that do not comply with IFRS, providing that this method is used for internal reporting.

The AMF notes that regulators have always recommended that the use of so-called ‘non-GAAP’ indicators in disclosures be subject to certain precautions. Indeed, the COB in its time, and subsequently the AMF, CESR, and IOSCO have all made the same recommendations:

- define these indicators precisely;
- keep the same composition from one accounting period to the next;
- reconcile these indicators to the accounting data that are disclosed.

It is necessary to define the composition of sector performance and to use the same composition from one accounting year to the next. As for the reconciliation to accounting data, IFRS 8 requires only reconciliation to consolidated totals. However, many users would like to have this information, so companies may therefore consider disclosing it voluntarily.

8.1.4. Disclosure of changes in accounting method

IAS 8.5 defines accounting policies as the specific principles, bases, conventions, rules, and practices adopted by an entity to draw up and publish its financial statements. In the event of a change in accounting policy (in particular, if the change is required by a standard or an interpretation – see IAS 8.14), the entity must provide certain disclosures required by paragraph 28. These requirements apply whatever the circumstances, unless it is impossible to provide some information, such as the quantitative impact on periods reported as comparative information. Thus the AMF considers that while IFRS 8 applies only to information provided in the notes, entities opting for early application of the standard should specifically disclose any change in accounting method, as required by IAS 8.28(a)-(c).

8.2. Delaying application beyond 2008

If the decision is made not to apply IFRS 8 to 2008 financial statements, then, in accordance with the provisions of IAS 8.30-31, information on the impact of this standard should be provided in the notes, since it has been adopted by the IASB but is not yet effective. This information should include:

- the anticipated date for implementation of the standard
- the impact that can be expected on financial disclosures
- an indication of possible additional write-downs of goodwill due to changes in allocation to groups of CGUs.

9. New standards and interpretations

9.1. Application of standards and interpretations in the European Union

In order to be applicable, the standards and interpretations of the IASB must first be endorsed by the European Union. A delay in adoption by the EU can result, in some cases, in an inconsistency between the accounting framework published by the IASB and the EU framework.

The AMF reminds readers that:

- a standard that has not yet been endorsed by the EU may be applied in advance if it does not conflict with the standards that have already been endorsed by the EU. An interpretation may also be applied before it has been endorsed by the EU. In both cases, the specific transition

provisions do not apply, and the new issuance should be applied retrospectively as provided by IAS 8;

- the AMF has adopted the recommendation of IOSCO, published by IOSCO on 6 February 2008[15], calling on issuers who apply an accounting framework that is close but not identical to IFRS, to mention this fact in the notes and to explain the differences between the two frameworks.

The AMF also reminds readers that, in accordance with the position taken by the Accounting Regulatory Committee in November 2005, it is possible to take into account, starting on the balance sheet date, standards and interpretations endorsed before the financial statements are signed. [16]

Finally, when a standard or interpretation has been issued by the IASB but application is not yet mandatory, information on the anticipated impact of the standard should be disclosed in the notes, in accordance with IAS 8.30-31.

9.2. Annual amendments

On 22 May 2008, the IASB published 35 amendments affecting 20 standards. Most of these amendments become mandatory for accounting periods starting on or after 1 January 2009. Mandatory application of the amendments to IFRS 5 is delayed; they apply to accounting periods starting on or after 1 July 2009.

At present, the EU is not expected to endorse these amendments before the third quarter of 2009. Nevertheless, in accordance with the provisions described above, individual amendments may be applied in advance if they do not conflict with the standards currently in force in the EU.

However, the following amendments may not be applied to 2008 financial statements because they are not compatible with the current provisions of EU-endorsed standards:

- IAS 23 – *Borrowing costs* - Components of borrowing costs
- IAS 40 – *Investment property* – Accounting treatment of investment property under construction.

[15] Press release of 12 February 2008, available at http://www.amf-france.org/documents/general/8172_1.pdf

[16] 2) Approval procedure continuing after the balance sheet date
The Commission noted that a question had arisen regarding the application date for standards endorsed by the European Union. This is especially relevant where the IASB publishes a standard before the balance sheet date of a company but it is endorsed by the EU and published in the Official Journal after that date. In general, European regulations that endorse IFRS require companies to apply a standard "no later than the end of the financial year". This approach is similar to the approach taken by the corresponding IFRS, which incorporate an application date and a provision encouraging early application.
For this reason, the Commission has informed Member States that regulations endorsing IFRS that have been published in the Official Journal and that become applicable after the balance sheet date but before the financial statements are signed may be used by companies (without their being mandatory) if early application is permitted in the regulation and the related IFRS.

9.3. IFRIC 11: IFRS 2 – Group and treasury share transactions

This interpretation was endorsed by the EU on 1 June 2007. Application is mandatory for accounting periods starting on or after 1 March 2008. Companies whose accounting periods start on 1 January or 1 February may, under this rule, choose not to apply IFRIC 11 to their 2008 financial statements. Thus this rule creates an inconsistency between the accounting framework published by the IASB and that endorsed by the EU.

From the point of view of the AMF, it would be helpful if, as far as possible, issuers could adopt the same application date: in most cases, 1 January 2008. This would avoid inconsistencies with IASB standards.

Some issuers may not wish to apply IFRIC 11 to their accounting period that starts on 1 January 2008. Because this would create inconsistency with IASB standards, the AMF reminds the issuers concerned that it has adopted the IOSCO recommendation on 6 February 2008, calling on issuers who apply an accounting framework that is close but not identical to IFRS to mention this fact in the notes and to explain the differences between the two frameworks. Moreover, IAS 8.30 requires the disclosure of information on the impact of the application of the future standards on the next financial statements.

9.4. IFRIC 12 – Service concession arrangements

This interpretation, issued by the IASB in November 2006, received positive endorsement advice from the EFRAG in March 2007. However, it has not yet been voted on by the members of the ARC and thus has not yet been endorsed by the EU.

The IASB set the application date for this interpretation at 1 January 2008. Since the EU has not endorsed the interpretation, this creates a new inconsistency between the IFRS accounting framework and EU-endorsed standards. In practice, however, the application of this interpretation can be compatible with the standards that have already been endorsed by the EU. Thus the interpretation may be applied even before it has been adopted by the EU, with the exception of the provisions relating to first-time application, which waive the requirement under IAS 8 to make retrospecctive adjustments in the event of a change in accounting method.

9.5. IFRIC 13 – Consumer loyalty programmes

Award credits granted to customers under a customer loyalty programme are considered as a separate component of a sale consisting of multiple components. Consequently, a portion of the initial sale price should be allocated to such credits and should not be recognised as income until later, when the customer uses the award.

Application of this interpretation is mandatory for accounting periods beginning on or after 1 July 2008.
The interpretation received positive endorsement advice from the EFRAG (in May 2008) and the ARC (in

July 2008), and should be endorsed by the EU before the end of the year. Early application to 2008 financial statements is possible since the interpretation does not conflict with the standards that have already been endorsed by the EU.

9.6. IFRIC 14 – The limit on a defined benefit asset, minimum funding requirements, and their interaction

This interpretation deals with the determination of the economic benefits resulting from overfunding of an employee benefit plan and from minimum funding requirements. It provides details on the methods for determining whether a surplus resulting from refunds or reductions in future contributions can or cannot give rise to the recognition of an available asset.

It also specifies the effect of statutory or contractual minimum funding requirements on the valuation of the asset or liability for post-employment or other long-term benefits. In particular, it requires that a liability must be recognised if the employer is required to pay contributions to cover a funding shortfall for past service on the minimum funding basis, if those contributions are not available to the employer.

Application of this interpretation is mandatory for accounting periods beginning on or after 1 January 2008. The interpretation received positive endorsement advice from the EFRAG (in April 2008) and the ARC (in July 2008), and should be endorsed by the EU before the end of the year. It should therefore apply to 2008 financial statements.

9.7. IFRIC 15 – Agreements for the construction of real estate

Interpretation IFRIC 15 deals with the accounting treatment of revenue from construction contracts (in particular, for real estate developments). It was approved by the IASB in June 2008 and applies to accounting period beginning on or after 1 January 2009 (retroactive application). Early application to 2008 financial statements is permitted.

This interpretation stems from the doubts expressed by a number of users as to whether IAS 11, which deals with long-term contracts, should apply to real estate development contracts. Indeed, although this type of contract involves performance over more than one accounting year, the acquirer generally purchases the property before construction is completed and has only a very limited ability to modify the specifications of the property. The IFRIC confirmed that, when this decision-making power is limited, IAS 11 does not apply and revenues should be recorded at completion. However, the IFRIC recognised that specific requirements of local law or the contract can result in a gradual transfer of the risks and benefits associated with ownership of the property, and that consequently the application of IAS 18 can result in the recognition of revenues by the developer or construction company on a percentage-of-completion basis as construction progresses. For issuers who do construction business in France, it would appear that the so-called VEFA pre-sale contract, which calls for a phased transfer of the risks and benefits associated with ownership of the property, falls within the class described above, where application of IAS 18 is likely to result in the recognition of revenue as construction progresses.

It should also be noted that the scope of IFRIC15 is voluntarily limited to real estate construction contracts (IFRIC 15.4-5). The basis for conclusions (BC5 and BC6) confirms this restrictive view: the IFRIC did not wish to enlarge the interpretation's scope of application.

However, as the Basis for Conclusion also indicates (particularly BC6), the principles established by IFRIC 15 may be taken into consideration by issuers in the treatment of contracts that share the characteristics of real estate construction contracts. BC6 raises this possibility explicitly, drawing a link with IAS 8.

The reasoning given in the interpretation is interesting: the analysis of the contract is conducted in four steps:

- identify the various separate components of the contract and, for each component, analyse the following questions:
- does the component satisfy the definition of construction contract as defined by IAS 11?
- or is it only a provision of services?
- or, finally, is it a sale of goods ? in this case, the question is the date on which the risks and benefits associated with ownership of the property are transferred:
    - is the transfer gradual, as construction of the property proceeds?
    - or does the transfer occur on a specific date (for example, the date of completion or delivery)? Only in this last case are revenues recognised at completion.

10. European proposal regarding exemption from consolidation

The application of Regulation (CE) 1606/2002, which requires companies traded on a regulated market to apply IFRS, has been subject to numerous discussions regarding its relationship to the 7th Directive (83/349/EEC) on consolidated accounts. These discussions have focused on the consequences of Article 13 of the 7th Directive, which provides that a subsidiary or group of subsidiaries need not be included in consolidated accounts if they are not material. However, the articles establishing the obligation to draw up consolidated accounts do not take this criterion into account.

On the other hand, IFRS take the materiality of the interest into account. Some preparers consider that when there are one or more non-material subsidiaries, IAS 27 does not apply, and consequently that they are not required to draw up consolidated accounts in accordance with IFRS.

We note with interest that, on 9 June 2008, the European Commission published a proposal to modify the 7th Directive whereby companies whose subsidiaries, taken individually and collectively, are not material would be exempt from the requirement to draw up consolidated accounts in accordance with IFRS.