

Beyond the GAAP

February 2009

Editorial

Spring is coming along with several key steps for standards setting. In March, the IASB will receive the comment letters on major projects: Consolidation, Relationship with the State and Constitution Review. Then they will receive the answers to Revenue Recognition and Financial Statement Presentation. We kindly invite you to pay particular attention to the study on the presentation of financial statements in this issue. Changes proposed by the Board should be examined carefully.

Happy reading!

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A Frenchman at the helm of the IVSC

On 4 March, the International Valuation Standards Council (IVSC) announced the appointment of a new Board of Trustees. It will be chaired by Michel Prada, former president of the AMF, the French market regulator.

The IVSC develops valuation procedures based on a single collection of valuation standards recognised worldwide.

On taking up his position, Michel Prada stated that there was a greater need than ever for clarity in valuation standards.

The standardisation of valuation, under the auspices of an independent global organisation, was in his view a vital step in reducing investment risk, increasing confidence in financial statements and providing a consistent approach to the valuation of portfolios and assets.

Finally, he noted that in the current crisis he feared conflicting responses, and reiterated the IVSC's intention of working in close co-operation with other standard setters and international regulatory organisations.



MAZARS

IFRS news

➤ Regulated activities

In December 2008, the Board decided to include a project on regulated activities on its agenda. In February 2009, the Board defined the scope of the future standard as price regulations satisfying the following criteria:

- emanating from a body duly authorised to fix prices applicable to the client,
- being of the "cost-of-service" type (or "time & materials" contracts under IAS 11).

According to the Board, only these regulatory regimes can create an asset or a liability, insofar as prices are set in order to enable the recovery of specific costs borne by the entity for the supply of goods or services (minimum profit or within a range).

The Board will publish an exposure draft by June 2009.

➤ Derecognition of financial instruments

In February the IASB completed its deliberations prior to the publication of an exposure draft on the conditions for the derecognition of financial instruments.

This project has been energetically pursued as part of the measures to be taken to remedy the problems highlighted by the financial crisis.

Having examined two possible approaches, the Board has come down in favour of the more restrictive option which is also closer to the provisions of IAS 39. The second - more conceptual - approach will, however, also be presented as an alternative in the exposure draft. The two approaches are accompanied by requirements for additional disclosures.

The publication of the exposure draft is expected at the end of March.

➤ Valuation of insurance liabilities

Continuing its deliberations of September and October 2008, a tiny majority of members of the Board said they would prefer a "fulfilment value" approach to insurance liabilities.

Under this approach, insurance liabilities are measured on the basis of the forecast cash outgoings to which the entity is exposed (and not on the basis of those to which any market participant might be exposed).

The Board has reiterated the need for consistency between the standard on insurance liabilities, the standards on provisions and other non-financial liabilities (IAS 37 revised) and the standard on revenue recognition (current DP ahead of revision of IAS 11 and IAS 18).

Some would like to see this as a tipping-point in the Board's deliberations, although the members of the Board remain very divided.

➤ Fair value measurement specifications

In January, specifications for the measurement of liabilities at fair value were discussed, specifically under illiquid market conditions.

The Board continued its work in February and decided that the fair value of a liability was necessarily equal to the fair value of the corresponding asset held by the creditor.

➤ XBRL at the heart of the work of the IASCF

XBRL (eXtended Business Reporting Language) is a computer format for encoding financial information and producing standardised financial statements. Its "taxonomy" is a dictionary for use in encoding financial data.

On 12 January the IASCF published the IFRS Taxonomy 2009 for public comment. To allow it to be used anywhere in the world, this taxonomy faithfully reflects the most recent technical XBRL specifications. The aim is to share the same coding system so that information in XBRL can be exchanged and accessed using comparable criteria.

This IASCF initiative is thus part of an overwhelming trend towards the adoption of XBRL throughout the world:

- the US SEC recently published a binding text which will eventually compel all companies quoted on its securities market to submit their information in XBRL, in accordance with the American accounting standard (US GAAP) but also, for foreign entities, under IFRS.

- Similar projects are under way in Japan, Israel, China, Latin America, Canada, Australia and most European countries.

From an accounting point of view, around 2700 elements ("tags" in XBRL jargon) are required to express IFRS concepts.

The financial community is invited to submit comments on the IFRS Taxonomy by 12 March. The final version is expected in early April 2009.

XBRL requires no technical knowledge; only IFRS accountancy expertise is required to ensure that the concepts of the most recent IFRS standard have been correctly transcribed in the taxonomy.

The taxonomy, and details of how to submit comments and suggestions, are available on the IASB web site: <http://www.iasb.org/XBRL/XBRL.htm>

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Presentation of financial statements: is the revolution just around the corner?

On 16 October 2008, the IASB and the FASB published a Discussion Paper entitled "Preliminary Views on Financial Statement Presentation", as part of phase B of the Performance Reporting project begun in 2004.

This text proposes major changes in the presentation of financial performance:

- increased consistency between different financial statements,
- distinction between activities creating value (the 'business' activities) and financing in financial statements,
- presentation of cash flows using the direct method,
- presentation in the notes of a statement reconciling changes in assets and liabilities over the period,
- the result for the period and cash flows, etc.

This Discussion Paper is the result of several years of discussions by the Boards, conducted in parallel with the consultation of experts¹. Comments may be submitted until 4 April 2009.

¹(JIG, Joint International Group and FIAG, Financial Institution Advisory Group)

➤ Before phase B... phase A!

Phase A of the Performance Reporting project (see Beyond the GAAP N°4 of April/May 2007) culminated in the publication of the revised IAS 1 standard in September 2007. The amendments related to the definition of the statements that comprise a complete set of financial statements and to the comparative periods for presentation.

At the time, the main topic of discussion concerned the presentation of transactions impacting on equity and conducted with third parties who are not shareholders (or elements of "other comprehensive income"). For the IASB, this amendment was an opportunity to define the "statement of comprehensive income", the statement presenting all the income and expenses for the financial year, whether these are included in the net result or recorded directly in equity.

To forestall significant opposition, the IASB decided to authorise the presentation of this statement of comprehensive income in two separate statements:

- the first – known as the "statement of financial position" - presents the income and expenses that contribute to the formation of the net result;
- the second – which is also known as the statement of comprehensive income – is based on the net result and presents only the other elements of the comprehensive income.

The IASB introduced this presentation option as a temporary measure, and with the publication of the Discussion Paper on phase B of the Performance Reporting project it confirms that it would like to eliminate it.

➤ Objectives of financial statements

The Boards identified three principal objectives underlying the proposed model for the presentation of financial statements:

- to portray a cohesive financial picture of the entity in its financial statements;
- to break down the information so that it is useful in predicting an entity's future cash flows;
- to help the reader of financial statements to assess an entity's liquidity and financial flexibility.

Cohesion

The main idea is that, for any given homogenous group of assets or liabilities, it should be possible to follow, line by line, the income and expenses associated with these groups and the associated cash flows. The items presented in the statement of changes in equity (which now only includes transactions with shareholders) would be excluded from this approach.

As far as possible, an entity should therefore ensure that the descriptions used in the balance sheet, the profit and loss account and the statement of cash flows are identical. Similarly, the hierarchy of the various elements should be the same from one financial statement to another.

According to the Board, the classification of assets and liabilities in the balance sheet dictates, in a mechanical fashion, the classification of income and expenses and of the associated cash flows in the profit and loss accounts and the cash flow statement respectively.

Disaggregation

In order to be able to assess more easily the amount, timing and uncertainty of future cash flows, the Boards believe that financial information should be broken down into homogenous groups. This breakdown should allocate the various elements in the accounts to the following categories:

- **Business:** this category must demonstrate how an entity creates value in the course of its activities (for example by producing goods or providing services). This category is itself subdivided into two headings: "Operating", which includes all the elements relating to the entity's principal current activity, and "Investing" which corresponds to assets and liabilities outside the core business. Thus this section has no connection with the 'Investment' category as it currently exists in the cash flow statement;
- **Financing:** this category must demonstrate how an entity finances its operational activities. Items allocated to this category must be presented in such a way as to distinguish between different sources of finance.

The classification of items in the Business and Financing categories should reflect the "management approach". Under this approach, each asset and each liability should be allocated to the category best reflecting the way in which the entity uses this asset or this liability. Thus an entity has no choice of category, this being dictated by the manner in which it uses the assets and liabilities to create value or to finance its activities.

In the notes to the financial statements, the entity should explain its policy in allocating different items to the Business and Financing categories, describing the activities in which the entity is engaged and the way in which the management conceives each activity.

Liquidity and financial flexibility

An entity should present information in a way that helps the users of financial statements to assess the extent to which the entity:

- will be able to meet the due dates for the repayment of its loans;
- will have the capacity to finance the development of its operational and investment activities.

In practice, the proposal is that this objective should be met by requiring assets and liabilities to be presented not in accordance with a distinction between the current and the non-current, as happens today, but by distinguishing between short-term (i.e. less than one year) and long-term. Thus the breakdown would no longer reflect the length of the operating cycle (which may vary from one enterprise to another, and which may exceed one year).

➤ What are the consequences for the presentation format for financial statements?

In practice, the application of the principles set out in the Discussion Paper would lead to a presentation format for financial statements that can be summarised as follows:

Statement of financial position	Statement of comprehensive income	Statement of cash flows
<p>Business</p> <ul style="list-style-type: none"> • Operating assets and liabilities • Investing assets and liabilities 	<p>Business</p> <ul style="list-style-type: none"> • Operating income and expenses • Investing income and expenses 	<p>Business</p> <ul style="list-style-type: none"> • Operating cash flows • Investing cash flows
<p>Financing</p> <ul style="list-style-type: none"> • Financing assets • Financing liabilities 	<p>Financing</p> <ul style="list-style-type: none"> • Financing asset income • Financing liability expenses 	<p>Financing</p> <ul style="list-style-type: none"> • Financing asset cash flows • Financing liability cash flows
<p>Income taxes</p>	<p>Incomes taxes on continuing operations (business and financing)</p>	<p>Income taxes</p>
<p>Discontinued operations</p>	<p>Discontinued operations, net of tax</p>	<p>Discontinued operations</p>
	<p>Other comprehensive income, net of tax</p>	
<p>Equity</p>		<p>Equity</p>

In detail, the implications of the practical application of the measures contained in the Discussion Paper would be as follows.

Statement of financial position

The balance sheet would no longer be presented in the traditional format as we know it today, i.e. on the basis of a division between assets and liabilities.

Some further clarifications can be made:

- cash equivalents should be presented in the same way as other short-term investments. Thus they would no longer be presented along with cash. In practice, the concept of cash equivalent would simply disappear;
- an additional breakdown would be carried out for assets and liabilities of a similar nature which are valued in different ways. For example, long-term debts recognised at amortised cost should be recorded separately from long-term debts measured at fair value;
- total assets and total liabilities should be presented either in the balance sheet or in the notes. Additionally, sub-totals should be presented for short-term assets and liabilities respectively, and long-term assets and liabilities respectively.

Statement of comprehensive income

As previously described, phase B of the *Performance Reporting* project goes much further than the conclusions which the IASB had reached in phase A. Nevertheless, some may welcome the fact that the concept of net result has not (yet?) disappeared from the single statement of overall performance which should be presented. Indeed, the Discussion Paper does not propose that the various items corresponding to the other income and expenses booked directly in equity (such as the changes in fair value of AFS financial assets) should be allocated to the expenses and income lines in the statement of financial position. One of the main fears associated with this project seems thus to have been removed. However, the project does not tackle the thorny issue of recycling other elements of the comprehensive income in the net result, particularly cash flow hedges or securities held for sale (where these shares are written down or sold).

Furthermore the Discussion Paper proposes breaking down the profit and loss account first by function, then by nature, to the extent that each of these pieces of information is useful in forecasting the entity's future cash flows. If details are not available by function, this would indicate that the enterprise did not regard this information as relevant. Such information can be supplemented by a closer level of detail if this is considered relevant. This additional information can be presented in the notes to the financial statements, in order to avoid overburdening the profit and loss account.

Finally, a tax expense or benefit would not be allocated to the different categories of income and expenses. The only disaggregation would result from the distinction between continued and discontinued operations. Taxation relating to other income and expenses (presented net of tax below the profit and loss account in the statement of comprehensive income) would be allocated line by line in the notes.

Foreign exchange differences, whether resulting from the conversion of transactions or from the conversion of financial statements in foreign currency, should be allocated to categories identical to those used to classify the assets and liabilities that give rise to these differences.

Statement of cash flows

Several major changes are also proposed for the establishment of the statement of cash flows.

Thus this statement should in the future reconcile not the amount of cash and cash equivalents between the opening and the closing of a given period, but simply the amount of cash. However, most financial analysts would have preferred the changes to move rather in the direction of a reconciliation of an entity's net indebtedness.

Further, IAS 7 currently authorises two methods for the establishment of a statement of cash flows:

- the direct method, in which the main incoming and outgoing cash categories are presented;
- the indirect method, which uses net result as a starting point and presents variations in operating cash flow, adjusting for the expenses and income which have no impact on cash flow (such as allocations to depreciation).

While the indirect method is the method most used by groups, the Discussion Paper proposes to eliminate this method in favour of the direct method. According to the IASB, only this method can achieve the objective of coherence between financial statements. This proposal is likely to meet with strong opposition from commentators since both analysts and preparers favour the indirect method.

Finally, the application of the principle of coherence could also lead to a change in the presentation of certain flows. For example, the acquisition of property, plant and equipment and intangibles to meet the needs of the entity's core business should be classified in operating cash flows rather than investment cash flows.

Supplementary reconciliation schedule to be provided in the notes:

This is another crucial point in the Discussion Paper. The DP proposes to require the presentation of a schedule in the notes to the financial statements, which would reconcile the statement of cash flows with the statement of comprehensive income. This would make it possible to explain changes in the assets and liabilities between the beginning and end of the financial period.

The reconciliation schedule would be established as follows:

- disaggregation of changes in assets and liabilities into those which have an impact on cash flows and those which do not;
- for non-cash movements, distinguishing those changes which result from remeasurements and those which do not;
- finally, the disaggregation of changes due to re-measurements into those resulting from recurring remeasurements (such as adjustments to the fair value of securities available for sale at each closing date) and others.

The reconciliation schedule would thus result in the preparation of a table with seven columns:

	Changes in assets and liabilities excluding transactions with owners						
	not from remeasurements		From remeasurements				
	Cash component	Accrual components					
A	B	C	D	E	F	G	
Caption in statement of cash flows	Cash flows	Accruals, allocation and other	Recurring fair value changes/ valuation adjustments	All other	Comprehensive income (B+C+D+E)	Caption in statement of comprehensive income	

The exposure draft which will follow this discussion paper is expected in the first half of 2010, while the final standard will not be published before 2011. In the meantime, many comment letters should be written.

IFRIC 18 - Transfers of Assets from Customers

On 29 January 2009, the IASB published interpretation IFRIC 18 - Transfers of Assets from Customers, approved by the IFRIC in November 2008.

This interpretation deals with the determination of the circumstances and conditions under which the revenue from the transfer of assets by a customer under a commercial contract will be recognised. Its application is particularly relevant to public service sectors such as water, electricity and telecommunications distribution. Some subcontracting agreements can also be affected when assets are to be transferred to the subcontractor by a client.

Beyond the GAAP provides you with an overview of the main provisions of this new Interpretation.

➤ Scope

IFRIC 18 deals with the handling of transfers of items of property, plant or equipment in the accounts of entities which receive such a transfer from a customer. The contracts concerned are those which make provision for the receipt by an entity from one of its customers of a transfer of an item of property, plant or equipment to be used to connect the customer to a network and/or provide it with access to goods or services.

IFRIC 18 also applies when an entity receives cash from a customer to finance the acquisition or the construction of an item of property, plant or equipment to be used to connect the customer to a network and/or provide it with access to goods or services.

The IFRIC does not prohibit the application of this Interpretation by analogy to other asset transfers, e.g. a transfer of intangible fixed assets.

However, IFRIC 18 explicitly excludes from its scope the situation where the asset transferred is an infrastructure used in the course of a concession contract falling within the scope of IFRIC 12 - Service Concession Arrangements. This type of agreement does not involve transferring a right to control the use of the infrastructure to the operator.

➤ Who controls the transferred item of property, plant or equipment?

Whether a transfer of ownership is involved, an entity receiving a transfer from a customer must determine if it controls the item or if the customer retains control.

IFRIC 18 refers to the definition of an asset given in the IASB Framework and specifies that the fact of an entity's being able to decide how the item will be operated, maintained or replaced indicates that this entity controls it.

The fact that the entity has to use the item of property, plant or equipment in order to create the agreed service or services in exchange for the transfer is thus not significant in this analysis.

➤ How shall the item of property, plant or equipment be recognised in the financial statements?

If the entity controls the item of property, plant or equipment, it must recognise that item in accordance with IAS 16 - Property, Plant and Equipment.

As the transferred item of property, plant or equipment is acquired in exchange for the supply of one or more services (connection to a network and/or provision of access to goods or services), its initial cost is measured at the fair value of the item on the date of the transfer.

➤ What is the corresponding entry for the transferred item of property, plant or equipment?

IFRIC 18 presumes that the exchange transaction described above forms an integral part of the normal business activities of the entity. The issue arises of the recognition of revenue from normal activities on the basis of IAS 18 - Revenue, namely immediate or deferred recognition.

Under IFRIC 18 and in accordance with paragraph 13 of IAS 18, the entity must identify the service or services which it is contracted to provide in exchange for the transfer of the item of property, plant or equipment by the customer: connection to a network and/or provision of access to goods or services.

The Interpretation provides indicators which allow the identification of separately identifiable services within a single contract. Among them, we note that:

- The fact that a reduced price for the provision of access to goods or services (or for the goods and services themselves) is offered only to customers who have transferred an item of property, plant or equipment indicates that the provision of access is a separately identifiable service;
- conversely, the fact that an entity's having to charge an identical price to each of its customers in order to comply with a regulation regardless of whether they have transferred an item of property, plant or equipment, indicates that the provision of access is not a separately identifiable service

On this last point, we note that the IFRIC has taken into consideration the comments submitted on the draft D24 - Customer Contributions. These comments disputed the assertion that an entity should in every case have an obligation of performance once the connection to the network was made. In its final Interpretation, the IFRIC took an approach based on the principle of identification of separately identifiable services set out in IAS 18.

➤ Recognition of revenue from normal activities

If a single service is identified, IFRIC 18 refers to paragraph 20 of IAS 18 setting conditions for the recognition of revenue from the provision of services.

If more than one service is identified, IFRIC 18 refers to paragraph 13 of IAS 18 which states that the fair value of the consideration received or to be received must be allocated to each service and that the revenue recognition criteria must be applied to each service.

Finally, if the provision of access to goods or services is a service identified in the contract, the period of access provision is generally specified in the contract. If not, IFRIC 18 states that revenue cannot be deferred beyond the period of use of the transferred item of property, plant or equipment.

➤ How shall a transfer of cash by a customer be recognised in the accounts?

According to the IFRIC, a transfer of cash by a customer of which the sole object is to finance the acquisition or the construction of an item of property, plant or equipment to be used to connect the customer to a network and/or provide access to goods or services produces the same economic effects as a transfer of an item of property, plant or equipment. In consequence, revenue recognition must be similar.

In practice, the entity accounts for the item of property, plant or equipment at its purchase or construction price as defined in IAS 16. It recognises a total revenue equal to the total cash received from the customer, which is either recognised immediately or deferred depending on the services identified.

➤ Effective date and transitional provisions

IFRIC 18 applies prospectively to transfers of assets received on or after 1 July 2009. Earlier application is permitted provided that fair valuations of the items transferred could be obtained at the time those transfers occurred.

Events and FAQ

Events/publications

Conference on tax law changes 2009

Please save the date: Mazars is organising a conference on tax law changes and their application on 21 May 2009 provided that the new legislation will be accepted by then. A confirmation will be sent 3 weeks before the event.

The language of this event will be Hungarian.

Frequently asked questions

- Forward sale of emission rights;
- Timing of recognition of a compensation indemnity with a suspensive condition;
- Deferred tax asset recognition post-allocation date for the cost of a business combination;
- Lease income from operating leases: Recognition on a straight-line basis over the lease term or another systematic basis?
- Accounting treatment of income from advertising agency: commissions or turnover?
- Financial instruments: preferred shares subscribed by the state in connection with the crisis.

Upcoming meetings of the IASB, IFRIC and EFRAG

IASB

16 - 20 March 2009
23 - 25 March 2009
20 - 24 April 2009

IFRIC

5 - 6 March 2009
7 - 8 May 2009
9 - 10 July 2009

EFRAG

26 - 27 March 2009
28 - 30 April 2009
4 - 5 June 2009

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