While the IASB has pledged that no new standards will become compulsory before 1st January 2009, there is still plenty of news from the Board: it has published the exposure draft on IFRS for SMEs and an exposure draft of proposed amendments to IAS 24 on Related Party Disclosures, as well as continuing with round-table discussions on the subject of measurement, and so on.

In this environment, there is much debate within professional bodies. Mazars plays a key role in these debates, as witnessed by our presence in a number of these institutions.

Happy reading!

Michel Barbet-Massin   Jean-Louis Lebrun
### Changes to the procedure for adoption of IFRS in Europe

The procedure for adoption of IFRS in Europe, which was already complex, has recently been modified. The SARG (Standards Advice Review Group) has been created in order to guarantee the objectivity and balance of recommendations made by the EFRAG to the European Commission. Moreover, the role and powers of the European Parliament have been increased. Doctr’in gives an overview of the impact of these modifications to the procedure for adoption of IFRS in Europe.

Europe has had an adoption procedure since 2002, when the European Regulation on the adoption of IFRS in Europe was published. This procedure aims to ensure that European law, of which the IFRS form part, is not under the sole control of the IASB in this area.

The adoption procedure can be summed up as follows:

- First of all, the EFRAG (European Financial Reporting Advisory Group) issues an opinion, in its role as a group of independent experts, on the possibility of Europe adopting a rule published by the IASB. The opinion assess the technical quality of the standard or interpretation;
- Next, the ARC (Accounting Regulatory Committee), which is composed of two representatives from each EU country, states whether or not it endorses the adoption of the rule;
- Finally, the European Commission, overseen by the European Parliament and the Economic and Financial Affairs Council (EcoFin), decides whether or not to adopt the standard (or interpretation), after consideration of the opinions of the ARC and the EFRAG. Parliament has a right of veto over the adoption procedure in order to ensure that the European Commission does not exceed its remit. EcoFin only intervenes if the European Commission proposes to adopt a rule which was not endorsed by the ARC.

In practice, a standard or interpretation is adopted in the European Union approximately six months after its publication by the IASB. This period may be extended due to changes made to the adoption procedure in 2006.

After officially recognising the EFRAG, the European Commission decided in July 2006 to create a new committee, the SARG, to advise the European Commission on the objectivity and balance of the adoption or rejection recommendations from the EFRAG. The European Commission has no control over the EFRAG, which is a private organisation. The seven members of the SARG were recently appointed (Official Journal of the European Union, 6 February 2007) and will have to provide an opinion within a month of the European Commission’s receipt of the EFRAG’s recommendation. The SARG will start work in March with the IFRIC 12 interpretation on concession.

The role and powers of the European Parliament have been increased: the rules proposed by the Commission will potentially be subject to an in-depth review by an ad hoc scrutiny committee. It is impossible to tell currently what impact such a change could have on the adoption procedure for IFRS in Europe, in terms of either time periods or political situation.
Related parties: IASB publishes exposure draft

The IASB published an exposure draft on 22 February 2007 on the proposed modification of the IAS 24 standard on related parties. Comments can be sent to the IASB until 25 May 2007.

The proposed amendments are:

- Entities which are controlled or significantly influenced by the State would be exempt from providing specific information on transactions between one another or with the State. This exemption would not apply if there are indicators that one entity has influenced the other (non-market rate transactions, shared resources, economically significant transactions, etc.);

- A change in the definition of a “related party” in order to eliminate inconsistencies in the current standard. Thus, a subsidiary of entity A and an associate of entity A (i.e. a company in which A has significant influence but not control) could be related parties. On the other hand, two associates of the same entity would not be considered related parties. Finally, if an individual has control, joint control, a significant influence or significant voting rights in an entity in addition to a key management role in the reporting entity, details must be provided of the relationship between the two entities.

It should be noted that the exposure draft does not clarify the concept of “key management personnel”, although this was interpreted in very different ways by companies when preparing the first financial statements under IFRS.

Mazars’ Doctrine department produced a technical brochure in November 2006 on the implementation of IAS 24 by Eurostoxx 50 companies for IFRS publication in 2005. This brochure is available on request (doctrine@mazars.fr).

IFRS financial statements: the main traps to avoid

The consolidated financial statements for listed companies closing on 31 December must be prepared in conformity with IFRS, for only the second time ever. In this context, we felt it would be useful to take another look at the main traps to avoid when preparing IFRS financial statements.

Attention must be paid to the information required by the various standards from the IASB framework and the feedback on analysis of IFRS accounts for 2005.

The following elements are most often omitted or left incomplete:

- The accounting principles used for subjects which are not explicitly covered by IFRS (put options on minority interests, variations in interest rates after the takeover date, concessions, etc.) and management’s opinions (IAS 1);

- A list of the standards and interpretations for which early application has been rejected, and the expected impact of their application. This is the case for:
  - IFRS 7 “Financial Instruments: Disclosures”;
  - The IAS 1 amendment “Presentation of Financial Statements – Capital Disclosures”;
  - IFRIC 6 “Liabilities Arising from Participating in a Specific Market – Waste Electrical and Electronic Equipment”;
  - IFRIC 7 “Applying the Restatement Approach under IAS 29 Financial Reporting in Hyperinflationary Economies”;

News in brief
IFRIC 8 “Scope of IFRS 2: inclusion of transactions where the consideration received is not identifiable”;
IFRIC 9 “Reassessment of Embedded Derivatives”.

- The reporting entity’s balance sheet date and the date on which the accounts will be approved (IAS 10);
- Information relating to events after the balance sheet date (IAS 10);
- Information on transactions with related parties (IAS 24);
- Information on financial risks (IAS 32);
- The implementation guidance for impairment of assets with an indefinite useful life (IAS 36).

Particular attention should also be paid this year to information required by the adoption of the revised IAS 19 standard. The following key elements must be provided:

- A comparison of the opening and closing balances for the fair value of pension plan assets;
- The sensitivity of medical insurance liabilities and the corresponding balance sheet elements to a single percentage point change in medical costs;
- The present value of defined-benefit plan liabilities for the current year and the four preceding years, the fair value of plan assets and the plan’s surplus or deficit, as well as experience-related adjustments to plan assets and liabilities.

**IASB publishes exposure draft on IFRS for SMEs**

The IASB published the exposure draft on IFRS for SMEs on 15 February 2007 (see Doctr’ in October 2006) in the form of a 255-page draft standard, an application guide and the basis for conclusions. The aim is to provide a simplified version of IFRS, which stands alone and can be used by unlisted companies, as long as they have no financial responsibility to the public (financial institutions).

The simplifications made by the IASB to the current IFRS have cut the volume of the regulations for SMEs by 85%.

The modifications to the IFRS fall into three broad categories:

- Several subjects have been deliberately omitted as they are considered inapplicable to most SMEs (although it is compulsory to refer back to the IFRS if necessary) or too expensive for companies. These subjects include: interim financial reporting (see IAS 34), profit per share and segment reporting (information not required for SMEs), hyperinflation, payments per share, etc.;
- When the IFRS offer several accounting treatments, only the simpler option is included. For example, the model for revaluation of the fair value of tangible and intangible assets will be eliminated from the version for SMEs. An SME will however be able to choose a more complex option by referring to the full IFRS, unless a particular jurisdiction forbids this possibility when IFRS for SMEs are adopted;
- Several simplifications will be made to accounting and valuation procedures. These simplifications will notably apply to:
Financial instruments, notably including a simplified procedure for derecognising assets;
- Goodwill and intangible assets with an indefinite lifespan: it will no longer be obligatory to carry out an annual impairment test; this will only be carried out if indicators suggest that impairment is likely;
- Research and development expenses: they could be recognised as an expense, capitalisation being an option;
- Investment in joint ventures and associates which could be initially recognised at cost.

It is up to each State to decide which accounting framework (IFRS or non-IFRS) will apply to SMEs in that country. In any case, the European Union has not yet pronounced on the fate of this framework (this body of standards is not covered by Regulation 1606/2002 on the IFRS).

Mazars will comment on this exposure draft. The deadline for comments is 1st October 2007. It should be pointed out that for the first time, the IASB will publish official translations of the exposure draft in French, German and Spanish; these will be available in April 2007.

Presentation of financial statements

The Board’s March discussion was important as it dealt with the methods of analysing gains and losses by type of flow (cash flow, variations in fair value, variations in estimates, etc.).

This analysis, which was presented in table form in the 2003 balance sheet, was deeply criticised at the time.

In the proposals prepared by the staff for the March Board meeting, the balance sheet is still presented in list form. However, the staff suggested that a line-by-line comparison between the opening balance sheet and closing balance sheet should be required as an appendix, in order to show all the variations in assets, liabilities and equity by type of flow.

These proposals were welcomed in principle by the Board; however, their application across the board was rejected. Further discussions will thus take place.

In addition, the Board rejected the direct presentation method for the cash flow statement and considered eliminating the notion of cash equivalents.

Business combinations phase II

There was a dramatic development at the Board’s March meeting: the IASB members, having originally rejected the full goodwill method (recognition of goodwill attributed to minority interests), have finally adopted it, on condition that the assessment does not entail undue cost or effort.

In this context, the problem of convergence between the US GAAP standards and IFRS could be almost resolved.
IASCF Trustees publish the “Due Process Handbook for the IFRIC”

Following several months of discussions, the Trustees, at their January 2007 meeting, ratified the new due process for the IFRIC. The Due Process Handbook was published on the IASB website on the 2nd February 2007.

The IASCF decided to dissolve its Agenda Committee, the committee responsible for selecting topics for consideration by the IFRIC. There was a strong consensus among commentators on the dissolution of this committee.

Beginning with the March meeting, the IFRIC will hold public preliminary discussions to decide as to whether a topic should be included in the agenda. The decision will be made by simple majority. The outcome of these decisions will be posted on the IASB’s web site.

The IFRIC looks at IFRS 5

In March 2007, the IFRIC discussed certain difficulties in the application of the IFRS 5 standard, in the case of an entity which has undertaken to partially sell the securities it holds in a subsidiary, where that sale entails losing control of the company. Following the sale, the parent company will hold either a stake in an associated company or in a joint venture, or available-for-sale securities (non-consolidated).

Two main questions arise:

- At what point are the criteria for group-classification of non-current assets held with a view to sale fulfilled? When the sale entails losing control, or when the percentage sold is sufficiently significant to consider that the book value of the stake will be recovered principally by means of a sale, rather than by the continued use of the consolidated group of assets?

What portion of the assets and liabilities in the group which is to be sold is it appropriate to reclassify on the balance sheet: the entire stake or the portion which corresponds to the share of capital to be sold?

The IFRIC sees the two questions as linked: according to the committee, transferring control entails classification under IFRS 5; it is therefore appropriate to reclassify 100% of the consolidated assets and liabilities of the subsidiary as a group of assets held with a view to sale.

Further questions arise from the previously described situation, notably: should a subsidiary be classified as a discontinued activity when the subsidiary fits the definition of an activity under IFRS 5, but the entity intends to retain a significant influence over its ex-subsidiary following the sale?

The IFRIC observes that retaining a residual interest should not affect the classification of a company intended for sale as a discontinued activity under IFRS 5. This may well lead to divergence with regard to the US GAAP on this point, until convergence between the two frameworks on the concept of discontinued activities is achieved.

The IFRIC will decide at its upcoming session whether all or part of these issues should be subject to an analysis, given that certain issues are likely to be considered by the IASB in the framework of the Business Combinations Phase II project.
D20: client loyalty programmes

At its March 2007 meeting, the IFRIC continued to analyse the comments received following the publication of the D20 interpretation project relating to the accounting for client loyalty programmes.

The discussions focused on the method of allocating revenue. D20 suggests allocating the revenue to the various elements of the sale transaction on the basis of the relative fair value for each element. There are three types of objection to this:

- D20 goes beyond IAS 18 because the standard does not require this method of allocating revenue to be used when a transaction has several elements;
- Other valuation methods seem more suitable, such as valuation of the benefit granted on the basis of the residual fair value;
- This method could be used, by extension, in inappropriate situations.

The IFRIC has stated its preference for allocating revenue on the basis of relative fair value. The committee would however be prepared to accept an alternative method of valuing the benefit granted, such as valuing the benefit granted at fair value and recognising the revenue immediately as the difference between the total amount billed and this fair value.

The condition stipulated by the IFRIC for using this alternative valuation method is that it should not be the same as valuing the benefit granted at cost. The IFRIC staff have been asked to carry out a more in-depth analysis for discussion at the next meeting.

In addition, the IFRIC discussed improvements to be made to the interpretation project, such as adding guidance and examples, particularly on the method of recognising the lapse rate of the benefits granted, from the start until the obligation to the client is eliminated.

Finally, the IFRIC did not make a definitive statement on the implementation date of the interpretation, but it is likely to be published in time to be applied for the year beginning 1st January 2008 at the latest. If the application of this interpretation requires a change in accounting method from that previously used by an entity, the method must conform to IAS 8, which requires retrospective application unless this is impractical.

A revised interpretation project should be presented by the IFRIC staff at the next meeting in May. The IASB’s Board should vote on it in the June session.
Real estate: how are sales before construction is complete treated under IFRS?

When a property developer sells flats in a block which is still being built, should the proceeds of the sale be recognised as significant construction acts are completed or when the flats are delivered? Here is a summary of the issue, which the IFRIC has been debating for more than a year now. DOCTR’in brings you an update on the debate, which could have a significant impact on the companies concerned.

Is a sale of property a specifically negotiated contract?

Should revenue be recognised as work proceeds or on completion? In IFRS terms, this means: should we apply IAS 11 – Construction contracts or IAS 18 – Revenue?

In an initial and relatively literal reading of IAS 11, the IFRIC questioned whether a specifically negotiated contract as defined in the description of a construction contract under IAS 11 exists. It must be admitted that the concept is somewhat vague. Would the client’s choice of tiles for the bathroom or the colour of the carpet in their future flat be enough for the contract to qualify as “specifically negotiated”? The evidence would suggest not. On the other hand, would the client have to define the technical specifications of the overall job to meet the requirements of IAS 11? Again, no.

The client’s involvement in decisions on technical specifications is a concept borrowed from the US GAAP standards (SOP 81) and does not have an equivalent under IFRS. Moreover, some contracts which are currently recognised under IAS 11 do not involve the client in technical decisions. For example, the construction of a bridge does not involve the State or local authority making decisions about piles, or cables for a suspension bridge. However, it is beyond question that the contract should be recognised in the construction company’s accounts under IAS 11.

The IFRIC is currently looking for appropriate criteria for identifying construction contracts.

Has the IFRIC taken into account the specificities of real estate sales before construction is complete?

Sales prior to completion of construction are defined by the French Civil Code. They involve contracts in which the seller (i.e. usually the property developer) transfers ownership of the building to the buyer as construction continues. This type of contract also exists in Belgium and the Netherlands. A very large majority of real estate construction contracts take this form.

The specificities of these contracts were presented to the IFRIC staff by Jean-Louis Lebrun, Mazars Partner and member of the IFRIC:

- Ownership of the land is transferred to the buyer upon signature of the contract;
- The risks and rewards relating to the building are transferred to the buyer as construction progresses. In particular, the buyer is exposed to the risk of variations in the value of the building and the capacity to benefit from the rewards relating to the building, to the extent that the property rights can be sold or secured.

The IFRIC is currently developing an interpretation project which should clarify the criteria for identifying construction projects. It will be necessary to ensure that the criteria proposed by IFRIC will still permit revenue from sales before completion is complete to be recognised as significant acts are performed. If not, most of the companies involved would have to modify their accounting principles.
In the context of the “Measurement” phase of the revision of the Framework, the IASB organised round-table discussions in Hong Kong and London in January, and in Norwalk in the USA in February. This phase can be broken down into three stages:

- **Stage 1**: developing a common language for identifying, defining and describing the measurement bases currently in use.
- **Stage 2**: assessing the measurement bases identified according to the quality of information provided.
- **Stage 3**: translating the results of the previous stages into conceptual terms and addressing the practical issues relating to the use of the most robust measurement bases.

Doctrin presents the main elements of the round-table discussions held in London on 29 January 2007, which were attended by Jean-Louis Lebrun, Mazars Partner. The discussions relate to Stage 1 as described above. It should be noted that the participants are from a variety of backgrounds: members of the Board and the IFRIC, auditors, chartered accountants, bankers, analysts, representatives of accounting bodies and the financial markets, etc.

**Fair value should not be used across the board**

One of the clearest issues to come out of the discussion was the participants’ aversion to using fair value across the board. Similarly, it was not considered possible to use historical cost for all balance sheet elements.

A consensus seemed to emerge on the use of a mixed model: recognising some elements on the balance sheet at fair value and others at historical cost.

The IASB’s Board, six members of which attended the round-table discussions, also said that it did not feel the whole balance sheet should use fair value. As a reminder, fair value cannot be used for subsequent valuation on the balance sheet, notably for stocks and intangible assets (except where there is an active market, which is extremely rare in practice) and is only the main valuation method for a limited number of areas.

**Current situation and major issues**

Many different measurement bases are currently available to companies preparing their accounts. With this in mind, the following issues were raised:

**Need for a unique model?**

No agreement could be reached at this stage on a framework of accounting principles which would permit a single measurement basis to be used.

**Market value versus entity-specific value**

As the assets and liabilities on a balance sheet interact, the value from the entity’s point of view would seem more relevant than a market value which has no connection with use in a given environment.

However, using the utility value for the entity does not make it easy to compare the accounts of groups in the same segment.

The participants suggested a “mixed” approach: such a method might consist of distinguishing between those balance sheet elements valued at market value and those valued in other ways: for example, operational and non-
operational assets, or financial assets and non-financial assets, could be valued at market value or not as the case may be. Such a model could be used for assets, but seems less appropriate for certain liabilities. Moreover, there are limits: how could you justify using a different valuation for the same item on the pretext that its use is different?

Moreover, as segment information is of crucial importance in performance assessment, many participants agreed on the need to use the same valuation methods for both management and accounting, so as not to have to manage two sets of accounts.

Relevance of fair value
The participants felt that fair value was not applicable to valuation of assets and liabilities in all segments as it did not always reflect the same economic reality. An investment bank will work in terms of market value, whereas an industrial firm will often work in terms of the cost of replacing its operational assets. Moreover, the goal of an industrial firm is not to realise the value of its asset by selling it, but to generate a result by using it to produce goods and services.

The discussions concluded that fair value was not appropriate for the public sector either, as this sector works primarily on the basis of replacement costs, notably with regard to the concept of the potential service expected (there is often no active market for the goods involved, and traditional performance indicators are inappropriate).

Presentation and measurement of performance
Several analysts said that their assessments were based more on the profit and loss account than on the balance sheet, and that it was important to be able to compare actual performance with stated targets.

Moreover, financial analysts distinguish between the result derived from operational activity and the result derived from the environment when analysing performance. In particular, they said that they would not want a balance sheet using market value. On the other hand, they need to know the reasons which lead the management to use a specific valuation method in order to assess the management’s capacity to manage the group efficiently.

Performance is a result of both creating value (a financial concept) and operational performance. Using the same presentation once used by the IASB for the profit and loss account, a balance sheet could have two columns: one for valuation at cost and the other for valuation at market value.

Finally, the analysts pointed out that segment information is of primary importance to their assessments given the variety of activities carried out by many groups.

Conclusion

It is apparent that there is no universal method and that each method can involve some degree of uncertainty.

In any case, it seems crucial to define valuation models which will be of lasting utility to investors over the next ten years.
Doctrine in daily life

Mazars’ presence in the international accounting bodies

Mazars has representatives in the international bodies, bearing witness to the firm’s commitment to actively participating in the discussions instituted on the work in progress at the IASB (revision of the Conceptual Framework, BC II, the concept of fair value, etc.). Doctr’in takes stock of the scope of the firm’s presence.

International bodies

Jean-Louis Lebrun, Mazars Partner, is a member of the IFRIC (International Financial Reporting Interpretations Committee). Sébastien Landry, Fondé de Pouvoir at Mazars, is on the staff of the IASB, working in particular on issues regarding the IFRIC.

Charles Vincensini, Mazars Partner, represents France at the International Institute of Actuaries.

European bodies

Françoise Flores, Mazars Partner, is a member of the EFRAG (European Financial Reporting Advisory Group). Patrick de Cambourg, Michel Barbet-Massin and Nicolas Robert, Mazars Partners, are members of the FEE (European Federation of Accountants) and participate in the Financial Reporting Policy group and the Banks and Insurance sections respectively.

NB: the above list is not exhaustive. Moreover, it only covers participation in accounting standards bodies. Not cited, therefore, is Mazars’ participation in work regarding professional standards, legal and fiscal issues, quality control and professional ethics.

Issues most frequently raised with the Doctrine department

IFRS standards

- Tax rate to use in the calculation of tax liabilities on the revaluation of property where the property will be sold with the assets of the subsidiary which owns it;
- Review of the control exercised by a company over a joint venture under a shareholders’ agreement;
- Hedging of internal group cash flow;
- Is an unlisted company subject to the same obligation to publish accounts as a listed company if its principal subsidiary is a listed company?
- At what cost should one record the acquisition of a property development which is subject to a finance lease (i.e. exercise of option) where the contract had been classed from the start as a simple lease agreement? What happens with recorded prepaid expenses under the simple lease agreement?
- Method for energy provision agreements,
- Recording perpetual floating rate notes for which returns are both fixed and variable;
- Accounting method for free allotment of securities in the accounts of the tender and the beneficiary;
- Accounting modalities for a business combination under joint control;
- Accounting treatment of energy production contracts;
- Accounting treatment of an OBSAAR issue (equity bonds and/or acquisition of reimbursable shares).

Calendar of upcoming meetings of the IASB, the IFRIC and the EFRAG

<table>
<thead>
<tr>
<th>IASB</th>
<th>16th to 24th April 2007</th>
<th>14th to 18th May 2007</th>
<th>18th to 22nd July 2007</th>
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<tbody>
<tr>
<td>EFRAG</td>
<td>25th to 27th April 2007</td>
<td>30th May to 1st June 2007</td>
<td>11th to 13th July 2007</td>
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