

## AMF Recommendation Financial Statements 2014 – DOC-2014-13

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

### Executive Summary

The AMF, like ESMA and other European regulators, seeks to identify, before each year end, those topics which seem the most important in the given situation, in order to draw the attention of listed companies and their statutory auditors to them, thereby contributing to disclosure of good-quality accounting and financial information. It is acknowledged, however, that drafting and interpreting the international accounting standards is the exclusive role of the IASB and the IFRS Interpretations Committee (IFRS IC). As regards these topics, it is essential that all those reading financial statements should understand the accounting treatments applied and the judgements made by the issuers.

The recommendations contained in this document call upon companies to pay particular attention to the topics presented below.

Like last year, ESMA, together with all the market regulators, has identified a number of common priorities at the European level. For 2014, these priorities concern the new standards applicable to consolidation and deferred tax assets.

On the topic of the new consolidation standards, the AMF recommendations are very close to those of ESMA and references are made herein to the ESMA document to make it easier to see the link between the two documents.

Regarding recognition of deferred tax assets, the points made by ESMA are in line with the AMF recommendations of 2011.<sup>1</sup> **ESMA also recommends that in the event of material uncertain tax positions, which are currently the subject of discussions within the IFRS IC, issuers should disclose the recognition and measurement policies they have applied.**

ESMA also makes reference to the Asset Quality Review conducted by the ECB and covering Europe's largest banks. **The AMF, like ESMA, expects any impacts of or following this review to be described in the notes to the financial statements, in line with the applicable accounting standards (IAS 8 and IAS 1), where such impacts are of material importance.** For example, these might be impacts related to a change in an accounting estimate or the correction of an error, or also appropriate disclosures in the notes to the financial statements, for example regarding capital. A reference to the information published in the context of the work of the ECB could be usefully included.

In addition, all the European regulators support the projects underway to restore meaning to financial disclosure and to financial statements in particular. To this effect, **the AMF encourages companies to pursue their efforts to give preference to information that is relevant and useful to those reading their accounts.**

The AMF has also deemed useful to add two topics to those identified by ESMA: the classification of financial instruments as debt or equity and the cash flow statement. Concerning the classification of financial instruments, given the complexity of some of the financial instruments that are issued and the discussions underway within the IFRS IC, **the AMF deems useful to reassert some key principles for this analysis, and to highlight the importance of disclosing precise information about such instruments in the notes to the financial statements. The AMF also mentions that it is useful to have a multilateral discussion (between the issuer, its statutory auditors and the regulator(s)) prior to any significant issues of financial instruments that have innovative features and the issuance of which is not customary for the company in question.**

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<sup>1</sup> AMF Recommendation on Financial Statements 2011- DOC-2011-16, 2.1 Recognition of deferred tax assets on tax loss carryforwards



**Concerning the cash flow statement, in the course of its reviews, the AMF has identified difficulties in the application of certain aspects of the standard.**

IFRS 15 – *Revenue from contracts with customers* was published in May with an effective date of 1<sup>st</sup> January 2017. Although it has not yet been adopted by the European Commission, companies are encouraged to begin working to identify any issues in implementing this standard. **It is indeed possible that modifications to information systems may be necessary and, accounting issues aside, it will be useful to prepare the market for the expected impacts of this standard once they are known with a sufficient degree of reliability.** The IASB has also set up a temporary working group jointly with the FASB to analyse the difficulties encountered in implementing this standard. **It should be emphasised that any interested parties may inform this group of the difficulties they have identified in implementing the standard and that the ANC has set up a working group to collect French contributions.**

**When implementing new standards that may have a material impact and require new disclosures in the notes to the financial statements, as is the case this year with the standards on consolidation, the senior management or governance bodies shall ensure that the items presented are easy to understand and clearly reflect the effects of these standards on the financial statements.**

Some of the recommendations contained in this document require issuers to provide descriptions or explanations in the notes to the financial statements. Regarding particular aspects of the standards, the topics addressed may not apply to all issuers. The level of detail of the information that is disclosed will also need to be adapted according to the relative importance of the topic in order to highlight the most relevant information.

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## 1. Organisation and relevance of disclosures in notes to financial statements

The question of notes to financial statements is the focus of considerable work, such as the IASB Disclosure Initiative or round table discussions of January 2013, exchanges between European authorities and individual initiatives, notably by several companies. The aim is to deliver responses that are satisfactory in the eyes of those who prepare and those who read financial statements, notably in the face of increasingly complex operations and the growing volumes of information.

All the different stakeholders (standards setters, listed entities, investors, auditors and regulators) have a role to play in the face of this issue and its many facets:

- Investors want an assurance that all the important information is delivered and appreciate a presentation that helps them to find the information they are looking for quickly. As mentioned in the 2012 recommendations,<sup>2</sup> this corresponds to the IFRS principle of materiality requiring that more weight be given to the information that is of material importance and relevance to the reader.
- Those reading accounts often remark that the notes to them are too general and not sufficiently adapted to the specific features of the company, or that the wording could sometimes be more concise, and also more detailed at other times on a given topic. As emphasised by the AMF in 2013, information relating to the accounts can usefully be adapted to describe the most relevant points for an understanding of the financial position and performance.<sup>3</sup>

Consequently, it is of particular importance that all market stakeholders should be mobilised to contribute to making the notes to financial statements more relevant and useful to the reader.

It would appear useful to conduct a watch of any solutions for highlighting the important points that are adopted by certain listed groups<sup>4</sup> with the aim of contributing to exchanges with the international standards body in its work. It is not impossible that this work might also be used in future initiatives by market regulators.

### **Recommendation:**

**The principle of relevance, and in particular the resulting notion of materiality, is a key point to be kept in mind when preparing notes to financial statements. Although it is aware of how difficult it can be, the AMF encourages companies to give more weight to the most significant information in order to provide information that is relevant and adapted to the market context and operations of the period being presented, thereby enabling those who make use of the accounts to find the key points easily and understand the financial position and performance of the company.**

## 2. New applicable standards, notably on consolidation

*[Certain aspects of these standards have and continue to be the subject of discussions in the IFRS IC. It is also a priority for ESMA in 2014].*

IFRS 10 – *Consolidated Financial Statements*, IFRS 11 – *Joint Arrangements* and IFRS 12 – *Disclosure of Interests in Other Entities* have been applicable in the European Union since 1<sup>st</sup> January 2014, with early application being possible from the 2013 financial year.

<sup>2</sup> AMF Recommendation on Financial Statements 2012 – DOC-2012-16

<sup>3</sup> See also ANC Recommendation 2012-01

<sup>4</sup> In their notes to their 2013 financial statements, Valéo, ITV Pandora and Volvo indicate that they have conducted work on the presentation of the notes to their financial statements



## 2.1 Consolidated financial statements and control

### 2.1.1 Analysis of control

According to IFRS 10, an investor controls another entity when it has power over that entity, is exposed to the variable returns of the entity and has the ability to affect those returns through the power it has over the entity.

In its 2013 recommendations,<sup>5</sup> the AMF stressed the importance of conducting a detailed analysis that takes all the relevant facts into consideration and is not based on a single paragraph of the standard taken out of context, or on any similarity to an example in the standards application guidance. This recommendation remains topical for the 2014 accounts and should be applied, among others, for securitisation funds and structures. See *ESMA page 3 “Application of the control principle”*

The concept of de facto control, which was only recognised implicitly in IAS 27, is henceforth clearly defined by IFRS 10 which sets out analysis criteria for this purpose. Those companies having previously concluded that they held or did not hold de facto control are therefore obliged to update their analysis in the light of the indicators set out in IFRS 10 (breakdown of voting rights, analysis of other facts and circumstances). Where this analysis concerns material entities, the notes to the financial statements should specify which criteria were decisive.

**It is worth noting that the case of control of another entity with a holding of less than half of voting rights is one of the cases mentioned specifically by IFRS 12.9(b) as requiring disclosure of the main judgements and assumptions on which the company based itself.**

See *ESMA page 6 “Significant changes resulting from the first-time adoption of IFRS 10 and IFRS 11” paragraph 2*

### 2.1.2 Information to be disclosed in notes to financial statements

[The services of the AMF have analysed disclosures in the notes to financial statements at 31 December 2013 from 15 French companies that applied the texts from 1<sup>st</sup> January 2013 and a comparable sample of 30 mainly European companies.]

#### **Recommendation:**

**Within the framework of first-time adoption of IFRS 12, and given the highly detailed nature of the provisions of that standard, the AMF encourages companies to prioritise the relevance of information and to ensure that the information delivered in the notes to financial statements meets the objectives of IFRS 12, which is to say that it should provide a good understanding of the interests held in other entities and the risks associated with them, as well as the effects of those interests on its financial position, financial performance and cash flows.**

### 2.1.3 Disclosure of non-controlling interests

For all subsidiaries having material non-controlling interests, the standard requires general information to be disclosed about the subsidiary (name, percentage of control and ownership interests held, etc.) and also the profit or loss and shareholder's equity allocated to the non-controlling interests, the dividends paid to them and summarised financial information about these subsidiaries (IFRS 12.12 and B10). As specified in the basis for conclusions of the standard, the objective is to enable users to understand notably the effects of the presence of these non-controlling interests on the ability of the entity to receive future cash flows or the assets of the subsidiary.

As a whole, general information is provided by almost all the companies in our sample, but summarised financial information is only provided by half of those with material non-controlling interests. Almost one quarter of the sample presents the profit or loss and shareholders' equity of the group allocated to non-controlling interests only for the main contributors, and no summarised financial information. Conversely,

<sup>5</sup> AMF Recommendation on Financial Statements 2013 – DOC-2013-19



the quarter of the sample that does deliver more information presents the main aggregates of the income statement, balance sheet and cash flow statement (IFRS 12.B10). On the basis of the analysis of a restricted sample of companies and within the framework of first-time adoption, it would appear that the information provided could be improved in certain cases.

**Recommendation:**

**In accordance with IFRS 12, the AMF reminds companies having subsidiaries with material non-controlling interests that they must disclose the dividends paid to them and also the relevant balance sheet, income statement and cash flow statement aggregates in order to understand the interests of these non-controlling interests in the activities and cash flows of the group.**

**For the AMF, the breakdown of the profit or loss and shareholders' equity of non-controlling interests between the main contributing subsidiaries is not enough in itself to meet this objective. It is also useful for users, where appropriate, to allocate these minority interests to the operating segments.**

*See ESMA page 4 "Disclosure of non-controlling interests (NCIs)" paragraphs 1 and 2*

In its discussions of September 2014, the IFRS IC confirmed that identification of the material nature of non-controlling interests requires a judgement to be made on the basis of a quantitative and qualitative analysis, depending on the situation. Depending on the case, this analysis may be carried out on the level of the entities or the level of the subgroups.

In its 2013 recommendations,<sup>5</sup> the AMF recommended that the granularity of the information to be disclosed should be determined according to the specific situations, taking into consideration, for example, the existence of significant cash balances or the weight that these interests represent in the aggregates used by the group. This recommendation remains topical for the 2014 year end.

**Recommendation:**

**The AMF recommends that companies should indicate how materiality was assessed in the notes to the financial statements.**

*ESMA page 4 "Disclosure of non-controlling interests (NCIs)" paragraph 2 encourages companies to disclose, where appropriate, that although the group has a significant amount of non-controlling interests globally, none of those non-controlling interests is individually significant.*

**The AMF also reminds companies that the summarised financial information that is presented must be before elimination of intercompany accounts and operations (IFRS 12.B11).** At its meeting of September 2014, the IFRS IC provisionally concluded that when the information required by the standard was presented for a subgroup, balances and transactions within that subgroup should be eliminated.

*See ESMA page 4 "Disclosure of non-controlling interests (NCIs)" paragraph 2.*

#### 2.1.4 Restrictions

IFRS 12.13 requires the disclosure of any restrictions limiting the ability of the group to access assets or settle liabilities of the subsidiary. As an example, this paragraph mentions cash and payment of dividends.

Also, in accordance with IAS 7.48, entities should disclose the amount of significant cash and cash equivalent balances that it holds and that are not available for use by the group. This information should be accompanied by a commentary by management. In its 2010 recommendations,<sup>6</sup> the AMF noted that this information was rarely disclosed and issued a reminder of the requirements of the standard.

<sup>6</sup> AMF Recommendation on Financial Statements 2010 – DOC-2010-12



In the sample of companies that applied the standard in 2013, this information was almost never disclosed, even when the groups held subsidiaries in countries where there are exchange controls or other requirements suggesting that such restrictions do exist (Argentina and Venezuela, for instance).

**Companies facing significant restrictions on their access to assets or the settlement of liabilities in their subsidiaries must disclose them in the notes to the financial statements (IFRS 12.13).**

See ESMA page 4 “Disclosure of non-controlling interests (NCIs)” paragraph 3

**2.1.5 Non-consolidated or structured entities**

IFRS 12 notes the importance of disclosing, in the notes to the financial statements, the nature of the risks associated with their interests held in consolidated structured entities, in unconsolidated subsidiaries and in unconsolidated structured entities.

**Recommendation:**

**Where these risks can have a material impact on the accounts, companies shall assess the relevant level of information and aggregation to meet the expectations of users.**

See ESMA page 4 “Nature of risks associated with an entity’s interests in structured entities”

**2.2 Joint ventures and joint operations**

**2.2.1 Distinction between joint ventures and joint operations**

[The notion of joint operations was the subject of much debate at the beginning of 2014 at the IFRS IC.]

According to IFRS 11.14 and 15, the distinction is made between a joint venture and a joint operation on the basis of the rights and obligations of the parties. For an arrangement to correspond to the definition of a joint operation, the partners must have both rights to the assets and obligations for the liabilities of the joint arrangement (IFRS 11.15). Entities that do not fulfil this definition are joint ventures and shall henceforth use the equity method for their accounting.

IFRS 11.27 states that the rights and obligations are assessed on the basis of the legal form, contractual arrangements and, where relevant, other facts and circumstances generating such rights or obligations.

Since early 2014, the standards interpretations committee (IFRS IC) has examined whether a certain number of structures could be qualified as joint operations or joint ventures in the light of this standard.

The first question addressed by the IFRS IC consisted in determining in which cases the analysis of these “other facts and circumstances” could conclude that there are rights and obligations that are direct in substance. After consulting the Board, the IFRS IC concluded that the other facts and circumstances should create direct rights to the assets and direct obligations for the liabilities that are enforceable. For example, past practices, the intention of the parties or needs linked to activity are not sufficient to create rights to assets or obligations for liabilities.

At its July meeting, the IFRS IC examined the case of a project entity, the features of which showed that the partners had direct obligations for the liabilities, but not necessarily direct rights to the assets. It was concluded that the entity could not be classified as a joint operation. The IFRS IC also considered that in the case of a joint arrangement structured through a separate vehicle, the project entity creates a screen that prevents from being classified as a joint operation, subject to exceptions. The IFRS IC should finalise the wording of the summary of its decisions at the beginning of next year.

**Consequently, for a joint operation to be classified as a joint operation, the partners must have not only direct obligations for the liabilities, but also direct rights to the assets, and those rights and obligations must be enforceable.**

See ESMA pages 4-5 “Classification of joint arrangements” paragraph 1

**Recommendation:**

**The AMF recommends to all companies with project entities that they update their analyses and take account of the conclusions of the IFRS IC when closing their 2014 financial statements. It would also seem useful that those companies for which the issue is of material importance should provide details of their analysis in the notes to the financial statements.**

*See ESMA page 5 “Classification of joint arrangements” paragraph 2 and “Disclosures related to joint arrangements” paragraph 1*

**2.2.2 Disclosures related to joint arrangements and joint ventures**

*[The services of the AMF analysed disclosures in the notes to the financial statements at 31 December 2013 of 15 French companies having applied the texts on consolidation on 1<sup>st</sup> January 2013 and a comparable sample of 30 mainly European companies.]*

On the whole, the companies in our sample having interests in material associates or joint ventures delivered the main summarised financial information concerning such entities (current and non-current assets and liabilities, income and profit or loss) as required by IFRS 12.21(b) and B12. It should also be pointed out that most of the companies presented the material joint ventures and associates separately, and aggregated joint ventures on the one hand and associates on the other by segment, business or geographical area.

Some of the companies presented aggregates that were relevant to the activity or country (cash, financial debt or investment property, for example).

**As pointed out by the IFRS IC in July in a draft decision, IFRS 12.21(b) requires the main financial information of material joint ventures and associates to be presented individually, while this information may be aggregated for non-material joint ventures and associates using criteria that are relevant to the entity, as allowed by the standard (IFRS 12.4, B2 and B3).**

*See ESMA page 3 “Aggregation of disclosures”*

**Recommendation:**

**The AMF encourages companies to consider the aggregates to be disclosed in the light of the objective, i.e. to enable users to assess the nature, scope and financial effects of their interests in joint arrangements and associates, as was done by most of the companies that applied the standard from 1<sup>st</sup> January 2013.**

**Given that the standard does not specify the qualitative and quantitative items to be used to determine whether the joint venture or associate is material, it is useful to disclose, among other things, the qualitative information taken into consideration to determine that materiality (strategic importance of the entity, for example).**

*See ESMA page 5 “Disclosures related to joint arrangements” paragraph 2*

Concerning material joint ventures, the standard (IFRS 12.B13) provides for the disclosure of certain supplementary information (cash and cash equivalents, current and non-current financial liabilities, interest income and expenses, depreciation and amortisation expense). As stated in the basis for conclusions, it is useful for users to understand the debt and cash positions of joint ventures and the necessary details of the income statement to be able to assess the value of the company’s investment in the joint venture (depreciation and amortisation, for example). In our sample, this information was more rarely provided. The analysts also noted that the link should be shown with operating sectors.

Also, pursuant to IFRS 12.B18, mention should also be made of any commitments made for joint ventures but not yet recognised that may give rise to an outflow of cash.

**Recommendation:**

**For material joint ventures, it is important to present additional information in the statement of financial position and income statement (notably current and non-current financial liabilities, cash and cash equivalents and information from the income statement, such as interest and amortisation), on commitments given on account of the interest held in the joint venture and on the operating sector in question.**



**In its notes to the financial statements, the company may usefully refer to certain information that may already have been disclosed in off balance sheet commitments or for operating segments, and/or aggregate various related information in a single note.**

*See ESMA page 6 “Disclosures related to joint arrangements” paragraph 3*

### **2.3 Impacts relating to first-time adoption of the IFRS 10 and IFRS 11 standards or to modifications to contracts**

The 2013 recommendations<sup>5</sup> mentioned the importance of explaining any modifications induced by the new standards by presenting the relevant specific factors in the notes to the financial statements.

IFRS 11 requires jointly-controlled entities to be accounted according to the equity method (proportionate consolidation no longer being possible). In its 2013 and 2014 reviews of accounts, the AMF identified cases of modifications of control further, for example, to a modification of partnership agreements governing companies that were previously under joint control.

**Recommendation:**

**In the case of a modification of the nature of the control exercised by the group, in particular where there has been no change in the capital held, the AMF recommends the greatest transparency where the impact is of material importance, by giving details in the notes to the financial statements not only of the impacts, but also of the analyses and judgements made (IFRS 12.7 and 8).**

*See ESMA page 6 “Significant changes resulting from the first-time adoption of IFRS 10 and IFRS 11” paragraph 1*

For example, when the principles introduced by IFRS 10 have led to a different conclusion in the analysis of control, it shall be useful to give details of the particular factors having led to the change of analysis. If the change of analysis is explained by a modification of the agreements with partners, this will be usefully described in detail.

**Also, in the case of impacts linked to first-time adoption of the standards, it is essential to give details and a clear explanation of these impacts (IAS 8.28).**

*See ESMA page 6 “Significant changes resulting from the first-time adoption of IFRS 10 and IFRS 11” paragraph 1*

This will apply in particular to companies that had hitherto opted to present any joint ventures using the proportionate consolidation method.

Further to the application of IFRS 11, for companies considering the presentation of the profit or loss of equity-accounted companies in an aggregate representing operating activities, the AMF reminds you that its 2013 recommendation<sup>5</sup> and that of the ANC on the presentation of the profit or loss of equity-accounted companies continue to apply.

The ANC recommends that for equity-accounted companies having an operational nature that is the extension of the activity of the group, the share of these companies' net profit or loss can be presented after the “Operating results” subtotal and before the “Operating results after the share of net profit of equity-accounted companies” subtotal.

The AMF 2013 recommendations<sup>5</sup> state that when companies consolidated by the equity method are considered as being the extension of the operating activities of the group, it is important that the chosen presentation does not alter the ratios used by the company and based on the aggregate in the income statement presenting the operating activity of the group (for example, operating profit or loss to revenue). Also, the titles used for these intermediate aggregates should clearly mention whether equity-accounted companies have been taken into account or not.



### 3. Financial instruments: classification as debt or equity

*[In recent years, the AMF has noted an increase in issues of financial instruments and in their complexity, in particular with the development of compound instruments with two components (liability and equity). A large number of questions have also been referred to the IFRS IC on the classification of financial instruments.]*

#### 3.1 Analysis criteria

According to IAS 32, financial instruments or their components should be classified according to the substance of the contractual agreement (IAS 32.15). IAS 32.16 states that a financial instrument is an equity instrument only if the following two conditions are fulfilled:

- The instrument includes no contractual obligation to deliver cash or another financial asset to another entity or to exchange financial assets or financial liabilities under conditions that are potentially unfavourable,
- Where an instrument will or may be settled in the entity's own equity instruments, it includes no contractual obligation to deliver a variable number of these equity instruments if the instrument is a non-derivative or, if it is a derivative, it will be settled by an exchange, by the issuer, of a fixed amount of cash or another financial asset for a fixed number of the entity's own equity instruments.

IAS 32 proves difficult to apply in practice, due to the absence of indications as to the terms of application of the principles. Some of these application and interpretation difficulties have been highlighted by the various questions referred to the IFRS IC on these subjects in 2013 and 2014, and the IFRS IC itself has sometimes had difficulties coming to a consensus on the treatment of certain instruments (notably instruments that are redeemable or convertible if an event occurs bringing into question the viability of the issuer).

In addition to the mere existence and legal nature of the contractual arrangements, analysis of their substance is fundamental in their accounting treatment (IAS 32.15). This point has been made by the IFRS IC in its decisions, stating that assessment of the substance of a contractual clause should take account of the economic and operational reasons justifying the existence and exercise of the said clause, in relation to all its detailed features.

For these reasons, a case-by-case analysis is necessary.

#### **Recommendation:**

**It is necessary to conduct a detailed, documented analysis of the classification as debt or equity of any financial instrument that is issued, on the basis of its features and the criteria in the standard.**

**The accounting treatment applicable to a material financial instrument that is being considered is often key to the company's decision to implement it or not. In such cases, it may be useful to enter into a multilateral exchange (company, statutory auditors, the AMF and the ACPR for financial institutions) on that accounting treatment before the financial instrument is issued on the market, when that instrument is not customary for the issuer and has innovative features.**

#### 3.2 Disclosures in the notes to the financial statements

#### **Recommendation:**

**In order to enable readers to understand the impacts of any material financial instruments that are issued, great transparency is required as to the way in which these financial instruments are presented not only in the statement of financial position, but also in the income statement or cash flow and, more generally, as regards the liquidity situation of the company, notably where they are compound instruments.**

**To this effect, the AMF recommends that issuers should give details in the financial statements, regarding the accounting treatment applied to a material financial instrument and all its features (par value, interest and any step-up clauses, coupon payment terms, trigger events, key contract dates, conversion or redemption options and the related arrangements).**

IFRS 7.17 states that where an entity has issued a financial instrument that contains both a liability and an equity component, and the instrument has multiple embedded derivatives whose values are interdependent (such as a convertible debt instrument), it must disclose the existence of those embedded derivatives in the notes to the financial statements.

Pursuant to paragraphs 55, 77 and 85 of IAS 1, the company presents additional subtotals where such a presentation is useful to understand the situation and financial performance of the entity.

**Recommendation:**

**When a financial instrument is classified either entirely or partly as equity and the amounts are material, the AMF recommends that issuers disaggregate them, for example in separate line items in the statement of financial position (as is already done by some issuers) or in the equity variation table.**

**In addition, a presentation disaggregating all related flows in the statement of cash flows and stating in the notes to the financial statements the amount of coupons paid to holders of instruments classified as equity (in addition to dividends on ordinary shares) is useful to allow the reader to identify these items easily.**

**Materiality shall be assessed notably on the basis of equity, financial debt and cash.**

It has been noted that this type of presentation is used by certain companies that have material equity instruments.

**Coupons paid on instruments accounted as equity must be deducted from the earnings taken into account to calculate earnings per share (IAS 33.12 and IAS 33.14), and this restatement must be presented in the notes to the financial statements.**

Also, in certain cases, determining the accounting classification of tax effects relating to coupon payments on these instruments that are classified entirely or partly as equity can be complex and raise questions as to classification as equity (pursuant to IAS 12.57 and 58(a)) or as profit or loss (pursuant to IAS 12.52A and B).

**Recommendation:**

**Where the classification of tax effects relating to a financial instrument classified entirely or partly as equity requires a judgement to be made, the AMF recommends that issuers describe this judgement in the notes to the financial statements and its impacts on the financial statements, when such impacts are material.**

#### **4. Cash flow statement**

*[In its reviews of financial statements, in particular of small or medium-sized companies, the AMF has identified a certain number of inconsistencies or difficulties in cash flow statements.]*

In its 2012 recommendations,<sup>2</sup> the AMF recommended that explanations should be provided on its main flows and that links should be shown with the other items in the financial statements. This recommendation remains topical for the 2014 financial statements.

##### **4.1 Transaction without an effect on cash flow - Compensation**

As indicated by IAS 7.44, many investing and financing activities do not have a direct effect on current cash flow and do not generate cash flows during the period. These transactions are therefore excluded from the statement of cash flows. For example, the acquisition of assets and posting of a debt



corresponding to a financial lease contract have no effect on cash flow and cannot be presented in the cash flow statement.

IAS 7 also states that significant flows must be presented separately and should not be reported on a net basis, except in certain specific cases which are explicitly listed in the standard. **The AMF therefore reminds companies that, subject to the exceptions listed by IAS 7.22-24, the flows may not be offset in the cash flow statement.**

#### 4.2 Choice of presentation in the cash flow statement

The work of the IFRS IC has shown that in the current state of the IAS 7 standard, several classifications may be considered for certain flows. Among others, mention can be made of costs incurred in a takeover, payments received within the framework of a subsidy and the classification of earn-out payments in business combinations. In its 2012 recommendations,<sup>2</sup> the AMF listed the main flows subject to discussions and stressed the importance of explaining the treatment adopted in the notes to the financial statements, whenever the flow was material. This recommendation remains topical for 2014 financial statements.

Also, for interest and dividends, IAS 7 allows a choice of presentation. Interest paid and interest and dividends received may be considered as flows from operating activities or flows from financing and investing activities respectively. In a sample<sup>7</sup> that was tested, about half the companies did not specify the classification of interest paid and received.

**Recommendation:**

**In the light of the variety of practices observed, the AMF recommends that companies having material cash flows linked to interest and dividends should state their classification in the cash flow statement.**

IAS 7.16 states that cash flows of a contract accounted for as a hedge of a position are classified in the same way as the cash flows of the position being hedged. However, IAS 7 does not specify the classification in the cash flow statement linked to contracts that are not accounted for as hedges (natural hedges).

**Recommendation:**

**The AMF recommends that companies with material cash flows on contracts that are not accounted for as hedges should indicate the classification adopted to present these flows.**

#### 4.3 Cash flows from operating activities

The cash flow statement is particularly useful for those making use of accounts. IAS 7 defines cash flows from operating activities by default in that it provides definitions only for those items considered as investing and financing cash flows.

**Recommendation:**

**It is important that companies think about the items to be presented as cash flows from operating activities and that they ensure that those items presented in this category do not correspond to the definition of cash flows from investing or financing activities and that conversely, all flows classified as financing and investing do correspond to the definition of these categories.**

<sup>7</sup> In the CAC 40 and a sample of 40 companies from small 90 and mid 100