

Actualités

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The New Financial Accounting System

KPMG Algérie

Further clarifications on Implementation An update on the latest texts



New Financial Accounting System (NFAS) was originally supposed to be implemented from 01 January 2009, as had been stipulated in the 2007 law and the implementation decree of 2008.

However, given the delay in the publication of more detailed texts and in the preparation of businesses, it was decided in July 2008 to delay implementation one year further.

Although the text specifying in detail the new system was published in March 2009, many firms and many accounting professionals thought, until recently, that the text could be pushed back to late 2010 or 2011.

However, given the more recent releases, we can say that it will not.

The supplementary finance law 2009 confirmed this in July. In this text, observers have been able to find various provisions clearly inspired by the New Financial Accounting system or designed to clarify the tax treatment.

"Official" confirmation that the application of the new financial accounting system (NFAS) would not be deferred appeared early November, following the publication by the CNC of instructions concerning initial implementation. This text definitively (in theory) clarifies the exact nature of the work to be carried out and the transition schedule.

Further clarification on the tax treatment of NFAS will likely be adopted in the 2010 Finance Law, which is at this stage still in draft form.

Part I - The various provisions of the SFL for 2009 in connection with NFAS

The SFL for 2009 has given rise to numerous comments, with new core investment and industrial policies and contains various provisions dealing with the NFAS which went more or less unnoticed.

We will review them to better understand its scope.

Follow-up on long-term contracts

The new article 140-3 provides that "taxable income for contracts (...) is acquired solely on a percentage-of-completion basis, regardless of the method adopted by the company (...)".

This text is very particularly for the many companies engaged in construction or contributing to investment projects.

The NFAS provides progression on long-term or construction contracts must, unless technically impossible, be followed on a percentage-of-completion basis.

The main question was whether tax authorities would accept the percentage-of-completion method, hitherto relatively uncommon.

The answer is clearly 'yes'. Even if a company did not apply this accounting method, although a requirement as stipulated in NFAS, it will be taxed on that basis.

In practical terms, this means that all the companies concerned must organize themselves in order to keep their accounts using this method, with the requirement, in terms of information management, (also indicated in the text) "the appropriate management tools (...) to follow-up on (...) revenue, expense and income estimates.

Provisions

The new article 141-5 states that "provisions (...) for inventories and third party accounts are deductible, provided that they are clearly designated, precise and the loss is probable. These provisions have to be recognized (...) and reported in the

statement (schedule) of change in provisions".

Again, this NFAS-related provision has considerable impact.

So far, recognition of provisions for inventory or receivables in Algeria was rare because they were inadequately defined by accounting texts and frequently challenged by tax authorities.

In the NFAS, there is a stricter, general framework, which provides that probable losses on inventory or claims should be subject to the necessary provisions.

This could potentially lead many companies to book significant provisions.

The question is will tax authorities accept these provisions?

According to the SFL for 2009, the answer is yes, provided that the provisions are sufficiently precise and probable, that they have been recognized and included in the statement of change in provisions.

Preliminary expenses

In the SFL, it is clear that most of the costs previously capitalized under "preliminary expenses" then amortized may no longer be maintained and must be taken off the balance sheet or recognized differently.

The new art 169-3 provides that "preliminary expenses previously listed (...) are deductible (...) according to the previous structure."

This confirms:

- That the former charges, even if they are eventually written off retroactively, will remain tax deductible,

- Only new charges will not, since they will no longer be capitalized and amortized as such according to the NFAS.

The revaluation of assets

In SFL, there are several provisions that allow a revaluation of assets, particularly tangible assets.

Prior to that however, it is important to ascertain their fiscal impact:

- Neutrality as to the revaluation, which was authorized in 2007,

- Taxation, as any free revaluation.

Section 185 responds well to this concern. It states that "Gains on revaluation of assets entering the NFAS (...) will be reported to result in five years."

In this context, the administration has adopted a middle position:

- No gift tax, contrary to what was granted in 2007,

- Not a full and immediate taxation,

- The ability to spread the capital gain, therefore the taxation over 5 years.

In practical terms, even with a tax spread, these revaluations are expensive and few groups should achieve, or may be some companies showing losses or not subject to the IBS (corporate tax).

The general framework

It was unclear whether the tax administration would validate the NFAS in it's entirely or reject it as has been the case in other countries.

The art 141 b provides that "companies must comply with the definitions given by the NFAS (...) unless this is incompatible with the tax rules."

In other word, the tax administration is supposed to accept all provisions and accounting consequences of NFAS when they do not contradict the existing tax laws.

Conclusion

With the SFL for 2009, it is therefore possible to confirm:

- A general principle of "compatibility", such as the one previously mentioned,
- Further clarifications on key points.

Even if this does not solve all problems, it is a clear sign that the tax administration is preparing for the imminent implementation of the NFAS, with no further delays.

Part II - The first application of the NFAS issued by the CNC

The long-awaited "first application instructions" came out very recently.

They were officially issued by the CNC on October 29, 2009, which may be an indicator that authorities will not further postpone the date of application.

The contents of these instructions

The instructions are only four pages long but are concise and resolve a number of issues.

They are accompanied by a mapping between the previous and the present charts of accounts as provided by the NFAS.

Examination of general provisions

It is recalled that all economic entities that do not implement government accounting rules will adopt the NFAS as of 1 January 2010.

As anticipated in our previous publications, it is then clear that the adoption of NFAS constitutes a change in accounting policies, and must be regarded as such.

The text includes the new regulations to be applied in this area:

- The impact will be calculated at 31.12.2010 and at 01.01.2010,
- The impact at 01.01.2010 (i.e. differences between the old and new systems at that date) must be charged to the opening equity,
- The residual impact at 31.12.2010 should impact net income for 2010.

If the calculations are done well it should ascertain the:

- impact on the variance related to change in method on the last closing date and the unassigned results.
- ensure that the 2010 transaction (such as depreciation expense) is consistent with that resulting from the new method,

Roughly the same method was retained under IFRS for the first application and it is technically known as a "retrospective application".

The mechanism is essential and is illustrated in the following example:

Imagine a truck at 15 million DZD bought 2 years ago and amortized using the straight-line method over a period of 5 years.

At 01/01/2010, the accumulated amortization will be 6 million. The allocation for 2010 will be 3 million. At the end of 2010, the combination will be 9 million, and a net value of 6 million.

Under NFAS, the straight-line method over 7 years proves a viable option. In late 2010, it leads to an accumulated expense of 6.428 million, instead of the 9 million accounted for. As at January 1st, 2010, this figure would be 4.285 million instead of 6 million.

	Opening accounts	Expense	Closing accounts
Previous method	6.0 mDZD	3.0 mDZD	9.0 mDZD
New method	4.3 mDZD	2.1 mDZD	6.4 mDZD

In the balance, in all cases with an opening figure of 6.0 MDZD, it should reach 6.4 MDZD.

Therefore, logically, expenses come to 0.4 MDZD:

- Either directly, by an allocation of 0.4 MDZD,
- By an allocation of 3.0 MDZD and a recovery of 2.6 MDZD.

The net expense of 0.4 MDZD does not make economic sense and does not correspond to the allocation under the old approach (3.0 MDZD) or by the new method (2.1 MDZD).

With the "retrospective application", it would be as follows:

- The variance at 01.01.2010, or 1.7 MDZD (6.0 minus 4.3) will be re-established in opening reserves (i.e. in accounting terms, debited from an amortization account, credited to a reserve account).
- To go from 4.3 MDZD to 6.4 MDZD, it would require 2.1 MDZD in expenses which corresponds to the allocation under the new method.

Ultimately, it appears that the 0.4 MDZD mentioned in the preceding paragraph would come down to:

- The impact of change in accounting method (1.7 MDZD),
- The allocation for the year by the new method (-2.1 MDZD).

Procedures that have to be implemented

The text explains the logical consequence of this approach.

It will be essential to:

- Draw up a mock balance sheet and income statement under NFAS at 31.12.2010 and at 01.01.2010 - "as if the company had already applied the NFAS",
- Establish variations compared to the previous chart of accounts on reserves as discussed above,
- Have data for the restated 2009 income statement so that they may be compared
- Include a detailed "Before / After" table in the 2010 financial disclosures.

The text then provides some details worth mentioning:

- Certain assets will be scrapped or provisioned (e.g. preliminary expenses),
- Others will be created (active leasing)
- Certain liabilities will be created (debt leasing, pension and retirement bonus provisions etc.).

All this will be calculated and booked through equity at 01.01.2010.

Other assets / liabilities will be reclassified, which will not require an adjustment of equity, but will generate differences in presentation and will need to be reflected in the reconciliation accounts.

It is clear that the comparative data for 2009, in order to be standardized and comparable, will require that the impacts on balance sheet positions be calculated at 01.01.2009.

If we go back to the truck example, in 2010, it will incur 2.1 MDZD in amortization expenses. Compared to 2009, the amortization expense would have to be calculated between 01.01.2009 and 31.12.2009 (2.1 MDZD – relatively simple in this case, but it could be more complicated) and presented as such.

Our comments on these procedures:

For many, these procedures may seem difficult. They are, however, consistent with what was anticipated in KPMG's previous publications and resided in the logic of the text itself and in IFRS.

Ultimately, this means that:

- All potential items in the balance sheets at the end of 2008 and 2009 that could be affected must be identified (preliminary expenses to be written off, credit leases, deferred taxes, pensions etc.),
- Impact at 01.01.2009 and 31.12.2009 should be calculated,
- The balance should be restated to obtain the income statement for 2009 and 2010 under NFAS and an opening balance sheet at 01.01.2010.

The opening balance sheet at 01.01.2009 will never be published but for 2009 income statement calculation purposes, it will be mandatory (see example above).

Accounting provisions related to the transition

The text identifies the specific documents and steps required in the preparation of NFAS accounts, allowing the traceability of conversion operations.

The following should be prepared:

- A mapping showing the concurrence in totals between the closing balance under the previous chart of accounts and the opening NFAS balance (i.e. before restatement),
- Statements that take into account the reclassification operations,
- The impact of restatements,
- The final data.

In more general terms, all these transactions must be documented and a

summary of impacts prepared so that:

- The Board of Directors can validate them,
- A summary of these operations may be included in the appendix,
- The statutory auditors can approve them.

In practice, companies can build on procedures in Europe in 2005, during the first IFRS application. The companies concerned had to publish reconciliation accounts, "before / after IFRS", summarizing and explaining the main variations.

Details that are not contained in the instructions

The "mapping" provided in the latter part of the appendices in the instructions could facilitate the transition in some respects.

However, one should be wary of the "one size fits all" approach.

As explained in previous articles, there is nothing automatic about mappings and a detailed examination of the existing situation requires time.

Either way, the chart of accounts presented in the appendix of the instructions is limited to a 3-digit breakdown of the accounts, while the French Chart of Accounts, on which it is based, uses 4- and 5-digit codes. This enables a more detailed classification of company accounts and their accounting schemes.

Without necessarily copying the French system in its entirety, the introduction by the CNC of 4- or 5-digit codes in the Algerian chart of accounts, would complete the system as certain sub-accounts, such as VAT for example, could be correctly managed.

Part III - Further confirmation: provisions under consideration in the 2010 Finance Law

To conclude this analysis, we will take a look at the different NFAS-related provisions that should be included in the draft finance law for 2010.

Finance lease

As stipulated by NFAS, assets under finance leases will no longer appear on the balance sheet of the "owner" company but on the balance sheet of the "user" company.

In the balance sheet, these assets should be amortized over the duration of economic life of the property concerned, in

accordance with NFAS rules, or possibly for the length of the contract, which, though easier, would generate variances, and therefore deferred taxes.

Amortization methods

Historically, tax authorities have accepted the straight-line and diminishing balance methods.

It is likely that the tax administration will comment on the new NFAS methods, and particularly amortization per economic component.

Revaluation adjustments

The draft finance law for 2010 could alter the provisions of the SFL for 2009 with further details.

In the 2009 SFL, opening revaluations were referred to in the NFAS, which may be taxed in an exceptional manner over 5 years (see Part 1 above).

The provisions applicable to free revaluations (i.e. after the NFAS transition period) and impairment test are yet to be clarified.

It will be interesting to see if the administration allows the deduction of provisions for "Impairment".

Grants

In the draft, regulations relating to grants received are included.

Investment grants present no particular complications and relating yield should offset each financial period's depreciation expense relating to the same investment, as is the case now. By this we mean that these subsidies would be reversed at the same rate as the amortization of the principal investment. Thus, the expense recognized on depreciation is offset by yield for the part covered by the subsidy.

For other grants, a tax text should clarify the NFAS provisions.

The text of the NFAS is also unclear on the following:

- It mentions the principle of attributing the subsidy to the year it is supposed to compensate.
- It also mentions that it must be recognized the year it is acquired, which is precisely the opposite of the first assertion.

For a balancing subsidy/grant or support of public services costs, IFRS recognizes the yield and a receivable subsidy claim for that

year, and not the following year, when it is received.

However in general, this grant is acquired or paid the following year. So if we apply the second principle, we will create a lag.

Therefore the approach favored by tax authorities has to be determined in order to know whether the year of appropriation or the year of payment factor into the calculation of IBS (corporate tax).

General Conclusion

The CNC has issued the instructions for implementation, which removes any remaining doubts about a possible postponement or on how to proceed.

The CNC, to its credit, has done a complete and relatively clear job so that conversions may be implemented without further hesitation, in much the same way this was done when IFRS was implemented elsewhere in the world.

All in all, the Tax Administration has already made good progress on major issues posed by the reform (NFAS).

Though the Finance Ministry has come under criticism in the written press for "unpreparedness" or "lack of readiness", it would appear that judgments were somewhat severe.

The tax administration, at least superficially, has clarified or will clarify most of the potentially complicated NFAS-related points.

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