

IFRS: evolution or revolution in retail?

CONSUMER MARKETS

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IFRS: evolution or revolution in retail?



Since 2002 companies listed in the European Union have been required by law to issue financial reports according to International Financial Reporting Standards (IFRS) for financial years starting on or after January 1, 2005.

The new reporting requirements have involved listed companies in extensive IFRS conversion projects. In April 2005 KPMG in France, working in conjunction with Cartesis, surveyed the progress of conversion projects at 100 French companies: the results suggested that while considerable advances had been made, many conversion projects were far from complete (despite having been in place for up to two years).

In a second study in December 2005 KPMG in France surveyed IFRS financial statements at 14 international retail groups, at which time all the companies surveyed had completed the required conversion of historic financial reports (meaning accounts for 2004 in the case of most companies), and had published their first quarterly reports under IFRS.

This study assessed the success of IFRS conversion to date in four key areas:

- Have companies across the retail sector succeeded in harmonizing the presentation of financial information?
- To what extent have retail groups taken a common approach to first time application of IFRS?
- Have financial statements improved in terms of consistency and relevance?
- Has the restatement of historic financial statements under IFRS led to better legibility?

The corporate sample

The sample used in the study consists of 14 large groups in the retail sector in Europe and Australia, (12 of which are included in the table below). The 14 groups were at different stages in the first-time application of IFRS: the three German groups (Karstadt, Metro and Otto) have already been publishing financial statements in accordance with IFRS for some years and therefore do not publish conversion information.

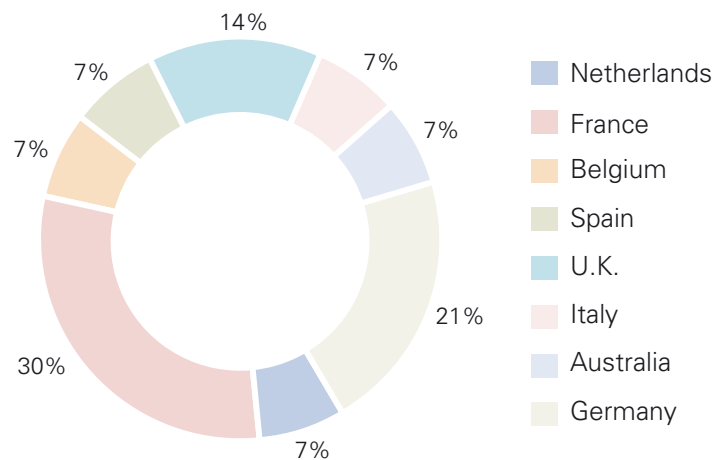
Company	Country	Main activities	Sales turnover 2004 (in billions of euro unless otherwise stated)	Stock-market capitalization (in billions of euro unless otherwise stated)
Benetton	Italy	Specialty retail	1.7	1.6
Carrefour	France	Hypermarkets, supermarkets, hard discount	72.7	26.5
Coles Myer	Australia	Supermarkets, discount, large stores, specialty retail	32.3 ⁽¹⁾	Not provided
Delhaize	Belgium	Supermarkets	18.0	4.6
Galeries Lafayette	France	Large stores, specialty retail	5.6	Not provided
Karstadt	Germany	Specialty retail	13.4	2.0
Inditex	Spain	Specialty retail	5.7	15.4
Metro	Germany	Hypermarkets, specialty retail, large stores	56.4	12.6
Otto	Germany	Specialty retail	14.4	Not applicable
PPR	France	Large stores, specialty retail	24.2	10.1
Sainsbury	United Kingdom	Supermarkets	24.2	5.0 ⁽²⁾
Tesco	United Kingdom	Hypermarkets, supermarkets	43.4	23.3

(1) Billion Au\$ (2) Billion UK£

Source: KPMG in France analysis, 2005

All the groups involved in conversion have published information about how their opening balances for 2004 were drawn up and about the impact of the IFRS changes on the 2004 accounts.

Distribution of companies in sample by country



Source: KPMG in France analysis, 2005

First-time adoption: how consistent?

Financial markets had hoped that the implementation of IFRS would lead to increased transparency of financial data, and harmonization of data presentation at the international level. Although IFRS 1* sets out detailed requirements for the first time application of IFRS, there remains considerable scope for variation in the way that IFRS is adopted, leaving potential for considerable disparities at the outset.

Some options are widely used

Most companies in the sample have selected similar options with respect to the elimination using consolidated reserves of conversion variances on the transition date; the elimination of actuarial variances; the application of IFRS 2* to plans dated later than November 7, 2002; or the application of IFRS 3* starting on the transition date without a restatement of previous business combinations (the PPR group is the exception in this last case).

* Please refer to the 'Glossary of standards' for further details

Other options have generated considerable divergence

The positions adopted by companies on standards for financial instruments and on the revaluations of fixed assets are much more diverse. Only half of the sample decided to apply IAS 32* and IAS 39* (financial instruments) starting in the financial years included in comparison, and they made very considerable revisions in this respect. Similarly, only a third of the sample decided to use the option available to revalue assets. The effects of these divergences on the opening capital and reserves, and on the financial structure of the balance sheets, is considerable.

Financial implications: transition and conflict

All the groups in the sample that have published figures have drawn up tables with the aim of presenting and summarizing changes resulting from the new standards. The tables reveal the extent of differences in approaches adopted by groups in the same sector; they also help to show the extent and the nature of the impact of IFRS on financial statements.

Limited impact on capital and reserves

The average effect of the transition to IFRS on opening capital and reserves is small – the average change in equity is less than one percent for the sample. However, this apparent stability conceals considerable individual disparities. These disparities are primarily the direct results of choices relating to first-time application (including acts of revaluation) but they also reflect specific circumstances on previous divergences between local GAAP and IFRS (for example, IAS 19* or IAS 36*).

* Please refer to the 'Glossary of standards' for further details



More volatile results

The average effect on the results of restatement under IFRS of the financial year used for comparison is much more marked. The transition resulted in an average increase in the results for 2004 of more than 60 percent; disparities between individual groups are also marked. As widely expected, the adjustment involving the elimination of the systematic amortization of goodwill in accordance with IAS 38* makes a very considerable contribution to the improvement in results (almost 15 percent in the sample). The adjustment of the 'recycling' of goodwill (that is, goodwill previously set off against reserves and recycled on the sale of the entity to which it related, which is not allowed by IFRS 3*) has the largest positive effect. The effects are extremely large for the group affected by this adjustment (+132 percent against a base reference of 100 for Sainsbury). The impacts of IAS 21* (which affects goodwill) and of IAS 32* and 39* have also been significant. However, other adjustments that have been the subject of lengthy debate have not had as large an effect on the restatement as expected (the effect was around +6 percent for IAS 19*; around -4 percent for IFRS 2*; less than +3 percent for IAS 2*; and less still for IAS 17*).

Overall, differences between the retail groups are marked. The overall effect for two groups was negative (Tesco and Benetton), while others published very considerable positive adjustments.

A new way of reading headline financial data

Retail groups in the sample have provided quite extensive (albeit varying) information about the effects of the transition to IFRS, including explanations of why the new presentation arrangements have generally resulted in a fall in turnover (income). PPR reported a fall in income of almost 7 billion euro as a result of the application of IFRS 5 (affecting assets held for sale and discontinued operations). Large adjustments also came from Galeries Lafayette, which published significant falls in turnover (-9 percent change) because of the reclassification of joint operations and supplier participation as deductions from the cost of sales; the fall is also attributed to changes in the accounting method for 'stand' sales at Galeries Lafayette and of sales made through concessions at PPR.

* Please refer to the 'Glossary of standards' for further details



- **Margins:** adjustments and reclassifications relating to income and overheads led to an increase in the average margin for the sample of 1 percentage point. This average conceals varying trends in both directions. The margins of four groups has altered by more than a single point in terms of absolute value (from -1.3 points to +5.2 points).
- **Financial structure:** the difficulty of analyzing the financial structures of the groups is caused both by the diversity of information provided, and also by the variety of calculation methods adopted and the complexity of the explanations given. For the groups that provide specific communications about the impact of the conversion on their financial debt, the switch to IFRS has a negative effect on the absolute value of the debt. IAS 32* and 39* (relating to early application from 2004 onwards) have a considerable impact; also significant have been IAS 27* (relating to the ad hoc consolidation of entities) and, to a lesser extent, IAS 17* (relating to leasing and financing). Overall the effect on the sample companies has been a clear decline in the gearing ratio.

Comparability and legibility: partial progress

Has there been an improvement of financial statements in terms of consistency in the sector and in terms of the relevance for the sector? Have communications relating to the conversion of comparative statements led to an increase in readability or to more confusion? An analysis of the information in the balance sheets, the profit and loss accounts and the cash flow statements under IFRS helps to establish some concrete answers to these questions.

IFRS balance sheets remain only partially consistent

Aside from the inconsistent effects of the first-time application options (in particular the option for the application date in IAS 32* and 39*), other inconsistencies include the presentation of data on investment properties, the fact that the accounting methods for investments in associates differ (only four groups from the sample use proportional consolidation), and disparities in the consolidation and presentation of reports on financial companies.

* Please refer to the 'Glossary of standards' for further details

Harmonization of income statements highlights national differences

Although French retailers retain the concept of turnover, the majority of companies present only a single line of data on return from 'ordinary' activities. Data on return from operations of financial and real estate subsidiaries remain areas where differences are marked. Although intermediate margin aggregates are almost always included in reports even though they are not required under IFRS, aggregates such as EBITDA (Earnings Before Interest, Taxes, Depreciation and Amortization) and EBITA (Earnings Before Interest, Taxes, and Amortization), are only used by the German retailers. There are no extraordinary results, but French groups use a heading for 'non-recurrent' income and expenditure (which can affect the assessment of performance), although they do not all use it in the same way. Also, the impairment of goodwill and assets are presented in a variety of ways in the income statement. The biggest variation in the sample is seen in the presentation of financial result aggregates.

Cash flow statement: room for improvement

The presentation approaches for this statement are still very heterogeneous and leave room for improvement in the light of the requirements of IAS 7*.

Segment information remains sparse

The presentation of segment information (IAS 14*) is an important criterion for the comparability and readability of financial information, as the structure of groups is expressed through this information. Of the eight groups studied which have defined two segmentation levels, six describe operations as the primary level. Only half of the groups provide specific information about the approach to segmentation, although approximately 40 percent of the groups provide detailed segment information in the income statement that goes beyond the requirements of IAS 14*.

* Please refer to the 'Glossary of standards' for further details



After 2005: much remains at stake

Although conversion to IFRS standards is currently mandatory only for listed European companies, these standards will be applied by an increasing number of businesses in the years to come. Unlisted companies in Europe can draw up their consolidated accounts in accordance with IFRS for financial years starting on January 1, 2005 or later. By the end of 2006, several thousands of listed and unlisted companies in Australia will have switched to IFRS. And from 2009, European companies listed in the United States will no longer be required to adjust their accounts published in accordance with IFRS in order to bring them into line with American standards. So much remains at stake in the implementation of IFRS.

Some IFRS standards continue to present challenges for retailers

The application of IFRS standards relating to the recognition of income, inventories, financial instruments and employee benefits has a significant effect on the interpretation of financial statements for retail groups. Also, the effect of transition to IFRS standards can vary considerably, depending on the decisions on first-time application of IFRS (IFRS 1*). Given these uncertainties, retail groups can be expected to pay close attention to each other's approaches.

Companies adopting IFRS today are corporate pioneers

Companies adopting IFRS standards in the future are likely to draw on the experience of those companies adopting the new standards today – especially given the current scope for interpretation. It is therefore not surprising that EFRAG (the European Financial Reporting Advisory Group) has noted that there remains considerable disparity in the accounting approaches used in the different countries of the European Union. Indeed, work in progress at the IASB (the International Accounting Standards Board) suggests that consistent application of IFRS cannot be achieved until the medium term at the earliest. Until then, the first positions adopted by reporting companies are likely to prove influential, as they will inevitably serve as points of reference for future adoptions of IFRS.

* Please refer to the 'Glossary of standards' for further details

Glossary of standards

Standards applicable for annual periods commencing on or after January 1, 2005

IAS 1	Presentation of Financial Statements
IAS 2	Inventories
IAS 7	Cash Flow Statements
IAS 8	Accounting Policies, Changes in Accounting Estimates and Errors
IAS 10	Events After the Balance Sheet Date
IAS 11	Construction Contracts
IAS 12	Income Taxes
IAS 14	Segment Reporting
IAS 15	Information reflecting the effects of price changes
IAS 16	Property, Plant and Equipment
IAS 17	Leases
IAS 18	Revenue
IAS 19	Employee Benefits
IAS 20	Accounting for Government Grants and Disclosure of Government Assistance
IAS 21	The Effects of Changes in Foreign Exchange Rates
IAS 23	Borrowing Costs
IAS 24	Related Party Disclosures
IAS 26	Accounting and Reporting by Retirement Benefit Plans
IAS 27	Consolidated and Separate Financial Statements
IAS 28	Investments in Associates
IAS 29	Financial Reporting in Hyperinflationary Economies
IAS 30	Disclosures in the Financial Statements of Banks and Similar Financial Institutions
IAS 31	Interests in Joint Ventures
IAS 32	Financial Instruments: Disclosure and Presentation
IAS 33	Earnings per Share
IAS 34	Interim Financial Reporting
IAS 36	Impairment of Assets
IAS 37	Provisions, Contingent Liabilities and Contingent Assets
IAS 38	Intangible Assets
IAS 39	Financial Instruments: Recognition and Measurement
IAS 40	Investment Property
IAS 41	Agriculture
IFRS 1	First-time Adoption of International Financial Reporting Standards
IFRS 2	Share-based Payment
IFRS 3	Business Combinations
IFRS 4	Insurance Contracts
IFRS 5	Non-current Assets Held for Sale and Discontinued Operations

Source: International Accounting Standards Board, April 2004

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