

News

letter

Institute of Certified
Public Accountants in Israel

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Editor's Note



I'm glad that this Newsletter will reach you when all the hostilities have ended.

We all hope that the present truce will prevail to save unnecessary loss of life on both sides. We are a nation who strives to establish a real and lasting peace with our neighbors.

This Operation has caused a very heavy financial burden on our economy which we hope we will overcome. Unfortunately, this took place at a

time when the entire world, including Israel, is suffering from severe recession.

I've tried to include in this Newsletter some new ideas on accounting standards which are very refreshing. I hope these articles will be of some interest to you. You will also find included a short note as regards to our meeting with delegates from the ACCA with whom we keep close professional relations.

We'll appreciate receiving any comments you may have on the contents of the Newsletter, especially as to the topics you'd like to read.

Morris Kanne

From the President



Dear colleagues,

The current financial crisis, which is affecting both the Israeli and the global economy, is bringing to the surface and amplifying all of the main problems that exist in the economy and in Israeli society as a whole. The crisis requires us to find immediate solutions and to act differently, to think outside of the box.

In Israel, we find ourselves just a few days before elections for the Knesset and the election of a new Prime minister. Whoever is elected will have the burden placed on his or her shoulders, not only of leading the country in the coming years, but also another heavy task which entails considerable responsibility: getting the Israeli economy out of the crisis as soon as possible.

As one of the most important bodies in the economy, whose 12,000 members are to be found at many of the central points of activity in the economy and in society at large, the Institute of Certified Public Accountants in Israel is committed to contributing to the stabilization and the strengthening of the economy. We believe that a strong, stable economy can assist in solving the main problem that has come up in the current crisis – the widening of the social gap in the Israeli society. This problem did not begin with the current crisis, but if the correct action is taken it can be reduced.

The Israeli society is facing complex challenges on the security front as well. Operation Cast Lead, which the IDF launched a couple of weeks ago, was a correct operation that is fully justified and one of its objectives was to achieve a better security situation, that will be more stable over time, on our southern border with the Gaza Strip. This military operation was crucial in order to remove the threat of rocket fire against communities in the south of the country. The war on terror is an ongoing war and determination, patience and focused action were crucial pre-conditions for victory. I hope and pray that peace will prevail, and that the words of the Prophet Isaiah will come to pass: "...and they shall beat their swords into plowshares, and their spears into pruning hooks: nation shall not lift up sword against nation, neither shall they learn war any more."

In effect, Israel has always acted under two parallel sets of pressures: on the military front and on the economic front. Our security situation has never been calm, and Israel has also experienced ups and downs on the economic front as well. However, in recent years, the Israeli economy has been going from one achievement to another. Despite the slow-down in the Israeli economy, we have not been harmed by the credit crisis to the same degree as other large western economies, and we are still expecting to see a small growth in Israel's GDP during the year 2009.

However, our central problem in Israel is political. On average, every two years we have to go through elections and this fact cancels out the strength that is afforded to our elected leaders by the very force of their election and at the same time increase the strength of the bureaucracy.



I recently suggested to the Prime Minister and also to the President of the State that we should move over to a multi-year outline for the state budget. It is possible to define the budget as the strategic plan for the development of the economy in order to eliminate the political commitments that are an inevitable part of the democratic process of coalition politics. Such an outline would provide the economy with a horizon, it would set targets for the execution of programs and projects, and it would permit a high degree of certainty for the business sector in Israel and also for investors from overseas.

The current crisis is also an opportunity to get rid of any unnecessary bureaucratic delays, which not only delay the development of the economy, but also constitute fertile ground for corruption. For example, reform in the planning and construction processes is extremely crucial, in order to enable the setting up of national infrastructure projects for plants and commercial zones.

It is also very important that assistance be provided for small and medium sized businesses, who are the main casualties of the crisis. The State must make credit and additional resources available in order to help them to survive this difficult period. A business that collapses is a world of its own, and it provides the income of a large number of families that could find themselves below the bread line, and then they will become yet another burden on the State. What I would like to say is that an economic policy, which provides assistance to the weaker members of the business sector, is the correct economic and social policy in the long-term.

The most important thing today is to do something. Not doing anything in the present situation is worse than doing the best that you can, since anyone can do something and make a mistake, but not doing anything is, in and of itself, a failure of leadership as well as a conceptual failure.

Reuven Shiff

The Ended Up Outside (of the money)

How the financial crisis has had an impact on the remuneration of employees and senior office holders: What has happened, what is going to happen and what is the appropriate accounting policy

Gil Katz, CPA (Isr)*

What has not been said already about the implications of the credit crisis on the markets across the globe? It all began in the USA with the mortgages crisis, where terms such as MBS (Mortgage Backed Securities) and CDO (Collateralized Debt Obligations) first came to our attention. It continued with the downwards trend that characterized the indices for real estate and financial companies, and at that stage we began to hear about the first buds of a developing crisis.

In March it was the turn of the investment bank Bear Sterns which collapsed and five months later so did Lehman Brothers, the fourth largest investment bank in the United States, which crashed overnight. Suddenly, we were hearing, without respite, in all of the news bulletins, about the crashing of the leading stock exchange indices both in Israel and across the globe, massive waves of redundancies that are expected to take place in many companies over the coming months, the withdrawal of monies from provident funds and heavy fears of a worldwide recession.

Is there anyone today who remembers that less than two years ago the newspapers had headlines that screamed in giant letters "The Tel-Aviv 100 Index crosses the 1,000 points line", whereas as of the time of the writing of this article the index stands at around about 640 points.

One of the direct effects of the worsening crisis that has hit the global markets in recent months, and which, as we have said, has lead to a sharp fall in share prices in

most sectors, it that the options and similar capital instruments that were granted to employees and senior officers in companies have lost a considerable part of their value within a very short period of time.

We should not forget that in many companies these capital instruments formed a sizeable component of the salaries of the employees, especially for senior officers. And so, in the light of the downwards spiral that the global markets have got into, and as a result of the crash of many shares, many employees have lost a significant portion of their remuneration packages, since many options are now far out of the money.

It is sufficient to look at some of the leading indices, both in Israel and across the globe, in order to see that they have lost 40%-50% of their value since the beginning of the year. As a direct result of this, the naïve value (the gap between the price of the share and the additional amount payable on the exercise) of the capital instruments has declined by similar rates, and in cases where the instruments are now out of the money, the loss even comes to 100% of their value.

They grew with the hi-tech phenomena and crashed back to earth with the market

Up to 15 years ago, the term "options" was foreign to most of the employees in Israeli companies. The use of the grant options and similar instruments as part of the remuneration was something that was primarily relevant to a limited number of senior officers and shareholders in companies.

In tandem with the growth of the Hi-tech companies in the market, a mechanism



grew up for the remuneration of employees by means of capital instruments, and this gathered more and more pace among a range of companies. The remuneration of employees using capital instruments such as options and similar instruments was intended on the one hand to reduce the payment of salaries in start-up companies, who wanted to avoid burning up their limited cash reserves, so far as was possible, and on the other hand, this served as a vital mechanism for creating a direct link between the interests of an employee and those of the company, where the success of the company would directly effect the wealth of the employee and hopefully his sense of contentment as well.

In the years in which the stock exchange was rising and the future could not have looked rosier, there were many employees who, if only they could, would have been prepared to swap most of their routine salary for options and similar instruments, whose value was going up day after day. I myself heard on more than one occasion of many employees in hi-tech companies who said that they would be willing to waive their entire monthly salaries (and maybe even take out loans) if in exchange they could receive a larger number of options for shares in the company, which (so they hoped) would be worth a lot of money one day.

At the time, the mix between the payment of a monthly salary and remuneration by way of options and similar instruments was not an even balance in many cases. And so, as one can see from the state of the markets today, the breach of such a balance can be cardinal, since employees, such as those described above, as well as many others, lost the hair on their heads in more ways than one.

On the accountancy front, matters were not treated with indifference. In September 2005, in the light of the increasing use of the use of options and similar instruments in Israel, the Israeli Accounting Standards Board published Accounting Standard 24 on the subject of Share based payments, which is based on International Financial Reporting Standard 2 (IFRS 2).

The standard determines the manner of the accounting treatment of share based pay-

ments. Prior to the publication of the standard there was not any binding accounting standard in Israel on the subject of the remuneration of employees and senior officers by way of shares or options, and so a very limited number of Israeli companies, especially companies whose shares were traded on stock exchanges in the USA, implemented the American standard on the subject (APB 25).

The objective of the standard was to require companies to give exposure in their statements of income and their balance sheets to the effects of share based payment transactions, including those expenses that are attributed to transactions in which options and similar capital instruments are granted to employees and senior officials. Moreover, the standard determines that capital instruments for employees are to be measured, except for in very rare cases, based on their fair value, where the expense in respect of them is to be spread over the length of the vesting period.

The requirement to measure the benefit using the fair value model, by contrast to the naïve value model, which was generally accepted in the past in the old American accounting standards, constituted a further important step in the direction of the implementation of the International Financial Reporting Standards (IFRS) in Israel, as from the year 2008. As of today, all companies in Israel, whether public or private, are required to measure the fair value of the financial instruments that have been granted to employees and senior officers.

Between the capital grant and the granting of a commitment

The standard determines a distinction between a grant that is cleared using a capital instrument (a capital grant), such as in the case of options and ESPPs (Employee Stock Option Plan), and share based payment transactions, which include a commitment to pay cash or other assets (the granting of a commitment), such as in the case of phantom options. The main test for the classification of a grant, whether as a capital grant and whether as the grant of a commitment, is dependent upon the manner in which the grant is cleared.

The manner in which the grant is classified is of considerable importance from the perspective of the possible dilution of shares in the company and also in respect of the manner in which it is presented in its financial statements. In the case of a capital grant there is no impact on the company's shareholders' equity (the salary expense is recorded against a capital reserve), whereas in the case of the grant of a commitment there is an impairment of its gearing ratio (the recording of an expense against a liability). In the fragile state that the companies are in today, and in the light of the fact that some of the companies are fighting desperately in order to comply with various financial criteria that have been set for them, it is possible that the manner of the classification of the grant will have an impact on those financial ratios (even though the value of the liability has also been reduced accordingly).

The nature of the classification of the grant will also have an impact on the time of the measurement of the capital instruments. Whereas in the event of a capital grant the measurement is carried out only once, at the time of the grant, in the case of the grant of a commitment, the measurement of the benefit will be carried out anew in each reporting period, until such time as the commitment is cleared.

Accordingly, despite the marked fall in share prices in the recent past, and the fact that many capital instruments are now to be found far out of the money, in the case of a capital grant, a company is required to continue to recognize the expenses in accordance with the fair value of the capital instruments at the time that they were granted. As compared with this, in the case of the grant of a commitment, since the benefit is re-measured in each reporting period, until such time as the commitment is cleared, so a company can reduce the expense that has been recorded in the financial statements and in some cases it can even cancel most of the expense that was recognized in previous periods.

In the light of the worsening of the global crisis, the question still needs to be asked as to what companies can do in respect of those capital instruments that have been granted to employees and senior officials, ►

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where those instruments have lost a considerable part of their value in the wake of the current financial crisis?

It is important to note is that so long as the uncertainty continues in the global markets, the companies will not, so it seems, be happy to make changes in the existing remuneration plans or to grant new plans, at least until the worst of the storm has passed by. Many companies are busy with "damage control" and are focused on surviving the crisis, and therefore the subject of the remuneration of senior employees is not at the top of the list of their priorities right now.

I believe that the answer that is most common among the companies on the questions of the remuneration of employees in the current time of crisis will be something along the lines of "If we can get through the crisis without having to cut employees' salaries or even worse, firing employees, that is enough for us". And so the question of the granting of new capital instruments or changing existing plans, is really not on the agenda at the present time. Moreover, it is clear that since the shareholders have been hurt by the crisis, this is not the time to improve the terms of the employees' options and all the more so where this relates to of senior officers.

How can the employees who have been hurt by all this be compensated?

Let us now take a step forward and have a look at the day after. We will try, all the same, to examine what companies can do in respect of those same capital instruments whose value has been impaired. Apparently, in order to compensate those same employees and senior employees who have been hurt, the companies can make changes within the framework of the existing plans. Those changes would include, for example, the reduction of the additional amount payable on the exercise of the options, the improvement of the conversion rates for the options, the amendment or cancellation of the conditions for execution under the existing plans or the extension of the period within which the instruments must be exercised.

The simplest method, apparently, will be to reduce the additional amount payable on the exercise of the options. However, as we have noted, it is possible that there will be additional adjustments to the existing plans, as well as the granting of new remuneration plans following the cancellation of the existing plans (cancellation and re-granting).

Such a course of action, if it does indeed take place, reminds us to a great degree of the trend that characterized the Hi-tech market following the bursting of the bubble in the year 2000. At that time we were witnesses to a wave of re-costing of existing remuneration plans as well as the granting of new capital instruments to employees and senior officers and this was as compensation for reductions in routine salaries. These changes resulted, over and above the accounting implications, in legal implications as well as tax implications which have to be taken into account when looking at the whole gamut of considerations.

From the accounting perspective, in the case of a change in the terms of capital grants, which constitute a benefit for the employees, the companies are required to measure the fair value of the capital instruments in accordance with the new terms, immediately after the change. A positive surplus of fair value is to be recognized as an expense over the balance of the vesting period (or immediately if no additional vesting period is required).

In addition, a company is required to continue to recognize the balance of the expense in accordance with its fair value, as it was calculated at the time of the granting of the capital instrument, and this ignores the fact that these options have in effect "been cancelled". In the light of the sharp decline in the share prices, one can assume that the additional fair value will have a significant value. This is particularly correct in those numerous cases in which the options are far out of the money, and in such cases the fair value of the addition will be more or less equivalent to the full value of the new options.

Moreover, the standard determines that in the case of the granting of new capital instruments as a replacement for capital instruments that have been cancelled, the accounting treatment is to be identical to

what is required in respect of a change in the terms of an existing plan.

Something which is just as interesting, and which should be taken note of, is that those companies, which have started to examine the possibility of making changes in existing plans and/or granting new plans for capital remuneration in recent months, have in some cases found that the employees and senior officers have demanded as an alternative to receive assured cash (or a demand for the payment of a cash bonus).

The cash option is enticing once again

In other words: In those cases in which the capital instruments are out of the money at the end of the day, or alternatively, where the amount of the benefit will be lower than the amount that is assured in the plan, the company is required to indemnify the employee in cash at the level of the difference. This change is hardly surprising in the light of the panic that is grabbing the various players in the market. Those employees who up until yesterday had made huge amounts of money on paper (and those are the magic words – on paper) have suddenly been left holding capital instruments that are worth nothing, and therefore as of today, the alternative of receiving cash seems more attractive than it was in the past.

A remuneration plan that contains the alternative of clearance in cash in certain circumstances, and whose clearance is not subject to the sole control of the company, constitutes a complex instrument that contains both a liability instrument and also a capital instrument, from an accounting perspective and as from the time of the grant each instrument is to be treated separately. The liability instrument reflects that same "safety net" that the company makes available for the payment of an assured amount to the employees, if the capital instruments do not achieve a minimum target that has been set.

This instrument is to be revalued in each reporting period until such time as the commitment is cleared, such that the further the share price falls, the higher the econom-



ic value of the commitment rises. In addition, a company is required to recognize the expense in respect of the capital element if it is worth more than the liability element at the time of the grant and this is to be done in accordance with the fair value at the time of the grant.

In this connection, it is important to emphasize that in the light of the position adopted by the tax authorities on this subject, it is possible that in certain cases such a plan will not fall within (the aegis) of section 102 of the Income Tax Ordinance, with all that that implies, and therefore the terms of the grant need to be considered meticulously.

So that all of us will end up with additional food for thought, we need to discuss in brief the question that has been coming up every now and again in the recent past, on the whole subject of fair value in general, and the measurement of the value of options in particular: What is fair value? Is it possible to assume that in the models that have been generally acceptable for the measurement of the value of options, that what has been is what will be?

Let's take for example the fluctuations in the price of a share, which, as aforesaid, constitutes the parameter that has the biggest influence on the valuation of options. Is it possible to assume that the sharp changes in the share prices that have taken place recently form a representative index and therefore they should be taken into account in the valuation? For many of us, these questions are something of an enigma at present. If the reader will permit me to be slightly optimistic for a moment, I believe that the current crisis will come to an end (we all like to know when it will finally be over), and the companies can busy themselves with things other than just "putting out fires". After the crisis and during the recovery from it, we will once again be witnesses to a wave of "migration" that so characterizes the employees of the Hi-tech companies. The direct result will be that the subject of the remuneration of employees and senior officers through the use of capital instruments in general and the use that companies will make of those instruments in order to "steal" the best brains in the market in particular, will once again become very prevalent. ■

The Association of Chartered Certified Accountants meeting in Israel

In December, a meeting between delegates from the ACCA (The Association of Chartered Certified Accountants) and high profile members of ICPAI took place at the Institute in Tel-Aviv.

The representatives from the ACCA were: Prof. Robin Jarvis, Director of Small Business, Mr. Pino Messina, Director of Special Projects, Mr. Jonathan Gibbons, Head of Europe Business Development, Financial Services and Corporate.

The representatives from the Israeli Institute were: Mr. Reuven Shiff: President, ICPAI, Mr. Alex Hilman: Past President, ICPAI; member of SMPs Committee in IFAC; member of Edinburgh Group, Mr. Adir Inbar: Head of Professional Committee, ICPAI, Mr. Arnon Ratzkovsky: Head of the Accounting Committee on Standards and Practices, ICPAI, Mr. Dov Sapir, Chairman of the Professional Committee of Israel Accounting Standards Board, Mr. Izhar Kanne: Deputy Chairman of the Auditing Committee on Standards and Practices,

ICPAI, Mr. Avi Friedman, CEO ICPAI.

The Institute's relation with the ACCA goes back to the early 1950's. Our members, who sought worldwide recognition in the profession, passed the ACCA examinations in Cyprus.

Throughout the years, we have maintained a close relationship with the ACCA's Presidents and executives.

Since this was an introductory visit, the representatives introduced their respective professional bodies. The meeting continued to explore the possibilities of collaboration between the Institute and the ACCA and promote strategic alliances between the two bodies.

One of the main concerns that was raised was the need to cater to the SMPs by supporting initiatives addressing the needs of SMPs and SMEs.

The discussions yielded several issues to be emphasized in future meetings and the representatives agreed to meet in the near future for further discussions. ■



From left to right: Izhar Kanne, Arnon Ratzkovsky, Ofer Minirav, Dov Sapir, Alex Hilman, Reuven Shiff, Pino Messina, Robin Jarvis, Jonathan Gibbons, Avi Friedman, Iris Ofri



The Accounting Version of Balthazar's Feast

Reflections on the IFRS, revaluation gains, the distribution of dividends and business combinations

Ron Alroy, CPA (Isr)*

Is international accounting based on principles, or have those principles been breached and have they become the twenty first century's accounting version of that well loved story "The Emperor's New Clothes"? And this time, it is the accounting that causes a failure on the part of boards of directors when they come to decide whether or not to distribute dividends. The Companies Law determines an accounting test as the basis for the decision on whether to distribute a dividend, which is accompanied by a test of the ability to make payments. In order to analyze the accounting test, one has to be familiar with the principles and the principles have been replaced this year.

Moreover: the International Accounting Standards claim to speak in a language of principles. The standards determine, on more than one occasions, that the "management approach" is to be adopted. The problem is the management is not always brought up to date on this point. The following article contains a list of cases in which the judgment exercised by managements and boards of directors is what determines the accounting principle and along with that determines the profit, and in this way it also predetermines the results of the accounting test in respect of the distribution of a dividend.

Since these words are intended more for boards of directors, not all of whose members will have accounting and financial skills, I have tried to use as little accounting jargon as possible, and I hope that members of the professional departments in the firms and my students at the Management College will forgive me for this.

* Ron Alroy, Chief Financial Officer.

Revaluation gains in respect of liabilities

According to the IFRS, it is possible to present liabilities in accordance with their fair value, in certain circumstances. An interesting example of this is where the management declares that it examines a specific liability together with a specific asset that is presented in accordance with its fair value (such things are also said when what is being discussed in a group of assets and liabilities, which are tested together).

The asset can be a security issued by a strong American investment bank (oops...), and the liability can be a non-marketable loan from a bank. Where the financial position of the company has taken a turn for the worse, its level of risk rises and its credit rating falls. The effect of these factors can be clearly seen today in the phenomenally high yield rates of the corporate bonds.

And what do the accounting standards have to say about all this? That the liabilities should be revalued downwards! Does that seem fantastic to you? You were right. By the way, for anyone who is wondering what the significance of this is, I will clarify the situation for you: what is being talked about is the recording of an immediate financing profit.

The absurd result is caused by the technique used for calculating the fair value, which is based on the discounting of the forecast cash flows that are expected to be paid in respect of the loans. The increase in the interest rates decreases the discounted cash flows, and lo and behold, a kosher source has been created from which a dividend can be distributed. The value of the asset, which we have almost forgotten, can be determined on the basis of a market quote, in other words: completely divorced from the actual state of the company and its credit rating.

Retained earnings can also be confusing

Do the retained earnings, which are presented in the financial statements constitute an index for examining the possibility of distributing a dividend? Not always. When the new Companies Law entered into force, tests for distributions were defined that were different from the accounting presentation rules. What is being discussed here is a complicated subject, which we will not expand upon here.

In general terms, one can say that the self-purchase of shares by the company itself or by a subsidiary company that it controls is (according to the law), an event that is identical to the distribution of a dividend. At the same time, the accounting presentation does not, of necessity, connect this event to the item retained earnings. And so, where such a purchase takes place, one needs to take into account the need to examine the amounts that are available to the company for the purpose of distribution as a dividend.

One cannot see the fixed assets for the real estate

When the International Standards were adopted, many accounting and legal experts were busy with the question: Is it possible to distribute dividends out of profits from the revaluation of investment property? The discussions have died down a little in the light of the dramatic falls that we have seen in the real estate sector.

In any event, for anyone who like me cannot remember the conclusion that came up from all of those discussions right now, let us just say that the key to it all is and remains the degree of belief that you feel, as a director, in the appraiser and in the appraisal that they put together. Everything else will be



clarified, if at all, in a forum in which there is a relatively small number of accountants and which is headed by a judge.

However, the storm that is raging in the real estate sector has pushed the question of revaluation gains in respect of fixed assets into a remote corner. According to the IFRS those gains are to be reflected directly under shareholders' equity and they are not to be reflected in the statement of income. Apparently, this is the reason that these profits have not attracted especial attention.

And now for the real story: the IFRS enables management to pass the profits on revaluation from the capital reserve under which they were initially reflected to retained earnings. For example, an asset whose net book value is 100 Shekels is revalued in accordance with its fair value of 120 Shekels and 20 Shekels are reflected under a capital reserve.

Where the financial position of the company has taken a turn for the worse, its level of risk rises and its credit rating falls. The effect of these factors can be clearly seen today in the phenomenally high yield rates of the corporate bonds.

And what do the accounting principles have to say about all this? That the liabilities should be revalued downwards! Does that seem fantastic to you? You were right.

Does this all seem very complicated to you? You're right, it is. The financial statements are less well understood today than ever before, and it seems just to make people angry – they are based more and more on the exercise of the judgment of the managements and the Boards of Directors that approve them. So, instead of attacking the directors, who quite unjustly and very rudely are called "the snack eaters", accountancy should be providing real tools for the analysis of financial statements, and this needs to be done with immediate effect.

On the assumption that the asset is depreciated over a period of ten years from now onwards, the company reports an annual depreciation charge of 12 Shekels instead of the 10 Shekels it would have charged were it not for the revaluation. According to this, the retained earnings are reduced by an additional 2 Shekels each year. As we have already noted, the accounting rules enable manager to provide compensation for the retained earnings by means of the transfer of 2 Shekels from the capital reserve.

It is here that the question arises which may be of interest to companies that are rich in fixed assets (and especially those whose balance sheets also include a significant amount of investment): is it possible to distribute these amounts that have been reflected under retained earnings as dividends? Since I will for certain get into trouble if I respond to this question, I am proposing a bit of mental exercise instead.

The transfer to retained earnings comes in order that the latter will not be impaired by the recording of the excess depreciation, which derives from the revaluation, in the statement of income. If this is so, then a company that does not recognize revaluation gains on its investment property for the purposes of the distribution of a dividend, is supposed to ignore revaluation losses (as the result of the additional depreciation) for the purposes of the distribution test, and it is permitted to distribute a dividend in respect of those same amounts that have been transferred from the capital reserve in respect of the fixed assets to the retained earnings.

However, the fly in the ointment is that the opposite is also correct. A company that decides to distribute a dividend on the basis of statements that have been revalued in accordance with market value, must think very carefully before it decides to distribute a dividend out of reserves that include those same transfers from the capital reserve.

Business combinations are complicating the picture

One of the more instructive methodologies that the International Accounting Standards offers can be found in the International Standard that deals with business combina-

tion (IFRS 3). Here too, this short article will not even be able to present even the beginning of the explanation.

However, it is appropriate to ask: Does the company that you are a director of have a subsidiary company in which your company holds less than 100% and the minority interests have an option to sell their share (Put)? A question, which we do not need to clarify at present, is whether the option is "in the money" or "out of the money". The accounting, at this stage, does not go into the little details.

If the answer to the first question is positive, it is necessary to clarify the accounting treatment that the company is adopting, out of the range of possibilities that IFRS 3 offers. The possibility that is most widely adopted by the companies is the reflection of 100% of the profits of the subsidiary company, even though in practice the subsidiaries are not wholly owned (the minority's share of the profits is not attributed to it) and in parallel, a commitment is created in respect of the put option against the expansion of the goodwill.

Anyone who does not believe me is invited to check. What is being talked about is an orderly accounting methodology and who are we to complain? However, if we go back to the matter of the dividend and to the responsibility of the board of directors, what is being talked about is the a profit that will never actually reach the parent company in the form of a cash flow or in any other form, however sanctified the accounting methodology may be, it would appear that one needs to exercise caution when distributing a dividend on the basis of a profit like this.

Where is Daniel when we need him?

What has been described are just a few examples of a flood of methodological problems that are hanging over the heads of the board of director when it approves the financial statements, and especially when it is about to decide on the distribution of a dividend. Especial attention is also required in cases where there are share based remuneration plans, an impairment in the value of assets, and of cause the main headline of the international standards: the rules for the recognition and measurement of financial instruments.



Does this all seem very complicate to you? You're right it is. The financial statements are less well understood today than ever before, and it seems just to make people angry – they are based more and more on the exercise of the judgment of the managements and the boards of directors that approve them. So, instead of attacking the directors, who quite unjustly and very rudely are called "the snack eaters", accountancy should be providing real tools for the analysis of financial statements, and this needs to be done with immediate effect.

The work will probably be done by the Americans, but they do have a road map, which ends in 2014. Up to then, meetings of a board of directors will be analogous to Balthazar's feast, where a hand suddenly appeared and wrote inexplicable messages on the wall, which only Daniel could interpret. Today too, the writing is on the wall, and just like them, what is written is not clear, it is difficult to interpret and this could all have a dramatic significance for investors and lenders. So where is Daniel when he is really needed? ■

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The 77th Annual General Meeting of the Institute of CPA in Israel

The 77th annual general meeting of the Institute of Certified Public Accountants in Israel took place in November at the Tel-Aviv Exhibition Grounds, in the shadow of the global financial crisis. Hundreds of important figures from the economy and the government participated in the meeting, including the Chairman of the Securities Authority, Prof. Zohar Goshen, and the Director of the Tax Authority Yehuda Nasradishi. Among the speakers at the annual general meeting were the State Comptroller, retired judge Micha Lindenstrauss and the Chairman of the Knesset's Finance Committee, Avishai Braverman MK.

Reuven Shiff, the President of the Institute of Certified Public Accountants in Israel said: "The government must take immediate action in order to prevent the suffocation of credit in the economy and in order to assist the small and medium sized businesses to survive the economic crisis. It is the small and medium sized businesses, which form an important engine for growth in the economy that are at high risk at the present time, and some of them could simply disappear if they do not get help. Liquidity is a vital need, today more than

ever, in order for them to survive and have room to breath".

Shiff also made a call for the heads of the political parties to reach agreed understandings so as to reduce the budgets for the election campaign: "We do not have two billion dollars of surplus money in the state budget with which to finance a wasteful election campaign, with conceited television advertising campaigns. The heads of the political parties have to come down to earth and fit in with the economic reality." ■



From the left to right: Prof. Zohar Goshen, Chairman of the Securities Authority, Mr Reuven Shiff, President ICPAI

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