CESR

THE COMMITTEE OF EUROPEAN SECURITIES REGULATORS

Ref: CESR/04-274

M. Donald T. Nicolaisen
Chief Accountant
U.S. Securities and Exchange Commission
450 Fifth Street, NW
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United States of America
E-mail: OCA@sec.gov;

cc: M. Scott Taub, Deputy Chief Accountant
(taubs@sec.gov)

London, 19 May 2004,

Dear Mr Nicolaisen,

Re: SEC Proposed Rule for foreign issuers reporting for the first-time under International Financial reporting Standards (IFRS).

At the March 2004 meeting of CESR-Fin in London, where CESR-Fin Members had the great pleasure to meet you, we discussed with you the possible interactions between the SEC proposed new rules for IFRS first-time adopters and a recommendation published by CESR on 30th December 2003 (Recommendation for Additional Guidance regarding the Transition to IAS/IFRS). I enclose a copy of this document for your convenience (Ref 03-323e), as well as a copy of the feedback statement (Ref 04-490b) that CESR published along with this recommendation after the public consultation.

In that context, CESR-Fin was very pleased to see the proposed rules amending Form 20-F that the U.S. Securities and Exchange Commission have published for comments. These proposed rules relate to different aspects of financial reporting by foreign issuers registered with the SEC and which apply IFRS for the first time. Their publication is very timely and we applaud the SEC's decision to seek a practical solution to the problems posed by the transition to IFRS to the approximately 400 European listed companies which are also SEC Registrants.

We would like to highlight a number of elements that we believe are important for ensuring a harmonious transition to IFRS for all companies listed in Europe and registered in the United States, and also for encouraging further convergence between U.S. and European financial reporting regulations.

First, we would like to express a strong support for different proposals that are set out in the proposed rules amending Form 20-F, in particular the proposition to allow foreign private issuers who have not previously published financial statements under IFRS to file two years rather that three years of financial statements presented in accordance with IFRS.

As explained in the paragraph 39 of the CESR recommendation, CESR has adopted the same approach as the SEC, as it had reached the same conclusions that this will enable investors to receive proper financial information without imposing burdensome and technically difficult restatements obligations to issuers. More specifically, you will see in paragraphs 40 and following of the recommendation that we make specific proposals for the presentation of previous GAAP financial information in a "bridge approach" format alongside with IFRS financial information. We note in your proposed new rules that the SEC envisages a similar approach.

The CESR recommendation has also provided guidance on the financial statements reconciliations and explanatory information that would be published for interim periods during the transition period.

CESR's position on interim period reporting is basically to encourage that such reporting be prepared on the basis of IAS 34 and, when this is not possible, that financial information published at interim dates as from 1st January 2005 is prepared in conformity with IAS/IFRS recognition and measurement principles that will be used at 2005 year end (see paragraphs 27 to 37 of the Recommendation). Issuers are permitted not to follow these guidelines (i.e. they could continue to prepare financial interim information using previous national GAAP), but in this case they are expected to explain the reasons why they were unable to do it or decided to depart from the guidance (see paragraph 9).

Determining which accounting framework is to be used for interim periods reporting during the first year of transition to a new set of accounting standards was a complex issue with some good technical and practical arguments in favour of each solution and this explains that some flexibility was left to companies. The CESR decision-making process reflected the results of our public consultation and our in-depth consideration of the feasibility of each solution.

It can be argued that in an ongoing situation, i.e. when the reporting framework is not changed thoroughly between two reporting periods, the interim financial information should preferably t be prepared on the basis of accounting standards used for the preparation and presentation of the last published financial statements. This allows investors to compare such interim information with the issuer's previously published annual financial statements and interim period's information (in this case, statements prepared in accordance with previous GAAP). However, it can also be argued that companies should be expected to anticipate changes to accounting policies and so avoid unnecessary surprises for investors at the end of the year.

Our conclusion in this case was that the unusual circumstance of a complete change in accounting principles and its potential impacts on financial markets represented by the mandatory application of IFRS in Europe as from 2005 would require full information for investors and analysts as early as possible in the process. As indicated in our recommendation, we are convinced that anticipating the importance of the event, many investors and financial analysts will be impatient to assess the real impact of the transition for listed companies. Around the turning point, accounting information will often be analysed in terms of its forthcoming significance under IFRS.

Our recommendation takes into account the objective of providing investors with useful and relevant information during the transition period, in particular at a time when all listed companies will be assumed to begin applying the new standards. Comparability with previous results and financial position is an important issue that needs to be addressed separately, as we did under the section 3.2 of the CESR Recommendation. We did it by way of recommending restating to IFRS the interim information previously published under national GAAP, in a manner broadly similar to what is required by IFRS 1 for the annual financial statements.

It is as well important to avoid that investors receive throughout 2005 interim financial information based on previous GAAP which would be contradicted only a few months later by annual information based on IFRS.

Mandating listed companies to report their 2005 interim periods information on the basis of their previous national GAAP would also create additional burden as this would force them to keep books and records in accordance with both set of accounting standards. Considering the cost of the transition and the need that this transition is conducted with all due care , it may also be harmful for the quality and reliability of financial reporting to oblige companies to continue reporting under previous GAAP at the same time as they adopt and implement the new standards.

It came out of the public consultation that CESR conducted on the exposure draft of the Recommendation that our proposal was supported by an important number of respondents to the public consultation. Many indicated that a complete application of IFRS as from 1st January 2005 was the most obvious and practical solution.

In order to give sufficient flexibility, we also indicated that reporting at interim dates under previous GAAP as from 2005 could also be accepted[1], but this non preferred option must be seen in the context of other guidelines set out in the Recommendation. First, issuers who choose this option must explain the reasons for doing it. Secondly, other guidelines for additional disclosures will be applicable during the whole transition period (this includes interim reporting dates in 2005). Indeed, listed companies are encouraged to regularly inform the market about the expected impact of the transition to IFRS. Such additional information can be narrative only in 2003 and during 2004 (i.e. explaining the main differences between previous GAAP and IFRS as well as the transition plans of the company). As from the year end 2004, we recommend that quantitative information is also provided (explaining the main impacts of the application of the new standards on the financial position and results of the company). We also recommended updating regularly these narrative and quantitative additional explanations.

As a conclusion, we would like to invite the SEC to adopt a regime that encourages European registrants in the United States to present interim financial information for the transition year (i.e. 2005 in most cases) based on IFRS and that does not require them to continue preparing financial information using previous national GAAP if they have already decided to keep their books under IFRS as from 1st January 2005. It is worth noting that the current SEC proposal would have the unintended consequence of providing local GAAP interim accounts only to US investors, with the EU markets expecting and receiving IFRS-compliant interim accounts which are far more relevant to users.

As European Securities regulators, we share the same objective as the SEC that investors in financial markets receive proper, reliable, comparable and understandable information, and

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[1] We understand that this could be the case for companies unable to adapt their internal accounting procedures for IFRS as early as 1st January 2005.

we believe CESR's recommendation usefully serves these objectives without imposing burdensome requirements on issuers.

We should be more than happy to discuss these elements in more depth with you.

Yours sincerely,

Philippe DANJOU
Chairman of SISE

John Tiner
Chairman of CESR-Fin

Appendices: 2

- *CESR Recommendation for Additional Guidance regarding the Transition to IFRS (Ref. 03-323e).*
- *Feedback Statement following CESR public consultation on the draft Recommendation (Ref. 03- 490b).*

THE COMMITTEE OF EUROPEAN SECURITIES
REGULATORS

Ref: CESR/03-323e

European regulation ON THE APPLICATION OF IFRS IN 2005

RECOMMENDATION FOR ADDITIONAL GUIDANCE REGARDING THE Transition to IFRS

DECEMBER 2003

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Foreword

This Recommendation contains several proposals whereby European listed Companies can be encouraged to provide markets with appropriate and useful information during the transition phase from local accounting standards to International Financial Reporting Standards (IFRS). Those recommendations relate primarily to:

- What type of information could usefully be published before the year of transition in relation with the changeover to the IFRS framework.
- The accounting framework to be used by issuers when interim financial information is published during the financial year beginning on or after 1st January 2005.
- How to achieve comparability of information published for the year 2005 with preceding periods.

The draft recommendation has been prepared by CESR's standing committee (CESR-Fin) in the area of financial reporting. CESR-Fin was chaired by M. Henrik Bjerre-Nielsen, Director General of the Danish Financial Supervisory Authority until November 2003 and by M. John Tiner, Chief Executive Officer of the Financial Services Authority in the UK, since then. The project of this recommendation was more specifically managed by the Sub-Committee on International Standards Endorsement (SISE) chaired by M. Philippe Danjou, Chief Accountant of the French Autorité des Marché Financiers (AMF, ex COB).

The present recommendation was originally released on 7th October 2003 for public consultation. The period for comments expired on the 20th November 2003, after a public hearing was held on the premises of CESR in Paris on the 12th November 2003.

During the consultation period, 55 letters were sent by varied organizations. All comment letters received have been published on the CESR website.

A feedback statement has been published along with the present final text of the recommendation, explaining CESR's position on the major comments expressed by respondents to the public consultation. The present recommendation should be read in the context of the feedback statement.

CESR

Context of the Recommendation

§1. In compliance with the European Parliament and Council Regulation n° 1606/2002 on the application of International Accounting Standards adopted on July 19th, 2002[2], for each financial year starting on or after January 1st, 2005, companies governed by the law of a Member State shall prepare their consolidated financial statements in conformity with the International Accounting Standards adopted at the European level (endorsed IASs or endorsed IFRSs[3]) if, at their balance sheet date, their securities are admitted to trading on a regulated market of any Member State (article 4)[4].

§2. Approximately 7000 European listed companies and indirectly many more consolidated subsidiaries will be affected by this regulation. In July 2003, a major step was accomplished when the Accounting Regulatory Committee[5] recommended that the European commission endorses all IAS and Interpretations existing as of 14 September 2002, except IAS32 and IAS39 and related interpretations on financial instruments. Following this recommendation, the European Commission adopted on 29th September 2003 a regulation endorsing all existing IAS and related interpretations, with the exception of IAS 32 and 39 and related interpretations.

§3. In view of the unusual importance of this complete change in accounting principles and its potential impacts on financial markets, CESR believes that useful guidance should be provided by its Members regarding the financial information that has to be published by European listed companies during the transition phase (starting at the date of adoption of the IAS Regulation) in order to:

- contribute to the successful implementation of this process ;
- foster the presentation of comparable information among companies during the transition phase ;
- promote a framework such that the information published is relevant and as understandable as possible by investors.

Indeed, it is probable that, anticipating the importance of the event represented by the mandatory application of IAS/IFRS as from 1st January 2005, many investors and financial analysts will be impatient to assess the real impact of the transition for listed companies. Around the turning point, accounting information will often be analysed in terms of its forthcoming significance under IAS/IFRS.

§4. The matters discussed below are not covered by the IAS Regulation but are closely linked with IFRS1 on First Time Adoption of International Financial Reporting Standards

[2] Published in the Official Journal on September 11th, 2002.
[3] International Financial Reporting Standards (IFRS) being the new name of IASs since May 2002.
[4] The Article 9 of the Regulation provides that "By way of derogation from Article 4, Member States may provide that the requirements of Article 4 shall only apply for each financial year starting on or after January 2007 to those companies :
(a) whose debt securities only are admitted on a regulated market of any Member State within the meaning of Article 1(13) of Directive 93/22/EEC ; or
(b) whose securities are admitted to public trading in a non-member state and which, for that purpose, have been using internationally accepted standards since a financial year that started prior to the publication of this regulation in the Official Journal of the European Communities.
[5] As defined in article 6 of the Regulation.

published by IASB[6] "*which explains how an entity should make the transition to IFRSs from another basis of accounting. The IASB through IFRS 1 has sought to address the demand of investors to have transparent information that is comparable over all periods presented, while giving reporting entities a suitable starting point for their accounting under IFRSs. (…). Under IFRS 1, entities must explain how the transition to IASB standards affects their reported financial position, financial performance and cash flows.*" [7]

§5. The following recommendations apply to the most common situations whereby companies will publish financial information under existing accounting requirements until the end of 2004, including the financial statements for the year then ended.[8]

§6. The present document is clearly a recommendation from CESR Members to themselves to encourage listed companies to adopt the proposed disclosure guidelines.

§7. Although each national regulator could decide to go beyond and require full or partial compliance with this guidance, CESR believes that a recommendation is sufficient at this stage in order to meet two objectives. The first objective is to keep the distinction between standards provided by EU regulations and directives in the area of financial reporting (notably through endorsement of IASB's standards) and additional guidance provided by CESR Members. The second objective is that the recommendation remains at the level of principles whose primary aim is to foster listed companies to adopt proper communication policies during the transition process with sufficient flexibility and not to create detailed reporting rules, in terms of timing and content of such reporting.

§8. Setting in advance adequate guidelines, where necessary, for financial reporting practices is a continuous concern for securities regulators who are in charge of overseeing financial information released by listed companies and this leads them to issue additional reporting guidance as the ones contained in the present recommendation.

§9. In this context, the recommendation can broadly be understood as proposing reference points that issuers, in accordance with national regulation, are invited to follow by applying the guidance as such or by explaining the reasons why they are unable to do it or why they choose to depart from the guidance.

Introduction

§10. As the 2005 deadline is getting closer, all companies affected by the Regulation should be encouraged to devote sufficient resources and to prepare this change as early as possible as it is vital that they have necessary procedures and processes in place to continue to meet reporting requirements in a seamless manner. Open communication on the transition process will be a positive signal that will help users of the financial statements becoming

[6] Standard published in its final form on June 19th, 2003. This standard is not yet adopted by the EU Commission but EFRAG has already recommended its adoption (letter dated 25 July 2003 posted on EFRAG's website http://www.efrag.org).

[7] Press release accompanying the publication of the standard.

[8] A similar rationale applies to companies which will enter into the transition phase at a later date (e.g. 2007). It is also applicable, upon adaptation in terms of timing, to companies whose financial period ends at another date than 31st December.

aware of the potential impact of the 2005 change in accounting policies and it will provide evidence that this project is properly carried out.

§11. The change towards IAS/IFRS implies a complex process that could usefully be accompanied by a particular effort of financial communication in order to prepare gradually the market to assess its impact on the consolidated financial statements. CESR has identified four different milestones in the transition process that coincide with the publication of the 2003 annual financial statements, 2004 annual financial statements, 2005 interim financial statements and 2005 annual financial statements.

§12. The four milestones discussed hereafter provide an opportunity for a gradual, but continued and phased communication on the transition to IAS/IFRS. In this way, the narrative explanations recommended in the following paragraphs will usefully be updated throughout the whole period of transition. The updates maintain an appropriate level of information of the market regarding the plans for and achievements of the transition process and about applicable financial reporting standards.

§13. In the context of a recommendation, the four proposed milestones are expected to be the most natural moments at which reporting on the transition would take place, but are not intended to create compulsory reporting deadlines. Other communication means and timings may be considered by listed companies where such other means and timings offer the same level of information and are in compliance with national requirements governing financial reporting.

§14. The recommended additional information described in the sections 1 and 2 hereafter, should be made easily available to all investors at the same time, and by means of communication that, in accordance with national regulations, are accepted for this purpose.

§15. CESR believes it is the responsibility of the issuer and its management, taking into account national regulations and practices, to decide on the need for an audit - or other form of independent verification - of information published in accordance with the present recommendation. CESR recommends that such information is clearly and unequivocally labelled as having been audited or not (with indication of the extent of the audit).

§16. It should be noted that when it elaborated the recommendation, CESR considered as its starting point the work plan and timetable published by IASB, according to which a "stable platform" of final accounting standards will be in place by March 2004. Consistently, CESR will evaluate possible developments in the process of finalisation and endorsement of all final financial reporting standards and, accordingly, reserves the possibility to later review or complete the present recommendation if needed.

1. Publication of 2003 financial statements

§17. Listed companies are encouraged to describe their plans and degree of achievement in their move towards IAS/IFRS when they publish their financial statements for the year

2003. This description could usefully cover the general policies to address the operational and control issues as well as the risks and uncertainties associated with the transition as they affect the business.

§18. This communication could also include information about the major differences identified to date between their present accounting policies (existing GAAP[9]) and the ones they know with sufficient certainty they will have to apply under IAS/IFRS in their 2005 financial statements. At this stage, such information exercise may be narrative only[10].

§19. As indicated above, it is important that, when considering the proposed communication on the major differences between accounting policies, companies proceed with an in-depth analysis of the applicability to them and the implementation by them of the future accounting policies. Consequently, it is recommended that, where relevant, the explanations are accompanied by appropriate caveats referring to the possible non-comprehensiveness of the disclosure.

2. Publication of 2004 financial statements

§20. Relevant information on the impact of the new reporting framework on the 2004 annual financial statements will have to be prepared in order to meet IFRS1 provisions on comparative information and on reconciliation (IFRS1 par. 38 and the following) and will have to be disclosed at the latest with the 2005 year end financial communication., i.e. at the beginning of 2006. However, when such information is available at an earlier date, CESR considers that a timely disclosure would serve the objectives described above.

§21. In addition, information on the impact of the change may, in some cases, be considered as price sensitive and could therefore be subject to provisions of the Directive 2003/6/EC of 28 January 2003 on insider dealing and market manipulation (market abuse).

§22. On this basis, CESR recommends that, as soon as a company can quantify the impact of the change to IAS/IFRS on its 2004 financial statements in a <u>sufficiently reliable</u> manner, it is encouraged to disclose the <u>relevant</u> quantified information. Such disclosure should be made in a way that is not <u>misleading</u> (i.e. covering all possible impacts, positive and negative).

§23. The need for reliability and relevance indicated in par. 22 implies that companies should not publish quantified information on the impact of the change to IAS/IFRS without having performed sufficient quality control and, where applicable, audit checks. In order to avoid the risk of later corrections of the quantified information, it is important that companies endeavour to identify the financial impact of all material changes introduced by IAS/IFRS. This objective of completeness should, however, not be as such a reason to postpone the publication of the information where the missing points are not material or not relevant, as this postponement could also lead to misleading communication.

[9] GAAP: Generally Accepted Accounting Principles (used in the Member State)

[10] Where the company has at its disposal material information additional to the narrative information whose disclosure is recommended in par. 18, it should consider carefully the need to provide such additional information along with the narrative information, in order to avoid giving false or misleading signals to the market.

§24. If the company is not in a position to follow this recommendation at the time of publication of the 2004 financial statements, it is recommended to continue the disclosure under the narrative format as recommended in par. 17 and following and explain why it is not in a position to do so.

§25. As to the form and content of the quantified information, CESR suggests that companies refer to Implementation Guidance IG 63[11] of IFRS1[12], namely:

- A reconciliation of shareholders' equity at the date of transition (for example 1 January 2004) from previously used GAAP to IFRS. It can take the form of a 3-column table presenting a summarised opening balance sheet under previous GAAP, the effect of the transition to IFRSs and the corresponding IFRS figures. It should be accompanied by a note explaining the effect on each line item presented.

- A reconciliation of shareholders' equity at the end of the reporting period (for example 31 December 2004) from previous GAAP to IFRS under the same format and with the same level of information.

- A reconciliation of the profit and loss account from previous GAAP to IFRSs under the same format and with the same level of information.

- An explanation of the main adjustments to the cash flow statement.

§26. Where the company intends to present its 2005 interim information on the basis of IAS/IFRS as recommended hereunder, it is necessary that the quantitative information mentioned above is released at the latest before the publication of this interim information. This recommendation follows from the need to have a clear and valid starting point for the preparation and presentation of the interim IAS/IFRS figures.

3. 2005 Interim Information

§27. The recommendation must be read in the context of applicable European and national legislation and market practices. Therefore, when reference is made to interim reporting (half-yearly and quarterly), it is only to the extent that such reporting is required by applicable legislation or market practices, and in the form defined by such frameworks, or provided on a voluntary basis by the issuer.

§28. In order to reduce the risk that investors be misled by interim financial information that will later become less relevant and/or less comparable, CESR believes it is vital that market participants be provided during 2005 with financial information that will be

[11] Contained in Implementation Guidance IFRS1 booklet

[12] In this regard, it is worth mentioning that in November 2003, the European Commission published a series of comments concerning certain articles of the Regulation EC No 1606/2002. In the last paragraph of the Comment 2.1.5, the European Commission indicated that: "Users of IASs should, in addition, consult individual IASs and Interpretations in order to ensure that any Appendices and Implementation Guidance are properly considered in determining the appropriate application of IASs".

consistent in terms of accounting matters with the IAS/IFRS-based information they will receive relating to the full year ending on or after 31 December, 2005.

§29. Therefore, it is recommended that as from January 1st, 2005, any published interim financial statement is prepared on the basis of endorsed IAS/IFRSs as follows:

3.1. Half yearly financial information and (when applicable) quarterly financial information for the 2005 period

§30. Where the issuer is required to, or chooses to, present half-yearly and quarterly financial information, it is preferred that such information is prepared on the basis of the accounting framework to be applied at year end, i.e. the IAS/IFRS framework. In this approach, the issuer will then have the possibility to adopt one of the following alternative methods for the presentation of the interim information:

- o either to fully comply with IAS 34 requirements[13],
- o or to present interim financial data as required by the national reporting rules and prepared on the basis of IAS/IFRS recognition and measurement principles which will be applicable at year end.

3.2. Comparative information presented for the corresponding preceding period(s)

§31. For both half-yearly and quarterly financial reporting in 2005, whether IAS 34 is applied or not, the amounts for the corresponding period of the preceding year will preferably be disclosed as follows:

§32. When issuers decide to adopt IAS/IFRS recognition and measurement principles for interim reporting in 2005, the best practice is to provide comparative figures for the same period in 2004 using accounting policies identical to those applied for 2005 (where permitted by the accounting standards themselves). Restating figures for the same period of the previous year, on the same basis as for the current year, is indeed expected to ensure the necessary comparability of figures presented in the 2005 interim reporting.

§33. In order to facilitate a continuing understanding of the issuers' financial communication, the published information for the previous interim period (on the basis of previous GAAP) may be provided again. This information can be displayed in separate columns on the face of the financial statements[14] or provided on separate pages (see under par. 36).

§34. When restating financial information, a detailed explanation of the restatements of the previously published data should be disclosed in the notes to the

[13] It is understood that IAS 34 "Interim Financial Reporting" is an optional standard. If it is applied, the company has to publish either a full set of financial statements (as complete as annual financial statements) or condensed financial statements under the conditions of the par. 9 and 10 of IAS34.
[14] Provided they are clearly labelled as not being prepared on the basis of IAS/IFRS.

interim financial statements. This information may contain the elements described above for the 2004 financial statements. If this information was already published, a cross reference should indicate where it can be found.

§35 If an issuer is required by national rules to publish financial information on three successive periods (i.e. from 2003 to 2005), it is considered acceptable by CESR not to require the restatement under IAS/IFRS of the first period presented; instead, it could be accepted that the previously published information for 2003 is provided "as is" and hence will be directly comparable to the middle period (2004) presented under the two sets of accounting standards and used as a "bridge" between 2003 and 2005.

§36. When issuers are obliged or choose to present again the previously published interim financial information as prepared under previous GAAP, they can choose to present them on the face of the financial statements using the "bridge approach" when the "old" and "new" formats of accounts are sufficiently comparable or, if it is not the case, to present the financial statements prepared under previous GAAP on separate pages.

§37. Indicative format when the information is displayed on the face of the financial statements:

Items of Financial Statements	First quarter 2005 Under IFRS	First quarter 2004 Under IFRS (restated)	First quarter 2004 Under previous GAAP (as published)	First quarter 2003 Under previous GAAP (as published)

4. 2005 Annual Financial Statements

§38. IFRS1 requires comparative figures for the preceding period(s) to be prepared under IFRSs and does not prohibit the previously published information to be presented again. When such information is deemed useful, the previously published data for 2004[15] can be presented again.

§39. Where an issuer is required to publish financial information for three successive periods (i.e. from 2003 to 2005), IFRS1 (par. 36) requires that at least one year of comparative information under IFRS be included (at least 2004). It is considered acceptable by CESR not to require the restatement of the first period presented in conformity with endorsed IFRSs ; instead, it could be accepted that the previously published information for 2003 is provided "as is" and hence will be directly comparable to the middle period (2004) presented under the two sets of accounting standards, which will be used as a "bridge" from 2003 to 2005.

§40. When issuers are obliged or choose to present again the previously published annual financial information as prepared under previous GAAP, they can choose to present them on the face of the financial statements using the "bridge approach" when the "old" and "new" formats of accounts are sufficiently comparable or, if it is not the case, to present the financial statements prepared under previous GAAP on separate pages.

§41. Indicative format when the information is displayed on the face of the financial statements

[15] I.e. information published under previously used GAAP.

Items of Financial Statements	Year 2005 Under IFRS	Year 2004 Under IFRS (restated)	Year 2004 Under previous GAAP (as published)	Year 2003 Under previous GAAP (as published)

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THE COMMITTEE OF EUROPEAN SECURITIES REGULATORS

Ref.: CESR/03-490b

CESR consultation on a draft recommendation for additional guidance regarding the Transition to IFRS

FEEDBACK STATEMENT

DECEMBER 2003

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Feedback Statement on the Consultation on a draft Recommendation for additional guidance regarding the Transition to IFRS

On October 7th 2003 CESR published for comments a draft Recommendation for Additional Guidance Regarding the Transition to IFRS.

The period for comments expired on the 20th of November 2003, after a public hearing was held on the premises of CESR in Paris on the 12th of November 2003.

During the consultation period 55 letters were sent by organizations mainly belonging to the private sector of Europe, in particular from the financial and accountancy sector. All comment letters received have been published on the CESR website.

These letters were considered by the CESR-Fin Subcommittee on International Standard Endorsement (SISE) in a meeting held in Paris on the 28th of November 2003. An in-depth analysis of all comments received conducted SISE to propose to CESR-Fin and then to CESR a new draft recommendation for the transition to IFRS, to be published along with a feedback statement providing the views of CESR on the critical areas and points dealt with by respondents to the public consultation and the rational laying behind the final recommendations.

CESR takes the opportunity of this feedback statement for thanking all respondents and participants to the public hearing for their fruitful and constructive contribution. Although an important number of questions were raised by respondents, the present document focuses on the major ones on which many respondents expressed views and on which CESR believed necessary to comment.

CESR observes that the draft recommendation on transition to IFRS has received sufficient support from those who responded to the consultation to go on with the final publication of a recommendation, considering the amendments brought to the initial text proposal and the clarifications given via this feedback statement[16].

1. Nature of the CESR guidance

Many commentators asked for clarification on the nature of the CESR's guidance indicating that CESR should not set standards additional to those issued by EU Institutions and IASB.

In preparing its recommendation, CESR took into consideration the need that a clear message is sent to issuers regarding the vital need to prepare without delay for the transition from national accounting standards to IFRS. A timely and transparent transition from one reporting framework to another is in the common interest of investors and of issuers themselves.

[16] In the present feedback statement, reference is sometimes made to the numbering of paragraphs of the draft recommendation published on 7 October 2003. It should be noted that the numbering of the paragraphs has been changed in the final text of the recommendation.

CESR has also considered that, in the absence of regulatory requirements at the European level and in order to swiftly and efficiently address the needs of the market participants, the guidance included in the recommendation could only take the form of an encouragement to follow the best practices described in the document. For that reason, the document proposed by CESR-Fin is clearly a recommendation from CESR Members to themselves to encourage listed companies to adopt the proposed disclosure guidelines. CESR members will therefore have to take additional step for disseminating the recommendation locally, in a form they will deem the most appropriate.

Although each national regulator could decide to go beyond and require full or partial compliance with this guidance, CESR believes that a recommendation is sufficient at this stage in order to meet two objectives. The first objective is to keep the distinction between standards provided by EU regulations and directives in the area of financial reporting (notably through endorsement of IASB's standards) and additional guidance provided by CESR Members. The second objective is that the recommendation remains at the level of principles whose primary aim is to foster listed companies to adopt proper communication policies during the transition process with sufficient flexibility and not to create detailed reporting rules, in terms of timing and content of such reporting.

Setting in advance adequate guidelines where necessary for financial reporting practices is a continuous concern for securities regulators who are in charge of oversight of financial information released by listed companies, and this lead them to issue additional reporting guidance as the ones contained in the present recommendation.

In this context, the recommendation can broadly be understood as proposing reference points that issuers are invited to follow, in accordance with national regulation, by applying the guidance as such or by explaining the reasons why they are unable to do it or why they choose to depart from the guidance.

It is possible that the CESR's recommendation heightens the market's expectations from listed companies in terms of communication on the transition process. This, however, would only reflect the fact that the recommended communication meets the needs of investors. In any case, the primary aim of the recommendation is more to make all market participants aware of the important changes that implementation of IFRS will bring to financial reporting in EU and to encourage transparent interactions and dialogue between all parties, issuers and investors.

It should be noted that when it elaborated the recommendation, CESR considered as its starting point the work plan and timetable published by IASB, according to which a "stable platform" of final accounting standards will be in place by March 2004. Consistently, CESR will evaluate possible developments in the process of finalisation and endorsement of all final accounting standards and, accordingly, reserves the possibility to later review or complete the present recommendation, if needed.

2. The 4 milestones

In the draft recommendation, CESR indicated that "*The change towards IAS/IFRS implies a complex process that could usefully be accompanied by a particular effort of financial communication in order to prepare gradually the market to assess its impact on the consolidated financial statements. CESR has identified four different milestones in the* *transition process that coincide with the publication of the 2003 annual financial statements, 2004 annual or interim financial statements, 2005 interim financial statements and 2005 annual financial statements*..”

For reasons on which the present statement will come back later, notably the risk of delays in the finalisation and endorsement at EU level of all international accounting standards to be applied by listed companies as of 1st January 2005 and the need for reliability of the reporting, some respondents expressed the fear that the proposed 4 milestones may prove to be difficult to be met by companies. In addition, some respondents suggested that CESR should offer more flexibility for the means and timing of communication on the transition.

Once again, it has to be emphasised that the recommendation does not aim at fixing rigid deadlines for financial reporting during the transition period, but rather suggests the 4 milestones as privileged, easy to identify moments at which information about the transition process could usefully be provided.

The choice of the 4 milestones has been driven by the fact that, with the exception of quarterly reporting in 2005, they correspond to natural reporting dates at which companies already have to provide financial information to the markets. Investors already expect to receive information at those dates.

CESR did not want to increase the burden of listed companies by recommending the publication of an additional, separate statement at another date. However, it is clear that where such a document is deemed appropriate by issuers, they should feel free to publish it or to recourse to other communication means in addition or even instead of the communication’s milestones recommended by CESR. The most important element is that issuers keep all market participants up to date about the overall transition process in a sufficiently transparent way, similar to what would have been achieved using the four milestones.

CESR believes, however, that delaying unduly all communication about the transition process and about expected consequences from this transition can only lead to distrust from investors, who will fear the threat of late surprising bad news. Instead, continuous and regular, fair and genuine communication tends to increase confidence.

The 4 milestones provide an opportunity for a gradual, but continued and phased communication on the transition to IAS/IFRS. In this way, the narrative explanations recommended will usefully be updated throughout the whole period of transition. The updates maintain an appropriate level of information of the market regarding the plans for and achievements of the transition process and about applicable accounting standards.

The final recommendation has made it clearer that the 4 proposed milestones are expected to be the most natural moments at which reporting on the transition would take place, but are not intended to create compulsory reporting deadlines. Other communication means and timings may be considered by listed companies where such other means and timings offer the same level of information and are in compliance with national requirement governing financial reporting.

3. Publication of the 2003 financial statements

The § 9 of the draft recommendation indicates that "*As early as when they publish their financial statements for the year 2003, companies should be encouraged to describe their plans and degree of achievement in their move towards IAS/IFRS as well as the major differences identified to date between their present accounting policies (existing GAAP) and the ones they know with sufficient certainty they will have to apply under IFRS in their 2005 financial statements. At this stage, such information exercise may be narrative only.*"

Some respondents to the public consultation have highlighted that companies may be hampered to follow the recommendation to describe the major differences between their current accounting policies (existing GAAP) and the ones they will have to apply under IFRS due to the fact that the present uncertainty as to the final applicable accounting standards in EU may be persistent when the 2003 financial statements will be prepared and published early 2004. This uncertainty may even continue for some time later in 2004. The uncertainty may be reinforced by the fact that companies will also have to consider the different options offered by the applicable accounting standards and the practical implementation choices (choice of valuation models, organisational arrangements…). This concern was more particularly highlighted in relation with IAS 32 and IAS 39 on Financial Instruments and with future standards on Insurance Contracts, by financial institutions many of whom responded to the public consultation.

It has to be recalled that a major step was accomplished when the European Commission adopted on 29th September 2003 a regulation endorsing all existing IAS and related interpretations, with the exception of IAS 32 and 39 and related interpretations on Financial Instruments. As a result of that decision an important part of the accounting standards applicable in 2005 is already in place, even if it remains subject to improvements as envisaged by IASB and to completion through forthcoming additional standards.

As a matter of fact, IASB published on 17 and 18 December 15 revised standards and gave notice of the withdrawal of another IAS, hence marking the near completion of its Improvements project.

Although many of the standards applicable in 2005 are thereby already known, it is likely that finalisation and endorsement of all final standards applicable in 2005 may not be achieved before the publication of the 2003 financial statements, in particular for standards on Financial Instruments and on Insurance Contracts.

Regarding IAS 32 and 39 on Financial Instruments the problem is twofold. On the one hand, IAS 39 is not totally finalised by IASB and major issues are still under discussion, so that their endorsement by the EU is not expected before the second semester of 2004. On the other hand, it appears that certain provisions in IAS 32 and 39 would apply only as from 2005 without requiring early application in 2004, this possibly resulting in less comparability between 2005 and 2004 figures.

Although CESR is aware of the situation, the recommendation has not attempted to tackle this specific and evolving issue. Accordingly, CESR may decide to reconsider the need for further guidance when relevant information in this area will be available.

In this regard, CESR would like to highlight the caution already suggested by the recommendation that explanations of differences with the current accounting policies should only concern those that companies "*know with sufficient certainty they will have to apply under IFRS in their 2005 financial statements*". It flows from this precautionary statement that listed companies should not feel urged to describe differences with future standards whose application, or options available, are not sufficiently certain or whose consequences for the company have not been fully assessed.

In order to strengthen the message, the final version of the recommendation has been completed as follow: "It is important that when considering the proposed communication, companies proceed with an in-depth analysis of the applicability to them and the implementation by them of the future accounting policies. Consequently, it is recommended that, where relevant, the explanations are accompanied by appropriate caveats referring to the possible non-comprehensiveness of the disclosures".

This cautionary approach means that companies should avoid to publish information they genuinely know in advance that it could subsequently prove to be false. This is actually not specific to the present recommendation, but a general principle for proper financial reporting.

As a result, considering once again that the recommendation does not mandate form and timing of communication on this topic, issuers may choose between different communications' models along the principles proposed by CESR in the recommendation.

Following suggestions received from respondents, the §17 of the final recommendation has been completed to indicate that description of the plans and degree of achievement in the move towards IAS/IFRS should usefully cover the general policies to address the operational and control issues as well as the risks and uncertainties associated with the problem as they affect the business.

4. Publication of the 2004 financial statements

4. a. Reliability of quantitative information

- In the § 12 of the **draft recommendation**, it was proposed that "*As soon as a company is ready to communicate on it in a sufficiently reliable manner, it should be encouraged to disclose the necessary quantified information on the impact of the change to IAS/IFRS in its 2004 financial statements*."

- Many **respondents** highlighted the importance of having stabilised accounting standards and sufficient internal and possibly external review processes undertaken to ensure that quantified information is reliable and will not be later revised, e.g. because of further consideration of the application of IFRS. It was also mentioned that, in this regard, the recommendation pulls back to early 2005 a (quantitative) communication that is legally only required for 2006 (with 2005 annual financial statements), thereby increasing an already challenging transition project for EU listed companies.

  Concerns were expressed that issuers may feel urged by the recommendation to release information without having gained sufficient experience in the application of the IFRS, whereas progressive application of those new standards throughout 2005 without the pressure of public communication on the transition would ensure a higher level of quality and certainty of information.

In addition, a few commentators oppose to any disclosure of quantified information without having complete view on all possible - or at least material - impacts of the transition to IFRS. In this approach, comprehensiveness of quantified information should prevail over the need to communicate swiftly.

- **Analysis**

  - To begin with, it has to be underlined that the draft recommendation suggested a publication of quantitative information as soon as the company is ready to communicate on it "*in a sufficiently reliable manner*". The draft recommendation also stated that "*if it is not possible to do it at the time of publication of the 2004 financial statements, it should be recommended to continue the disclosure under the narrative format*".

    It results from the draft recommendation that CESR fully supports the concern that listed companies should not release to the markets quantified information on the impact of the change to IAS/IFRS without having performed sufficient quality control and, where applicable, audit checks, in order to avoid the risk of later counterproductive corrections. The final text of the recommendation has reinforced this message by indicating that quantified information should not be published without having satisfied a number of criteria including the reliability o the information, its relevance and the need to communicate in a way that is not misleading.

  - The need to secure the reliability of the quantified information may lead the issuer to postpone the publication of quantitative information in the absence of an indication of the effects of all changes on its results and financial position. Accounting standards are often inter-related and piecemeal disclosure information on the impact of their implementation may not necessarily meet investors' interest. Piecemeal disclosure risks leading to erratic movements on the markets and may reduce the ability of investors to assess correctly the financial condition of the enterprise.

    It is also important to maintain a good balance between the search of perfection and the need to inform investors in a continuous and fair manner, as late communication of unexpected bad news will finally undermine the confidence of the market. It is not recommended to postpone unduly the publication of quantitative information if the remaining assessments and estimations to be made are not genuinely expected to have a significant impact.

    It has to be recalled that in accordance with the Directive 2003/6/EC of 28 January 2003 on insider dealing and market manipulation (market abuse), issuers will have to inform the public as soon as possible of inside information. Inside information is defined as an "*information of a precise nature which has not been made public,* *relating, directly or indirectly, to one or more issuers of financial instruments or to one or more financial instruments and which, if it were made public, would be likely to have a significant effect on the prices of the financial instruments or on the price of related derivative financial instruments*" (article 1 and 6). These provisions may apply where an issuer sees that the change to IAS/IFRS could have a significant impact on its results and financial position, that the market is not yet informed about it and that it is expect to have a significant effect on the price of its listed securities.

Besides, CESR's recommendation does not intend to replace or supersede possible national requirements for disclosure or restatement of specific items of the financial information on the basis of specific IAS/IFRS (e.g. specific request addressed to listed companies to inform the market about the possible impact of IAS 19, Employee Benefits on their financial position, or to provide segmented information).

4. b. Reference to the Implementation Guidance of IFRS1

In order to give issuers a useful and relevant reference for identifying the kind of quantified information they could provide the market with, the § 13 of the draft recommendation referred to the Implementation Guidance IG 63 contained in the Implementation Guidance booklet published along with the IFRS1.

CESR understands that the Implementation Guidance (IG) of IFRS1 is not mandatory as it is not part of the standard itself and because it will not be formally endorsed by the European Commission.

However, it is worth mentioning that in November 2003, the European Commission published a series of comments concerning certain articles of the Regulation EC No 1606/2002. In the last paragraph of the Comment 2.1.5, the European Commission indicated that: "Users of IASs should, in addition, consult individual IASs and Interpretations in order to ensure that any Appendices and Implementation Guidance are properly considered in determining the appropriate application of IASs".

As indicated in the final recommendation, CESR suggests that companies refer to the Implementation Guidance IG 63 of IFRS1 (as well as to other guidance offered by this document), and a reference to the comments of the European Commission has been included.

5. 2005 interim reporting

5.a. Applicable standards

First of all, it has to be stressed that CESR does not mandate the publication of interim information beyond what is required by existing national or EU legislations.

The draft Transparency Directive contains different provisions regarding the publication of half-yearly financial reports and quarterly financial information by companies whose shares or debt securities (only for half-yearly reports) are traded on a regulated market. This draft

Directive is currently subject to discussions at the level of European Institutions. The CESR's recommendation does not attempt to pre-empt the possible outcome of these discussions.

The recommendation has to be read in this context and where reference is made to interim reporting, it is therefore only to the extent that such reporting is required by applicable legislation or market practices, or published on a voluntary basis by the issuer.

The CESR's recommendations on interim reporting is basically to encourage that such reporting is made on the basis of IAS 34 and, when this is not the case, that financial information published at interim dates as of 2005 is prepared in conformity with IAS/IFRS recognition and measurement principles that will be used at year end.

This proposal was supported by an important number of respondents to the public consultation who indicated that application of IFRS as of 1st January 2005 was the most obvious and practical solution. Some even proposed that IAS 34 should be made compulsory for all interim reporting in 2005.

Other commentators indicated that application of merely IFRS recognition and measurement principles for interim reporting in 2005 may be hampered by the following elements: i) delays in adoption and endorsement of applicable accounting standards added to the need for companies to get sufficient knowledge of these new standards and reliability in internal reporting systems, before starting publicly reporting on their basis; ii) the fact that interim reports may be less adapted for showing with sufficient in-depth and highlight the fact that accounting standards have changed; iii) the need to ensure some continuity with the 2004 annual financial statements which were still prepared on the basis of previous GAAP.

CESR understands those concerns and reiterates that the application of IAS 34 or, alternatively the application of IAS/IFRS recognition and measurement principles, is only recommended as an appropriate solution for ensuring a phased transition to IAS/IFRS and for preparing the comparability of 2005 interim reporting with 2005 annual reporting.

Issuers may choose to continue producing and publishing figures on the basis of their previous GAAP (when they are not compliant with IAS/IFRS) for interim reporting in 2005, but this approach may not meet investors' expectations and may actually increase the cost for enterprises as they will in any case have to apply IAS/IFRS for the 2005 annual financial statements. More specifically, issuers who will have to prepare 2006 interim report on IAS/IFRS will have to produce IAS/IFRS comparatives for the same period of 2005. Therefore, anticipating this future requirement (where applicable) by immediately preparing and presenting 2005 interim reports on the basis of IAS/IFRS provisions (instead of local GAAP) should not result in additional cost of transition.

The final text of the recommendation has clarified the different options available to issuers for the preparation and presentation of 2005 interim reporting. In the final recommendation the guidance for half-yearly and quarterly reporting have been merged, but that does not mean that the level of compulsion for half-yearly reporting is the same as for quarterly reporting. Indeed, the current EU Directive 2001/34/EC already requires listed companies to publish half-yearly financial information and the Draft Directive on Transparency mentioned above also makes a clear distinction in terms of requirements between half-yearly and quarterly reporting.

5.b. Comparative figures

The draft recommendation proposed in its §22 that "*comparative figures should be provided and restated on the same basis as for the current year*" for both quarterly and half-yearly reporting in 2005, where such reporting is required.

It has been pointed out that CESR should not recommend retrospective application of accounting standards (for comparatives) when this is not required by IASB. In particular, as the IASB has indicated that IAS 32 and 39 are not required to be applied to the 2004 comparatives, CESR does not consider to change this principle. In addition, delays in the adoption and finalisation of standards may hamper the restatement of comparatives for the corresponding period of 2004.

CESR considered that the solution proposed was the most likely to provide the best level of comparability, although it was acknowledged that this solution could only be a recommendation in the present European legal framework. The cost of restating interim figures for the corresponding periods of 2004 may also be important, and companies may consider this aspect in evaluating the possible solutions. Alternative solutions were discussed by CESR Members but were finally rejected to avoid sending too negative a signal and missing the objective of comparability.

Based on future developments, notably in view of the possibility that finalisation and endorsement of all applicable standards may suffer some delays, CESR may amend its communication and propose other solutions.

Concerning the applicable standards, it is not the intention of CESR to mandate retrospective application of accounting standards when this is not required by the reporting framework, especially in the present circumstances. The message of the recommendation is that, upon respect of transitional provisions of accounting standards, comparability of financial statements is better achieved when juxtaposed and compared figures are prepared on the basis of the same set of accounting policies. This aspect is relevant in all circumstances and not only in the context of the transition to IFRS which is addressed by the CESR recommendation.

6. Audit and presentation of the information

6. a. Audit and location of the information

In different places of the draft recommendation, it was suggested to include the recommended disclosures in the annual report or in the notes to the financial statements (see previous §§ 10, 14[17]).

Respondents to the public consultation had various views on this point.

The intention of CESR on this aspect is to leave sufficient flexibility to issuers to include the information in the place they deem is more appropriate.

[17] See the point 6.b for the presentation of comparative information as recommended by § 24 of the draft recommendation.

It may be so that, if the information is included in the notes to the financial statements, it will fall in the scope of the statutory audit of the financial statements. According to the jurisdictions, the statutory auditor may also have to cover information included in MD&A, Operating Reviews….The scope of the audit of annual statements is not dealt with by the recommendation and will therefore continue to be governed by the specific provisions applicable thereto.

In the final recommendation, the references to specific location is replaced by the recommendation that narrative and quantitative information is made easily available for all investors at the same time, and by means of communication that, in accordance with national regulation, are accepted for this purpose.

Concerning the issue of audit, it is now indicated that it is the responsibility of the issuer and its management (taking into account national regulations and practices) to decide on the need for an audit (or other form of independent verification) of information published in accordance with the present recommendation. CESR recommends that such information is clearly and unequivocally labelled as having been audited or not (with indication of the extent of the audit).

6. b. The "bridge approach"

The drat recommendation proposed in § 24 that, "*If an issuer is required by national rules to publish financial information on three successive periods (i.e. from 2003 to 2005), it is considered acceptable by CESR not to require the restatement of the first period presented in conformity with endorsed IFRSs; instead, it could be accepted that the previously published information for 2003 is provided "as is" and hence will be directly comparable to the middle period (2004) presented under the two sets of accounting standards and used as a "bridge" between 2003 an d 2005.* " An indicative presentation format (the so called "bridge approach") was recommended when the information is displayed on the face of the financial statements.

The "bridge approach" was also recommended for the presentation of the 2005 financial statements when the issuer is required to publish two years of comparatives (in addition to 2005 figures) and when the earliest period presented (i.e. 2003) is not restated on the basis of IAS/IFRS.

Respondents to the public consultation underlined that the transition to IFRS will bring about important changes in financial statements layouts (formats, structure…), and indicated that it may be misleading to juxtapose IAS/IFRS financial statements and previous GAAP financial statements when formats of accounts are too different or when the captions do not have the same meaning in both standards. Confusion could result from the fact that figures seem comparable although they are not.

CESR was aware of this problem and only formulated the proposal to adopt the "bridge approach" for situations where the comparability between formats of financial statements under IAS/IFRS and previous GAAP is possible and not misleading. There are several merits that may be expected from the juxtaposition of financial statement under different GAAP when the formats of accounts are comparable. Such a presentation notably permits to easily and quickly identify the major changes brought about by the change of accounting standards.

The final text of the recommendation, has made it clear that, when issuers are obliged or choose to present again previously published financial statements as prepared under previous GAAP, they can choose to present them on the face of the financial statements using the "bridge approach" when the "old" and "new" formats are sufficiently comparable or, if it is not the case, to include the financial statements prepared under previous GAAP on separate pages.