

30 October 2003

RH/VS

Fabrice Demarigny
Secretary General
The Committee of European Securities Regulators (CESR)
11 - 13, Avenue de Friedland
75008 Paris
France

Dear M. Demarigny

Re: CESR's Advice on Level 2 Implementing Measures for the Prospectus Directive (July 2003)

The Institute of Chartered Accountants in England & Wales (ICAEW) is pleased to provide written comments on the consultation paper relating to CESR's Advice on Level 2 Implementing Measures for the Prospectus Directive published in July 2003 (CESR 03-210b).

We welcome in particular the opportunity to comment on the proposals for advice concerning the historical financial information to be included in the prospectus. We have already communicated in our response to CESR's Draft Technical Advice on Possible Implementing Measures for the Proposed Prospectus Directive (April and May 2003), dated 16 June 2003, a number of concerns relating to details of drafting in the Level 2 implementing measures so far as financial information is concerned. We are somewhat concerned as to the rather narrow focus of the current paper, and are disappointed that our wider comments on drafting in relation to financial information appear not to have been taken into account. We discuss our points in the appendix to this letter.

Should you wish to discuss any matters contained in this response please contact Vera Sabeva, Head of the Corporate Finance Faculty, at +44 20 7920 8796 (e-mail vera.sabeva@icaew.co.uk).

Yours sincerely



Robert Hodgkinson
Director, Technica

APPENDIX DETAILED COMMENTS

Annex E (July 2003) – Historical Financial Information for EU and non-EU issuers

Item 20.1, Annex A CESR/03-208

Question 57 *What are your views on the most appropriate way to present the financial information?*

Question 58 *What are your views on the importance of comparability within the audited historical track record and with the reporting standards that are to be adopted?*

Question 59 *What are your views on how this should be achieved?*

We agree with the principle set out in paragraph 45 of CESR/03-210b, but consider that the wording set out in Annex E does not satisfactorily achieve the objective stated. Difficulties arise because the proposed wording does not reflect adequately the distinction between historical annual accounts, on which an auditors' report may have been given ('audited historical accounts'), and historical financial information presented for the purposes of a prospectus and satisfying rules as laid down in item 20.1. To the extent that any adjustment is required to historical accounts to satisfy conditions of item 20.1, it becomes inappropriate to describe the historical financial information as 'audited', unless it is made subject to further audit reporting.

There is a particular inconsistency between the language of the opening paragraph, that information must "have been" prepared according to particular standards (which appears to impose conditions on pre-existing financial information), and the requirements of the second paragraph that the last two years 'audited historical financial information' must "be" presented and prepared in a form consistent with the next annual financial statements (which appears to envisage a reworking of existing historical financial information – consistent with paragraph 45 of the commentary – but which, if restated, cannot properly be described as "audited" unless it is re-audited). We discuss the point of consistency with the next annual accounts further below.

In order to accommodate a range of options more easily, it would be preferable if the opening sentence of 20.1 were to read 'Historical financial information covering 3 financial years to a date meeting the requirements of 20.6.1 (or such shorter period to such date if the issuer has been in operation for less than 3 financial years to that date) and an audit report or reports in respect thereof'. As a corollary, the words "have been" would be replaced by "be" in the second sentence of the first paragraph and the first sentence of the second paragraph. In the final paragraph "be or" should be added before "have been". Additionally, because of the wording of the final paragraph, and in order to make its application clear, the word "audited" would be removed in the first sentence of the second paragraph and the first sentence of the third paragraph, and replaced with the word "historical" at the beginning of the fourth paragraph. The final sentence of the third paragraph should be deleted. Such language would enable

existing historical accounts and the related audit reports to be reproduced if other conditions of 20.1 are met, but would also indicate the need for adjustments and a new audit opinion if the conditions are not.

(In suggesting the above drafting, we would also seek to address the possible inconsistency between the term 'latest' and the age of information permitted under 20.6.1, and to clarify which period should be covered for companies which have been in operation for less than 3 years).

In addition, in order to deal with cases where an issuer has not prepared accounts for a financial year, consideration should be given to adding wording as follows:

“Where the issuer has not been otherwise required to prepare historical financial information for a financial year, it should prepare and have audited historical financial information drawn up to date no later than [90] days before the date of the registration document.”

The reference, in relation to non Member States issuers, to local GAAP “equivalent” to IAS regulation would appear to raise interpretational difficulties. It is not clear that any GAAP could be ‘equivalent’ to IAS unless it is in fact fully compliant with IAS (that is, the local GAAP must be IAS). An obvious test of the wording is whether it would permit US GAAP to be used for the purposes of a prospectus. On the face of it, US GAAP is not ‘equivalent’ to IAS Regulation, although it is an internationally recognised basis of accounting. If the intention is to allow only IAS compliant financial information for non Member States issuers, the reference to local GAAP equivalent to IAS Regulation is redundant and potentially misleading. If the intention is to permit other internationally recognised GAAP, we recommend that the wording should be altered to reflect this, for example:

“or, in the case of non Member States issuers, to IAS Regulation, US GAAP or to a non Member State local GAAP which is customarily used in the context of international marketings of securities of the type being issued, or which is comparable to IAS Regulation when accompanied by a statement of differences between such GAAP and IAS Regulation.”.

In relation to the concept that historical financial information should be presented in a form consistent with the issuer’s next financial statements, whilst we consider this to be extremely important in relation to first time issuers, we are more doubtful that it is efficient or necessary in relation to subsequent issues by existing issuers. Existing issuers will be providing information to investors on a continuing basis, and it should be sufficient in the case of such issuers for the prospectus to reproduce information already published, without requirement for amendment.

On the assumption that the requirement for consistency with the next year’s financial statements would be applied only in the case of new issuers, although we note the strong preference of CESR members for option 2, we would favour Option 1, and a requirement for a three year comparable record, having regard to the fact that the benefit to investors would be likely to justify the additional cost. CESR should,

however, consider whether there is a need for transitional guidance on restatement in relation to, for example, prospectuses issued in 2005.

CESR should also consider the interaction of the proposals with IFRS 1, in particular the way in which a past IFRS record is derived. For example, an issuer seeking admission to trading in 2010 might present calendar year IFRS numbers for 2009, 2008 and (under Option 1) for 2007. The first IFRS accounts would be for 2010, and as IFRS 1 only applies to 'the first annual financial statements', the date of transition would be 1 January 2009. It seems uncertain how this would relate to the 2007/2008 numbers included in the prospectus. CESR might wish to clarify this with IASB before finalising its proposals.

Other financial information related elements of Annex A and Annex B CESR/03-208

- 2.2 Disclosure of details in relation to changes in auditors is not currently a requirement in all Member States at the time of such a change. The information required by 2.2 may thus need to be obtained for the first time for the purposes of a prospectus. We question whether, given the lack of disclosure at the time of change, the information would merit the effort required to obtain it after the event.
- 9.2.2 The reference to 'financial statements' should perhaps read 'historical financial information disclosed under 20.1' in order to avoid confusion as to what 'the financial statements' is intended to refer to.
- 10.2 In the context of disclosures of an issuer's capital resources, we are unclear what is intended by 'and explanation of the sources and amounts of and a narrative description of the issuer's cash flows'. Information on cash flows would be expected to relate to a specified time period – whether historical or future – and it would be unusual to employ a narrative description rather than a cash flow statement to disclose relevant information. If the intention is to disclose historical cash flows, this would be covered by the requirements of 20.1. It would not be normal practice to include cash flow projections. It may be that the intention is to refer to 'cash resources' rather than 'cash flows', but in this event the disclosure obligation would be adequately covered by 10.1 and 10.3. We would recommend deletion of 10.2.
- 13.2 The requirement that the independent accountant's or auditor's opinion must be that the forecast or estimate 'has been properly compiled' appears to preclude the possibility that the accountant will be unable to form that view. This may be intentional – that is, an issuer would not be permitted to publish a profit forecast if the accountant cannot provide the required opinion – but it is questionable whether the approach can be applied to statements included under 13.4, which would appear to be mandatory rather than voluntary.

We would also note that reporting on profit forecasts is an area of considerable technical difficulty, and would re-emphasise the point made previously that it is essential that a clear framework for reporting on the preparation of profit forecasts is developed. In turn, this needs a generally accepted framework for preparers of profit forecasts, which at the present time does not exist.

13.3 It is questionable whether ‘comparable with the historical financial information’ means anything different from ‘consistent with the accounting policies’ as envisaged in 13.2. On the assumption that the intended meaning is the same, we recommend deletion of 13.3.

19 On the assumption that related party transactions during the period covered by the historical financial information would have been included in the historical financial information prepared according to the IAS Regulation and therefore be disclosed under paragraph 20.1, paragraph 19 should perhaps only require disclosure of related party transactions in the period since the last audited balance sheet up to the date of the registration document.

Although not made explicit, it is evident that the ‘transaction’ envisaged by 20.2 is a transaction which has taken place (or is proposed to take place) after the date up to which the most recent financial information disclosed under 20.1 has been drawn up. This stems from Annex B, paragraph 5, which contemplates illustrating the effect of the transaction on financial information for the most recent or current accounting period. We believe it would be helpful if this were made explicit.

Where there has been a significant gross change transaction at some time in the past (that is during the three year period for the purposes of 20.1), the financial information on the issuer provided under paragraph 20.1 may not provide income statement and other information on all entities within the issuer for a full 3 year period. We consider that it may be necessary to provide that historical financial information is disclosed in relation to significant gross change transactions which have taken place during the latest three financial years for any part of the three year period for which such information is not disclosed in the historical financial information of the issuer.

20.3 20.3 indicates that ‘consolidated annual financial statements’ should be included in the registration document. For consistency with 20.1, which uses the term ‘financial information’ this should perhaps read: ‘it shall include at least consolidated historical financial information for the purposes of 20.1’.

20.4.1 There are inconsistencies 20.1 and 20.4.1 and scope for further clarification. 20.4.1 requires there to be a ‘statement that the historical financial information has been audited’ and the reproduction of qualifications and disclaimers from audit reports. If, per 20.1, an audit report is to be included, it would seem to be redundant to require separately a statement that the information had been audited, or the reproduction of extracts from the report. 20.4.1 also includes

the concept of ‘official’ auditors. It is not clear what the term is intended to mean.

20.4.2 We assume that taken with 20.4.3, 20.4.2 is intended to oblige issuers to describe as ‘audited’ any information extracted from the issuer’s audited financial statements (or perhaps more correctly in context, ‘audited historical financial information’). We believe it to be unnecessary to make this a requirement, and also believe that it is conceptually flawed. “Other information” outside of audited historical financial information will not have been specifically “audited” by the auditors. It would more correctly be described as ‘extracted from audited financial statements’. We would recommend that the paragraph is deleted.

20.4.3 As noted above, the source of ‘audited’ information should perhaps more correctly be described as ‘audited historical financial information’ of the issuer. However, we question the need for and the application of the requirement. The wording as drafted would appear to require any financial information extracted from any source other than the issuer’s the audited financial statements to be described as unaudited. Accordingly information extracted from the audited accounts of a subsidiary of the issuer, or any other company, would need to be described as unaudited. Although the drafting could be amended to deal with such anomalies, our general feeling is that the requirement is of limited value and could be deleted.


20.5.1(i) We consider that the reference in paragraph to “audited interim financial statements” requires clarification. Financial statements which it would be sensible to “audit” would be expected to be complete financial statements drawn up as they would be at the year end, even if they cover a shorter period. The term ‘interim’ may suggest that normal IAS 34 standard interim financial statements are intended. Such accounts can in theory be ‘audited’, in practice they are more typically made subject to a “review” opinion, since the extent of management time an effort involved in a full audit is not usually considered justifiable for such summary information.

We would suggest that paragraph 20.5.1 is conformed with the final text of the Transparency Directive, the current draft of which would for companies already admitted to trading on a regulated market negate the need for the “18 month” time limit.

20.6 In our view the interim financial information requirements for prospectuses should be aligned with the time limits for publishing such information outlined in any Transparency Directive. Under the current Transparency Directive proposals the interim financial information, as in half-yearly, should be required after 8 months. In addition, it may be necessary to import whatever quarterly reporting obligations are required under any Transparency Directive.

Where the term interim is intended to mean limited financial information, we would recommend that the text incorporates a requirement to comply with international accounting standards for interim reporting or, where the issuer has no subsidiary, in accordance with the national law of the home Member State (as in the current draft of Article 5 (3) of the Transparency Directive).

ANNEX B July 2003 - Pro forma financial information building block

- 1(a) typo: 'to' instead of 'for'. 
- 2 It is not clear whether paragraph 2 is outlining a requirement – i.e. whether 'may' entails 'may *only*', in which event 'depending on the circumstances' would suggest that in other circumstances another (unstated) requirements would apply – or whether the paragraph is illustrating an option, in which event it would be useful to list other options. It is clear from paragraph 6 for example that in some circumstances a pro forma cash flow statement might be presented. On the whole we doubt whether the paragraph is needed.
- 3 The final sentence in 3 replicates in the first line the requirement subsequently included at 4(b), and is probably unnecessary here. The reference in the second line to financial statements of the acquired businesses being included in the prospectus if applicable raises a number of questions. Since the disclosure requirement referred to is not part of the pro forma disclosure, it would be expected that there would be a reference to the disclosure in Annex A, but this appears not to be the case. The meaning of 'if applicable' is unclear in the absence of any requirements relating to the information set out elsewhere. And the reference to 'prospectus' is unusual given the registration statement/securities note approach.
- 4 and 7(b) We would suggest that references to the consistency of the basis of preparation with the accounting policies of the issuer should be clarified. Paragraph 38 of CESR/03-208 correctly notes that pro forma financial information is prepared on the basis of 'methodologies different than that of Generally Accepted Accounting Principles'. It also refers to the information as 'non GAAP'. In this context, it might be preferable to refer to consistency with the accounting policies 'given the underlying assumptions for the pro forma financial information'.

We believe that this Annex should also contain the 25% threshold at which significant gross change is determined together with indicators by reference to which such change is to be measured.

We would note that the word "historical" should be deleted from paragraph 3(a) as 5(a) permits presentation of the current period that could be a profit forecast.