THE COMMITTEE OF EUROPEAN SECURITIES REGULATORS

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EUROPEAN REGULATION ON THE APPLICATION OF IFRS IN 2005

DRAFT RECOMMENDATION FOR ADDITIONAL GUIDANCE REGARDING THE TRANSITION TO IFRS

CONSULTATION PAPER

OCTOBER 2003

11-13 avenue de Friedland - 75008 PARIS - FRANCE - Tel.: 33.(0).1.58.36.43.21 - Fax: 33.(0).1.58.36.43.30
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Foreword

This Draft Recommendation contains several recommendations 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 issues 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 January 1st,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 chaired by M. Henrik Bjerre-Nielsen, Director General of the Danish Financial Supervisory Authority and more specifically by the Sub-Committee on International Standards Endorsement (SISE) chaired by M. Philippe Danjou, Chief Accountant of the French Commission des Operations de Bourse (COB).

In order to give interested parties an opportunity to express their opinions on the Draft Recommendation, CESR will hold an **open hearing on 12 November 2003** at the CESR premises, 11-13 avenue de Friedland, Paris. Please register your interest in participating by e-mail to the secretariat of CESR at secretariat@europefesco.org.

The **deadline for submitting written responses to the consultation paper is 20 November 2003**. Responses should be addressed to Mr Fabrice Demarigny, Secretary General, CESR, by email at secretariat@europefesco.org.

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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[1], 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[2]) if, at their balance sheet date, their securities are admitted to trading on a regulated market of any Member State (article 4)[3].

§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[4] recommended that the European commission endorse 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 has 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 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.

§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 published by IASB[5] "*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.*" [6]

[1] Published in the Official Journal on September 11th, 2002.
[2] International Financial Reporting Standards (IFRS) being the new name of IASs since May 2002.
[3] 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.
[4] As defined in article 6 of the regulation.
[5] 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).
[6] Press release accompanying the publication of the standard.

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§5 The following recommendations apply to the most common situations whereby companies publish financial information under existing accounting requirements until the end of 2004, including the financial statements for the year then ended.[7]

> Question 1. Do you consider it useful that CESR Members provide recommendations to European listed companies on how to disclose financial information to the markets during the phase of transition from local GAAP to IFRS?

Introduction

§6 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.

§7 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.

§8 This specific financial information will be a positive signal that will help the users of the financial statements becoming aware of the potential impact of the 2005 change in accounting policies and it will provide evidence that this project is properly carried out.

> Question 2. Do you agree that European listed companies should be encouraged to prepare the transition from local GAAP to IFRS as early as possible?
>
> Question 3. Do you agree that those companies should also be encouraged to communicate about this transition process? If yes, are the 4 milestones identified by CESR for such communication appropriate?

1. Publication of 2003 financial statements

§9 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 this information exercise may be narrative only.

§10 Such information can be included in the annual report[8] or in a note to the financial statements.

[7] A similar rationale applies to companies that will enter into the transition phase at a later date.
[8] As defined in the Fourth Council Directive 78/660/EEC of 25 July 1978 and the Seventh Council Directive 83/349/EEC of 13 June 1983. It is often described as the management discussion and analysis, the operating financial review or the management report.

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Question 4. What are your views on an encouragement to listed companies to disclose narrative information about their process of moving to IFRS and about the major identifiable differences in accounting policies this transition will bring about? Do you consider it appropriate to include such information in the 2003 annual report or in the notes to the 2003 financial statements?

2. Publication of 2004 financial statements

§11 Relevant information on the impact of the change on the 2004 annual financial statements will have to be prepared in order to meet IFRS1 provisions on comparative information (IFRS1 § 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.

§12 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. If it is not possible to do so at the time of publication of the 2004 financial statements, it should be recommended to continue the disclosure under the narrative format as presented in § 9.

Question 5. Do you believe that listed companies should be encouraged not to wait until beginning 2006 for communicating about the impact of the transition to IFRS on the 2004 financial statements if such information is available earlier? Do you agree that quantified information in this regard should be given as soon as possible?

§13 In line with the IFRS1 provisions described in Implementation Guidance IG 63[9], this information may consist in:

- a reconciliation of shareholders' equity at the date of transition (for example 1 January 2004) from previously used GAAP[10] 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.

§14 This information can be included in the annual report or in the notes to the financial statements.

Question 6. Is it appropriate to refer to the Implementation Guidance published by IASB in connection with the IFRS1 for defining which quantified information should be disclosed as a result

[9] Contained in Implementation Guidance IFRS1 booklet
[10] GAAP: generally accepted accounting principles used in the member state

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of the recommendations in § 11 and § 12? Do you believe other disclosures should be envisaged? Do you agree with inclusion of such information in the annual report or in the notes to the financial statements?

3. 2005 Interim Information

§15 In order to reduce the risk that investors be misled by financial information that will later become less relevant, CESR believes it is vital that market participants be provided during 2005 with financial information that will be consistent with the IFRS-based information they will receive relating to the full year ending on or after 31 December, 2005.

§ 16. These developments on interim information follow the underlying principles of the draft Directive on transparency requirements with regard to information about issuers whose securities are admitted to trading on a regulated market, which had been proposed by the European Commission in March 2003 (COM 2003/138 final, 26 March 2003). The recommendations could be revised according to the final version of the Directive.

§17 Therefore, it should be recommended that as from January 1st, 2005, any published interim financial statements should be prepared in accordance with endorsed IFRSs as follows:

Question 7. Do you agree with the principle that any interim financial information published as of 2005 by listed companies should be prepared using the accounting standards that are to be used by those companies for the 2005 year end financial reporting, i.e. IFRS, in the way indicated here under?

3.1. Quarterly information for the 2005 period when applicable

§18 Where the issuer is required to, or chooses to, present quarterly information, it can elect one of the following alternative methods for the presentation of the first and the third quarter information:

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

Question 8. Do you agree that when listed companies do not elect to apply IAS 34 for quarterly information published in 2005, they should be encouraged to prepare and disclose financial data by applying IFRS recognition and measurement principles to be applicable at year end?

3.2. Half year financial information for the 2005 period.

§19 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, i.e. financial information containing minimum disclosures (IAS 34 § 4). In view of the fact that the draft European Directive on Transparency requirements may introduce a mandatory application of IAS34 for half year information probably for 2006 (i.e. imposing 2005 comparative information), CESR encourages the application of this standard as from 2005.

§20 If this accounting standard is not applied, key figures that are presented in order to meet national requirements on half-year reporting should be prepared in conformity with IAS/IFRS recognition and measurement principles that will be used at year-end.

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Question 9. Do you agree with the proposed encouragement for European listed companies to either fully apply IAS34 for half yearly reporting as from 2005 or, if this standard is not applied, to prepare the key half-year financial data that are to be published, in conformity with IFRS recognition and measurement principles to be applicable at year end?

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

§21 For both quarterly and half-year reporting in 2005, when IAS 34 is not applied, the amounts for the corresponding period of the preceding year should be disclosed as follows:

§22 Comparative figures should be provided and restated on the same basis as for the current year.

§23 In order to facilitate the understanding of the issuers' financial communication, the published information for the previous interim period may be provided again. This information can be displayed in separate columns on the face of the financial statements or provided in the notes thereto.

§24 A detailed explanation of the restatement of the previously published data may be disclosed in the notes to the 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.

§25 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.

§26 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)

Question 10. CESR considered different possibilities for the presentation of comparative information for the corresponding period(s), but concluded that the above proposed solution could appropriately serve users of financial information without imposing too burdensome requirements on issuers. Do you concur with the proposed solutions? In particular, do you agree with the proposals that A) comparative figures should be provided and restated using same accounting basis as for the current year; B) previously published information for the previous period may be provided again; C) explanation of restatement of comparative figures should be given; D) in case of presentation of financial statement over 3 successive periods the restatement of the first (earliest) period could not be required; E) indicative format ("bridge approach") for the presentation of comparative information on the face of the financial statements when the first period presented is not restated?

4. 2005 Annual Financial Statements

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§27 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[11] can be presented again. This information can be displayed either on the face of the financial statements or in the notes thereto.

§28 If an issuer is required to publish financial information for three successive periods (i.e. from 2003 to 2005), IFRS1 (§ 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.

§29 Indicative format:

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)

Question 11. Do you agree that, in addition to the presentation of comparative information in conformity with IFRS1 (i.e. prepared on the basis of IFRS provisions), it could be deemed useful to present again the comparatives prepared on the basis of previously applicable accounting standards?

Question 12. Do you agree that, when presentation of financial statements over 3 successive periods is required, it would be acceptable not to require the restatement to IFRS of the first (earliest) period? If yes, do you agree with the indicative format ("bridge approach) for the presentation of comparative information on the face of the financial statements when the first period presented is not restated?

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

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