



Ref: CESR/03-323e

**EUROPEAN REGULATION ON THE APPLICATION OF IFRS IN 2005
RECOMMENDATION FOR ADDITIONAL GUIDANCE REGARDING THE
TRANSITION TO IFRS**

DECEMBER 2003



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.

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, 2002¹, 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 IFRSs²) 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 Committee⁴ 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 published by IASB⁵ *“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.



§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.⁷

§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 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.

⁷ 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.



§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 GAAP⁸) 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 only⁹.

§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).

⁸ GAAP: Generally Accepted Accounting Principles (used in the Member State)

⁹ 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.



§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 sufficiently reliable manner, it is encouraged to disclose the relevant quantified information. Such disclosure should be made in a way that is not misleading (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.

§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 63¹⁰ of IFRS1¹¹, 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

¹⁰ Contained in Implementation Guidance IFRS1 booklet

¹¹ 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".



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 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:

- either to fully comply with IAS 34 requirements¹²,
- 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 statements¹³ 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 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.

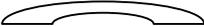
¹² It is understood that IAS 34 "Interim Financial Reporting" is an optional standard. If it is applied, the company has to publish either a full set of financial statements (as complete as annual financial statements) or condensed financial statements under the conditions of the par. 9 and 10 of IAS34.

¹³ Provided they are clearly labelled as not being prepared on the basis of IAS/IFRS.

§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 2004¹⁴ 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

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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¹⁴ I.e. information published under previously used GAAP.