THE COMMITTEE OF EUROPEAN SECURITIES REGULATORS

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TECHNICAL ADVICE

ON

EQUIVALENCE OF CERTAIN THIRD COUNTRY GAAP

AND ON

DESCRIPTION OF CERTAIN THIRD COUNTRIES MECHANISMS OF ENFORCEMENT OF FINANCIAL INFORMATION

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EXECUTIVE SUMMARY

SUMMARY OF CESR ADVICE ON EQUIVALENCE

1. CESR has completed its assessment of the equivalence of Generally Accepted Accounting Principles (GAAP) in the US, Canada and Japan (together the "third-countries") with International Financial Reporting Standards (IFRS) in accordance with the mandate of the European Commission.

2. CESR's advice is that these countries GAAPs, each taken as a whole, are equivalent to IFRS, subject to the following:

- That companies which have subsidiaries such as Qualifying Special Purpose Entities (QSPEs) which are not consolidated for third country GAAP purposes, but are required to be consolidated for the purposes of IFRS, report a pro-forma balance sheet and profit and loss account on their local GAAP basis, but including the unconsolidated subsidiaries .

- That companies reporting under Japanese GAAP which have either accounted for mergers by the pooling of interest method and/or have consolidated subsidiaries on the basis of GAAPs which are not consistent with either IFRS or any of the third country GAAPs, report a pro-forma balance sheet and profit and loss account on the basis of IFRS covering business combinations and consistent accounting policies, respectively.

- That Japanese and US third country issuers adopt accounting policies for the expensing of stock options on a basis equivalent (i.e. not necessarily identical) to IFRS, for implementation on or before 1 January 2007. We understand that Japan is considering proposals to adopt such a standard according to this timetable and that the US has recently adopted such standard that will in most cases be applicable as from 2006.

- That in respect of certain specified IFRS and if applicable, in addition to the above mentioned remedies, there should be additional disclosures of sometimes a descriptive nature and sometimes a quantitative nature.

3. The need to apply these remedies at a company level should be judged by the issuers on the basis of whether they are relevant and material to the financial position of the company. Employing the remedies requires that management apply in a reasonable manner its cumulative knowledge, experience and judgment to identify the transactions or circumstances and then to identify relevance and materiality for applying remedies. As the identified third country GAAP's are considered equivalent, the described remedies do not require management to keep two sets of accounts for EU reporting purposes (local GAAP and IFRS), nor do they require to provide a full reconciliation to IFRS. It is expected that the list of significant differences provided in our advice is complete in the view of those differences commonly found in practice or known to be significant as such by the financial and audit community in Europe and in third countries. However it is not intended to provide an exhaustive list of differences between third country GAAP and IFRS. In the exceptional circumstances described below (see paragraphs 21 and 22) in which our advice did not identify a significant difference, management shall use its judgement in developing and applying a remedy that results in providing information that is relevant to the economic decision-making needs of users. It should be underlined that this assessment will have to be conducted in the context of the considered third country framework. Hence, there is no need for systematic analysis of all differences between third country GAAP and IFRS, but only to consider this in light of the financial statement produced on the basis of third country GAAP.

4. CESR considers the rigorous application of remedies at a company level critical for the investor and recommends to the European Commission to determine a proper assurance level to be provided by the auditor as regards the remedies.

5. CESR notes that the scope of its mandate is limited to advise on equivalence and to describe enforcement mechanisms in each of the third countries. CESR would, however, like to emphasise that an assessment of the standards alone will not be sufficient to determine equivalence, or to afford

appropriate protection of investors. Filters in place for the interpretation and application for the standards, such as corporate governance, auditor oversight and appropriate enforcement mechanisms in the home country of the issuer (which may or may not be one of the third countries referred to above) together with similar filters at a company level, are essential. CESR conclusion on equivalence is therefore based on the assumption that the above-mentioned filters at country as well as at company levels, including internal control, are in place and functioning.

6. CESR advises that, based on academic research, there should be no remedy of reconciliation between Canadian GAAP, Japanese GAAP, US GAAP and IFRS. It is considered that a combination of qualitative and quantitative disclosures give better information to investors on the issues it has identified through the technical assessment of equivalence of these three third countries GAAP.

7. It is important to emphasise that CESR's assessment of equivalence is based on real world outcome of investor behaviour and is separate from other initiatives such as IASB convergence projects with the three countries considered. However, CESR is aware that each of the third countries is considering its policies concerning consolidation of SPEs and we would urge them to bring these to a conclusion as quickly as possible so that the need for any supplementary statements may be eliminated altogether. CESR also recognises the recently agreed convergence project between the IASB and the Accounting Standards Board of Japan, which builds on the considerable progress, already made in the accounting framework in Japan, and would recommend that accounting for business combinations and group consolidations be identified as early priorities.

8. On 22 April 2005, the European Commissioner for Internal Market and Services, Mr Ch. McGreevy and the Chairman of the US Securities and Exchange Commission (SEC), Mr W. Donaldson, met in the context of the EU-US Financial Market Regulatory Dialogue and discussed a "roadmap" setting out the steps necessary for the US SEC to eliminate US GAAP reconciliation requirements for foreign issuers that make use of IFRS for reporting purposes in the US. The stated objective is to allow elimination of the reconciliation requirements as early as possible, but no later than 2009. CESR greets this announcement and supports the efforts of both the EC and the US SEC to seek convergence of regulatory approaches that are in the interest of all markets participants, and for fostering the convergence towards high-quality international accounting standards. CESR also commends the initiative taken by the Canadian accounting standard setter (AcSB) to present a strategic plan for allowing a wider use of IFRS in Canada within the next five year.

DETERMINATION OF EQUIVALENCE

9. CESR's outcome-based approach to the GAAP equivalence, as a form of direct comparison of standards, has been predicated on the basis that investor's decision should be unaffected by the use of different accounting standards when assessing their buy, hold, sell investment decision. By analysing and evaluating financial information based on third country GAAP, investors should be able to make similar decisions irrespective of whether they are provided with financial statements based on IFRS or not. This outcome based definition of equivalence combined with how the market reacts to accounting differences are considered particularly relevant in the assessment of significance.

10. As explained in detail in a Concept Paper published earlier, the approach followed by CESR was to assess whether there are significant differences between third country GAAP and IFRS. Differences considered are those commonly found in practice or known to be significant by the financial and audit community in Europe and in third countries. This method for assessing comparison of GAAP can also be described as a direct comparison of standards and it avoids complications introduced by differences in how standards are interpreted and applied

11. It is important to emphasise that CESR's assessment of equivalence is based on the assumption that appropriate quality assurance, enforcement, and other filtering arrangements at a third country level are in place and that audit assurance at a listed entity level are effective for investors purposes. The quality of financial reporting is determined not only by the applicable GAAP, but also by the other filters mentioned.

12. Assessment of GAAP equivalence described in this paper is only one part of the total investor's decision making framework. Our conclusions are therefore based on the presumption that filters at country level, and audit assurance and enforcement at entity level are sufficient for investors to rely on. CESR assumes that third country GAAP are applied and complied with properly. This means that the necessary filters for ensuring market confidence are also in place for third country issuers participating in the EU capital markets.

13. In accordance with the mandate of the Commission, CESR compared third country GAAP with IFRS as endorsed in the EU. CESR does not express any opinion on the quality of/or preference for any specific set of accounting standards, be they those set by the IASB or by the relevant authorities in the third countries, or those endorsed by the EU. This however remains an important issue which is expected to be addressed through international convergence towards one single set of high quality global standards.

14. The EC mandate set 1st January 2005 as the cut-off date for the equivalence assessment. However, numerous indications have been received on significant standards developments expected to take place between 1st January 2005 and 1st January 2007 (the date on which the equivalence requirements under Transparency and Prospectus Directive will enter into force). These plans have been taken into account for the global and holistic assessment of equivalence, when it was apparent that the new accounting standards will be in force by 1st January 2007. Other potential standards changes that are still under consideration or discussion were not considered in global and holistic CESR's equivalence assessment. Indications on expected standard changes after 1st January 2005 are provided in connection with the detailed analysis of GAAP differences.

15. In view of the expected significant developments, such as the convergence initiatives mentioned, and other relevant future improvements envisioned by local standard setters, CESR considers a re-evaluation in due course as a critical step arising from the process of international convergence.

REMEDIES FOR SIGNIFICANT GAAP DIFFERENCES

16. Academic research suggests that financial markets, being fairly sophisticated, are usually effective in pricing the effects of financial and other information disclosed to the market. CESR, therefore, considers that additional disclosures related to the effect of differences in accounting standards will generally enable investors to act rationally, as if the financial information had been prepared based on IRFS, although there may be exceptional circumstances when reconciliation to IFRS or even a complete restatement may be necessary. This approach to remedies seems the most consistent with a cost benefit test.

17. Cost benefit considerations are multi-faceted. CESR is concerned with the costs to listed companies of complying with various remedies, but also seeks to protect the needs of investors. On the other hand CESR is aware that where differences are handled through disclosure rather than any other form of remedy, additional cost may be imposed on investors in order that they make rational decisions.

18. The approach summarised above is supported by the responses to the public consultation on the Concept Paper and also by a Consultative Working Group composed of experts with a range of experiences and capabilities in IFRS and in the third country GAAP.

19. CESR's mandate is to advice the Commission on possible implementing measures of the Transparency and Prospectus Directives regarding equivalence of financial reporting standards in Canada, Japan and USA. To this end, CESR proposes to the Commission to declare the three third countries GAAPs, each taken as a whole, as equivalent to IFRS, subject to remedies for a limited list of GAAP differences that CESR considers as significant. The advice also includes principle-based guidance for the application of remedies and for the assurance expected from the auditor on the proper application of these remedies.

20. A key element in this framework is that issuers should be made responsible for judging whether these differences and remedies are relevant and material to the financial position of the reporting company.

21. One important consequence of the outcome-based approach CESR has taken to the equivalence assessment is that its advice does not intend to provide an exhaustive list of differences between third country GAAP and IFRS. It is expected that the list of significant differences provided in our advise is complete in the view of those differences commonly found in practice or known to be significant as such by the financial and audit community in Europe and in third countries. However it is not intended to provide an exhaustive list of differences between third country GAAP and IFRS. It cannot be excluded that, in exceptional situations, a third country issuer would not find in the advice, specific remedies applicable to other GAAP differences that may appear in their specific case due to their particular business, operations or financial situation. CESR believes that, in addition to the remedies required for the identified significant differences, additional disclosures should be provided – in accordance with the first two sentences of paragraph 3 and also paragraph 110 - in limited situations resulting from:

a. Transaction(s) or event(s) or accounting treatments that, under third country GAAP are considered as industry specific.

b. Other unusual transaction(s) or event(s) giving rise to an unusual accounting outcome in the context of the application of third country GAAP.

So defined, it can actually be expected that these situations will be highly exceptional and will most commonly already be addressed by ad hoc disclosures in a reporting based on third country framework, providing the required information needed for the EU investor in making investment decisions.

Unusual accounting outcome from specific transactions and/or events which are not yet reflected in local GAAP disclosures, and which are deemed material for investors to better understand the economic reality of the company might need additional disclosures. This assessment will take place under local GAAP preparatory work. This reflects situations that, due to its nature, will be rare in occurrence.

22. In the absence of a prescribed remedy in situations as described above, management shall use its judgement in developing and applying a remedy that results in information that is relevant to the economic decision-making needs of users. Applications of such remedies should result in information that is reliable, in that the remedies represent faithfully the additional information required, reflect the economic substance of transactions, other events and conditions, considering the requirements and guidance of IFRS and concepts used in this advise, dealing with similar and related issues.

23. CESR has adopted a principle-based approach for the development of a possible framework for the application and audit of remedies. As highlighted by the consultation on the draft technical advice, further guidance might be necessary at different levels, such as the objective and content of the disclosure requirements for each significant GAAP difference, the industry specific issues, a review of disclosure requirements under third country GAAP or possible guidance for the auditing procedures necessary to obtain the desirable level of assurance. CESR agrees with this, but believes that, at this stage, it should not go beyond an initial principle-based framework. One needs to keep in mind that there are important projects in the three third countries to adopt new accounting standards in the near future and an important consequence of this is that several significant GAAP differences (and subsequently remedies) will disappear even before the legal entry into force of EU possible requirements on equivalence. This would lead to rapid obsolescence of many of the possible additional and detailed guidance. The work conducted by CESR on equivalence has highlighted that the issues are complex in many respects and will deserve more time for development and public consultation.

EARLY WARNING MECHANISM AND STANDARD CHANGES AFTER 1st JANUARY 2005

24. The assessment of GAAP equivalence is explicitly limited and based on the situation existing at a specific date, i.e. the 1st January 2005. However, it is recognised that the equivalence requirements under the Prospectus Directive and the Transparency Directive will not enter into force before 1st January 2007. As indicated above, important standards developments are expected to take place between 1st January 2005 and 1st January 2007 (notably in relation to convergence projects).

25. In this context, CESR considers it crucial to have an **early warning mechanism** in place in due time for considering the newly developed or changes to existing IAS/IFRS, the changes to third country GAAP and any other elements having an impact on the assessment of GAAP equivalence, in order to make relevant proposals to EU legislative bodies, for an upgrade of the list of significant GAAP differences and remedies.

26. CESR's advice on the early warning mechanism is that this mechanism could take the form of a mandate given to an existing or newly created body, appropriately funded and accountable for this task. Alternatively, Standards Setters concerned might inform the European Commission on an annual or biannual basis whether new standards or interpretations issued by them are diverging or converging.

27. At this stage, CESR believes that a **first review of the list of significant GAAP differences should take place at least for January 2007** (end of transitional period), for considering GAAP developments that will have effectively taken place since 1st January 2005. The first result of this review will probably be that several significant differences (and subsequently the remedies) will disappear as a result of standards changes.

DESCRIPTION OF ENFORCEMENT MECHANISMS

28. As regards the enforcement mechanisms, this report provides the description required by the Commission. This description is essentially based on the indications received from the three considered third countries. No external verification of the responses received has been conducted. As already announced in the Concept Paper, CESR has not assessed the effectiveness and efficiency of third country enforcement mechanisms. However, as further indicated in this paper, active enforcement mechanisms are a key element in the investment decision framework. Therefore, co-ordinating the approach of EU National Enforcers to the enforcement of financial statements of third country issuers (as for EU issuers) remains an important future area of activity for CESR.

SUMMARY OF MAJOR GAAP DIFFERENCES IDENTIFIED

29. The following tables provide a non-exhaustive synopsis of the technical differences between the three third country GAAP and IAS/IFRS identified by CESR as a result of its assessment of GAAP Equivalence. The first table sets out the significant GAAP differences for which a remedy within disclosure or supplementary statement is proposed. The second table sets out all the major GAAP differences identified, with an indication on their status under the proposed equivalence assessment.

30. Further detailed indications are provided further down in this advice on these GAAP differences and on the current projects in the considered three countries for improvement of existing standards or convergence with IAS/IFRS.

31. Applicable remedies for the purpose of equivalence are further defined and detailed in Chapter 1, Section 3 of this paper. The terms used in the summary tables have the following meaning:

Additional disclosures

32. Additional disclosures are narrative explanations that fall into one of the following two categories:

a **Disclosures A. Additional narrative and/or quantitative disclosures** augmenting the disclosures already provided pursuant to third country GAAP. They include elements such as

- explanation of the relevant transaction(s) and event(s) and the method for accounting this(these) transaction(s) and event(s) under third country GAAP
- indication of assumptions, valuation methods or hypothesis (e.g. economic data) used for the measurement and recognition of the transaction(s) and event(s) under third country GAAP
- disclosure of fair value of assets when such information is not already provided pursuant to third country GAAP

As CESR has not conducted an exhaustive review of disclosure requirements under third country GAAP (compared to IAS/IFRS disclosure requirements), some of these additional disclosures might already be included in the primary financial statements prepared under third country GAAP. In this case, the additional disclosures will not have to be repeated.

Disclosures A are also relevant for situations where principles for recognition and measurement are broadly similar to IAS/IFRS principles and the difference is at the level of detail.

For the sake of clarification, it must be underlined that Disclosures A do not imply any re-measurement of transaction(s) and event(s) on the basis of IFRS measurement provisions. They are an extension of disclosures provided under third country GAAP, with the purpose of allowing investors to fully understand the transaction(s) and event(s) and their accounting treatment under these GAAP, so as to reach a level of information that could be afforded under IFRS.

b **Disclosure B. Quantitative indication of the impact of an event or transaction, had this event or transaction been accounted for following IAS/IFRS provisions.** Such quantification should provide the gross and net of tax effect of the difference on the profit and loss or on the shareholders' equity of the issuer, as applicable. The impact has to be presented with relevant accounting entries, as under IAS/IFRS.

Supplementary statements

33. Supplementary Statements are pro-forma statements, prepared and presented on the basis of third country GAAP accounting principles and of the issuer's primary financial statements, but including a limited restatement for taking account of one identified aspect of IFRS requirement that is not present of not fully applied under third country GAAP.

34. Supplementary Statements do not purport to present the financial position and results of the issuer as if all IAS/IFRS had been fully complied with. Indeed, they remain fundamentally third country GAAP statements, with the exception of amendments reflecting specific and limited IFRS requirements.

35. Supplementary statements will at least be presented in the form of condensed income statement, balance sheet and possibly cash flow statement and supported by the range of additional disclosures described above.

SUMMARY OF SIGNIFICANT GAAP DIFFERENCES BY REMEDY [1]

	Canadian GAAP	Japanese GAAP	US GAAP
DISCLOSURE A	• Share Based Payments (IFRS 2) – current standard • Minority interest at historical cost (IFRS 3) • Step acquisition (IFRS 3) • Employee Benefits (IAS 19) • Reversal of impairment (IAS 36) • Decommissioning costs (IAS 37) • Investment Property (IAS 40)	• Share Based Payments (IFRS 2) – future standard ED 3 Japanese GAAP • Minority interest at historical cost (IFRS 3) • Step acquisition (IFRS 3) • Catastrophic provisions (IFRS 4) • Construction Contracts (IAS 11) • Non performing Loans (IAS 12 & 30) , except if disclosure is already provided • Costs for Assets retirement Obligation (IAS 16) • Employee Benefits (IAS 19) • Translation of goodwill (IAS 21) • Fair Value of derivatives (IAS 32) • Reversal of impairment (IAS 36) • Decommissioning costs (IAS 37) • Investment Property (IAS 40)	• Share Based Payments (IFRS 2) – SFAS 123 R • Minority interest at historical cost (IFRS 3) • Step acquisition (IFRS 3) • Replacement's costs (IAS 16) • Employee Benefits (IAS 19) • Reversal of impairment (IAS 36) • Decommissioning costs (IAS 37) • Investment Property (IAS 40)
DISCLOSURE B	• Date of exchange (IFRS 3) • Negative goodwill (IFRS 3) • Use of LIFO (IAS 2) • Impairment Test - non discounted future cash flows (IAS 36) • Agriculture (IAS 41)	• Share Based Payments (IFRS 2) – current standard • Date of exchange (IFRS 3) • Acquired R&D (IFRS 3) • Negative goodwill (IFRS 3) • Use of LIFO & cost method (IAS 2) • Uniformity of accounting policies (IAS 28) • Impairment Test - non discounted future cash flows (IAS 36) • Capitalisation of development costs (IAS 38) • Agriculture (IAS 41)	• Share Based Payments (IFRS 2) – current standard SFAS 123 • Date of exchange (IFRS 3) • Acquired R&D (IFRS 3) • Negative goodwill (IFRS 3) • Use of LIFO(IAS 2), except if disclosure is already provided • Uniformity of accounting policies (IAS 28) • Impairment Test - non discounted future cash flows (IAS 36) • Capitalisation of development costs (IAS 38) • Agriculture (IAS 41)
SUPLEMENTARY STATEMENTS	• Scope of consolidation (Definition of control- QSPE) (IAS 27)	• Pooling of interests (IFRS 3) • Scope of consolidation (Definition of control - QSPE) (IAS 27) • Uniformity of accounting policies (IAS 27)	• Scope of consolidation (Definition of control - QSPE) (IAS 27)
FUTURE WORK (O/S)	• Financial Instruments (IAS 39): possible Disclosure A	• Financial Instruments (IAS 39): possible Disclosure A	• Financial Instruments (IAS 39): possible Disclosure A

[1] The list provided in this table is not exhaustive. For further details, please see Chapter 1, Section 2.

SUMMARY OF GAAP DIFFERENCES (by IAS/IFRS)[2]

		Canadian GAAP	Japanese GAAP	US GAAP
IFRS 1	Transition IFRS	N/A	N/A	N/A
IFRS 2	Share based payments • Under current standards • Assuming SFAS 123 R and Japan ED3	 Disclosure A N/A	 Disclosure B Disclosure A	 Disclosure B Disclosure A
IFRS 3	Business Combination • Minority interest at historical cost • Date of exchange • Acquired R&D • Pooling of interests • Step acquisitions • Amortisation of Goodwill • Negative goodwill	 Disclosure A Disclosure B N/A N/A Disclosure A N/A Disclosure B	 Disclosure A Disclosure B Disclosure B Supplementary statement Disclosure A N/S Disclosure B	 Disclosure A Disclosure B Disclosure B N/A Disclosure A N/A Disclosure B
IFRS 4	Insurance contracts • General • Catastrophic provisions	 N/S N/A	 N/S Disclosure A	 N/S N/A
IFRS 5	Non-current assets Held for Sale and Discontinued Operations	N/S	N/S	N/S
IAS 1	Presentation of Financial Statements	N/S	N/S	N/S
IAS 2	Inventories • Use of LIFO method • Reversal of impairment • Cost method	 Disclosure B N/S N/A	 Disclosure B N/S Disclosure B	 N/S for issuers complying with SEC requirements – otherwise, Disclosure B N/S N/S
IAS 7	Cash flow Statements • For Investment Companies	 N/S	 N/A	 N/S
IAS 8	Accounting Policies, Changes in Accounting Estimates and Errors	N/S	N/S	N/S
IAS 11	Construction Contracts • Completed contract method	 N/S	 Disclosure A (for long term contracts)	 N/S
IAS 12	Income taxes • General • Non Performing Loans (NPL) effects (depending on existing disclosures requirements)	 N/S N/A	 N/S N/S for issuers disclosing in local accounts, otherwise: Disclosure A	 N/S N/A
IAS 14	Segment reporting	N/S	N/S	N/S

[2] The list provided in this table is not exhaustive. For further details, please see Chapter 1, Section 2.
Meaning of the abbreviations used in this table: N/A: not applicable - N/S: no significant difference - O/S: outstanding issue (needs further analysis).

		Canadian GAAP	Japanese GAAP	US GAAP
IAS 16	**Property, Plant and Equipment (PPE)**			
	• Revaluation of PPE	N/S	N/S	N/S
	• Initial operating losses	N/S	N/A	N/S
	• Replacements' costs	N/A	O/S	Disclosure A
	• Definition of useful life	N/A	N/S	N/A
	• Costs for Assets Retirement Obligation	N/A	Disclosure A	N/A
	• Non-monetary exchange of assets	N/S	N/S	N/S
IAS 17	**Leases**	N/S	N/S.	N/S
IAS 18	**Revenue Recognition**	N/S	N/S	N/S
IAS 19	**Employee Benefits**			
	• Employee Benefits	Disclosure A	Disclosure A	Disclosure A
	• Holiday pay	N/A	N/S	N/A
	• Return of substitutional portion	N/A	N/S	N/A
	• Discount rate	N/A	Disclosure A	N/A
	• Amortisation of transitional obligation	N/A	N/S	N/A
IAS 20	**Accounting for Government Grants and disclosure of government assistance**	N/A	N/S	N/S
IAS 21	**The Effects of Changes in Foreign Exchange Rates**			
	• General	N/A	N/S	N/A
	• Translation of goodwill	N/A	Disclosure A	N/A
IAS 23	**Borrowing costs**	N/S	N/S	N/S
IAS 24	**Related Party disclosures**			
	• Control relationships	N/S	N/S	N/S
	• Executive compensations	N/A	N/S	N/S
IAS 27	**Consolidated and Separate Financial Statements**			
	• Scope of consolidation (Definition of Control – Qualifying Special Purpose Entities)	Supplementary statement	Supplementary statement	Supplementary statement
	• Uniformity of Accounting policies in a group	N/A	Supplementary statement	N/A
	• Presentation of minority interest	N/A	N/S	N/S
IAS 28	**Investments in Associates**			
	• Uniformity of Accounting policies	N/A	Disclosure B	Disclosure B
	• Different reporting dates	N/A	N/S	N/S
IAS 29	**Financial Reporting in Hyperinflationary Economies**	N/S	N/S	N/S
IAS 30	**Disclosures in the Financial Statements of Banks and Similar Financial Institutions**	N/A	Disclosure A (see also IAS 12 on NPL)	N/A
IAS 31	**Interests in Joint Ventures**	N/S	N/S	N/S
IAS 32	**Financial Instruments: Disclosure and Presentation**			
	• Split Accounting (convertible bonds)	N/A	N/S	N/S
	• Fair value of derivatives	N/A	Disclosure A	N/A
	• Preference shares	N/A	N/S	N/S
IAS 33	**Earnings per Share**	N/S	N/S	N/S
IAS 34	**Interim Financial Reporting**	O/S	O/S	O/S
IAS 36	**Impairment of Assets**			
	• Impairment Test (non discounted future cash flows)	Disclosure B	Disclosure B	Disclosure B
	• Definition of Cash Generating Unit	N/S	N/A	N/S
	• Reversal of Impairment	Disclosure A	Disclosure A	Disclosure A
	• Definition of significant decline	N/A	N/S	N/A

		Canadian GAAP	Japanese GAAP	US GAAP
IAS 37	**Provisions, Contingent Liabilities and Contingent Assets**			
	• Definition of "probable"	N/S	N/S	N/S
	• Minimum amount as best estimates of liability	N/S	N/A	N/S
	• Decommissioning costs	Disclosure A	Disclosure A	Disclosure A
	• Discounting of long-term provision	N/A	N/S	N/A
	• Exit Plan	N/S	N/A	N/S
	• Constructive obligations	N/A	N/S	N/A
IAS 38	**Intangible Assets**			
	• Revaluation	N/S	N/S	N/S
	• Capitalisation of development costs	N/A	Disclosure B	Disclosure B
IAS 39	**Financial Instruments: Recognition and Measurement** (to be reconsidered later)	O/S (possible Disclosure A)	O/S (possible Disclosure A)	O/S (possible Disclosure A)
IAS 40	**Investment Property**	Disclosure A	Disclosure A	Disclosure A
IAS 41	**Agriculture**	Disclosure B	Disclosure B	Disclosure B

INTRODUCTION

A. General context

36. In the Concept Paper on Equivalence, CESR defined that, for Equivalence's purposes, investors should be able to make a similar decision irrespective of whether they are provided with financial statements based on IFRS or on third country GAAP. This definition of equivalence is an outcome based approach, and market responses to accounting differences are considered particularly relevant for our assessment of significance. This method used for assessing comparison of GAAP can be described as a form of direct comparison of standards, and is further explained in the Concept Paper on Equivalence (see annex 3). Our findings of these assessments are provided in the tables in section 2 of Chapter 1.

37. Other methods can be described as[3]:

- Cross-sectional comparison for a set of entities, to determine differences in accounting for similar events or transactions;
- Assessment of accounting practices within a given accounting policy;
- Assessment of actual reported numbers, quantifying differences.

38. The following observations have to be made:

- The objective of financial reporting standards, including IFRS, is framed in terms of investor decision-making. Financial reports are one element, albeit an important one, in a broad range of information sources used by investors for decision making. As a result, much of the information in earnings and financial statements is anticipated and priced by investors before they appear in the released financial statements. A focus exclusively on accounting standards would ignore these other sources of information for investor decision making;

- The quality of financial reports is an important factor determining their usefulness for investor decision making. However, accounting standards in isolation are not sufficient basis, as reasonable investors will make their investment decision based on the reduction of uncertainty through several filters Accounting standards are only one factor determining the quality of financial reports. As supported by academic research, the quality of financial reporting is not only determined by GAAP alone, other important factors, referred to as filters, include the corporate governance of reporting entities, legal environment, compensation schemes, auditing quality and auditors' independence, acceptable level of attestation using international standards on auditing, ownership structure, other incentives (such as the need for raising funds…) as well as the enforcement mechanisms and activities regarding financial reporting. Weakness in one filter can place increased pressure on the others. A focus exclusively on accounting standards could ignore these other factors.

39. The interaction between the different relevant elements can be further explained with the following diagram, which portraits CESR outcome-based approach into its broader context:

[3] Pownall, G. and Schipper, K (1999). 'Implications of Accounting research for the SEC's consideration of International Accounting Standards for U.S. securities offerings'.

<u>Accounting standards in the investment decision framework at country and firm level</u>

40. The following chart shows that CESR approach to assessment of GAAP equivalence is based on a technical comparison of GAAP with IFRS (first column of boxes – starting from the left -, with highlighted boxes showing CESR's field of activity under this mandate), with a focus on the outcome expected from this assessment. The expected outcome – second and third columns of boxes - is the financial statements prepared on the basis of IFRS (for GAAP that are non equivalent or for EU reporting entities) or on the basis of third country GAAP (for GAAP that are considered as totally equivalent for the EU) or on the basis of third country GAAP augmented by remedies identified (in case of partial equivalence). The fourth column of boxes shows that financial information is subject to additional filters as explained below, which are essentially defined at national or regional level. The market response (fifth column of boxes) integrates financial reporting and additional filters, as shown; conversely, market needs will influence the development of regulatory framework (GAAP, additional filters…) over the long term.

Assessment of GAAP equivalence

Company assessment

Outcomes

Additional national filters

Market response

IFRS

company

IFRS financial statements

GAAP Comparison (Differences as highlighted in this advice

Third country GAAP

company

Local financial statements

Company assessment of materiality

Remedies

company

Augmented local financial statements

Costs/benefits considerations

- active enforcement
- auditor's opinion on financial statements and remedies
- use of international standards on auditing
- corporate governance
- compensation schemes
- legal environment
- auditor independence and quality
- ownership structure
- other incentives (fund raising activity…)

- Share price
- Liquidity
- Bid & ask spreads
- Cost of new capital
- General confidence

41. According to the EU-mandate, CESR assessment of equivalence is based on a comparison between third country GAAP and IFRS, at country level. Investors use financial statements for investment decisions which are prepared at a company level, affected by the entities application of standards. Therefore accounting standards in isolation on a pure technical basis, an on a country level, do not seem to be a sufficient basis to address all issues to the equivalence project. This is

portrayed in the above shown diagram where CESR equivalence assessment (i.e. the highlighted boxes) clearly appears as one element of the broader framework.

42. Assessment of GAAP equivalence described in this paper is only one part of this framework. CESR conclusions are therefore based on the presumption that filters at country levels, and audit assurance and enforcement on entity levels are sufficient for investors to rely on. CESR assumes that third country GAAP are applied and complied with properly. This means that the necessary filters for ensuring market confidence are cetiris paribus considered to be in place for third country issuers using or participating in the EU capital markets.

43. Assessment of the existence and quality of these filters in third countries is not part of the mandate given by the European Commission, but CESR believes that it is a key element for market confidence and market efficiency (shown as market response in the diagram above).

44. The filters each contribute to protecting the investor's rights and investments. They are an important factor for investor decision making and related to market responses like liquidity, bid & ask spreads and the cost of capital. As these filters influence the level of uncertainty investors have in their decisions making process. Significant GAAP differences will have impact on these decisions; however the impact of weaknesses in the other filters cannot be ignored.

B. Regulatory EU background

45. The implementation of two new EU legislative measures will soon require the European Commission to establish whether a given third country GAAP is equivalent to IFRS. These measures include Prospectus Directive (including the implementing measures of this Directive) and the Transparency Directive.

46. As a result of the new EU-wide rules on prospectus, third country issuers (non-EU issuers) who have their securities admitted to trading on an EU regulated market or who wish to make a public offer of their securities in Europe, will be required as from 1st January 2007, to publish a prospectus including financial statements prepared on the basis of EU endorsed IFRS or on the basis of third country's national accounting standards (third country GAAP) if these standards are equivalent to the endorsed IFRS. In the meantime, appropriate transitional arrangements will apply under Article 35 of Commission Regulation (EC) 809/2004 on Prospectus.

47. Similarly, under the Transparency Directive[4], third country issuers whose securities are admitted to trading on a EU-regulated market will also have to provide annual and half-yearly financial statements (as from January 2007) which should either be prepared in accordance with IFRS or third country GAAP equivalent to the endorsed IFRS. Appropriate transitional arrangements will also apply under Article 26 (3) of that Directive.

48. The two EU legislative measures require the European Commission to take the necessary decisions as to whether a given third country GAAP is equivalent to IAS/IFRS.

49. The relevant provisions of the Transparency Directive and of the Prospectus Directive and Regulation are included in annex 1.

50. A basic assumption for assessing the equivalence is to consider that investors on European markets will have a reasonable knowledge of IAS/IFRS which will be used by European listed companies as from 2005. These international accounting standards, in particular their basic principles, will become the "accounting language" that European investors will use and recognise when analysing financial statements for investment purposes. Recognising, however, that it can be argued that Canadian, Japanese and US GAAP are already used to varying extents in EU markets. Actually, CESR also assumes that rational investors in securities of third country issuers will have a

[4] Directive 2004/109/EC of the European Parliament and of the Council of 15 December 2004 on the harmonisation of transparency requirements in relation to information about issuers whose securities are admitted to trading on a regulated market and amending Directive 2001/34/EC.

reasonable knowledge of reporting environment of considered third countries, as reporting framework in EU and in third Countries are not as such required to be identical under Prospectus and Transparency Directives.

51. Although the European Commission (EC) has asked CESR for advice on equivalence of three third country GAAP's with IAS/IFRS as benchmark, IAS/IFRS could not be a good benchmark for assessing equivalence with third country GAAP as to specific events or transactions that are uncommon or largely unknown in the EU.

52. In this framework, equivalence pronouncements should not be understood as disqualifying previous investment decisions made on European capital markets based on third country GAAP. The improvements for European investors sought by the European Commission should be welcomed considering this context.

C. Mandate of the European Commission to CESR on Equivalence

53. In June 2004, the European Commission granted to CESR a single and specific mandate in order to give a technical advice on the matter of equivalence between certain third country GAAP (i.e., Canadian GAAP, Japanese GAAP and US GAAP) and IAS/IFRS. This mandate covers implementing measures that are common to both the Regulation on Prospectus No 809/2004 and the Transparency Directive 2004/109/EC.

54. The mandate also requires CESR to describe the mechanisms provided for at least in the US, Canada and Japan ensuring that the third country GAAP mentioned above are respected.

55. The Commission mandate requires CESR to deliver the technical advice by 30 June 2005.

56. A complete version of the mandate is in **Annex 2**. The key elements of the mandate are the following:

In giving its advice CESR is required to take full account of the following key objectives:

When assessing as to whether financial statements prepared under third country GAAP provide a true and fair view of the issuer's financial position and performance, the priority should lie on assuring the protection of investors.

A global and holistic assessment of the quality of the financial information provided by the accounting system in question should be carried out from a technical point of view and independently from any international convergence project aiming at a single set of accounting standards, such as the project currently conducted by the International Accounting Standard Board and the US-Financial Accounting Standard Board.

The global and holistic assessment should be based on the entirety of the third country GAAP in force as of 1 January 2005. The assessment should focus only on the significant differences between IAS/IFRS as endorsed at EU level and the third country GAAP in question.

The assessment should not relate as to whether the third country GAAP in question might be conducive to the European public good. This is a criterion for endorsing IAS/IFRS at European level pursuant to Article 3 (2) of the IAS-Regulation, but not for assessing equivalence.

The assessment should also be carried out independently of whether the third country concerned already recognises IAS/IFRS as equivalent to their domestic GAAP.

CESR is invited to provide a technical advice by June 2005 on the following elements:

1. Scope of the assessment

CESR is invited to assess the equivalence of the following GAAP by June 2005:

a) US-GAAP
b) Japanese GAAP, and
c) Canadian GAAP.

The assessment should encompass standards applicable to annual and interim financial reporting as well as the objective and conditions for preparing consolidated financial statements, as they should be applied by issuers as from June 2005.

2. Objective of the assessment

CESR is invited

a) to undertake a global assessment as to whether the financial statements prepared under the third country GAAP mentioned above provide equivalently sound information to investors when those investors make investment decisions on regulated markets across Member States. Investors should be able to take economic decisions on the basis of understandable, relevant, reliable, and comparable information about the issuer's assets and liabilities, financial position and profit or loss;

b) to advice on an early warning mechanism in case of significant changes to the third country GAAP occurred after 1 January 2005; and

c) to describe the mechanisms (outside the areas of audit and of corporate governance) provided for at least in the US, Canada and Japan ensuring that the third country GAAP mentioned above are respected.

3. Remedies

In case where equivalence cannot be confirmed in respect of one of the third country GAAP mentioned above, CESR is invited to consider what kind of remedies should be applied by the competent authority of the home Member State:

a) Do the third country issuers concerned have to restate their financial statements in all cases?

b) Are there cases in which more limited remedies should be provided for? If so, what should be the reconciliation items or what should be explained further by notes or other explanatory material?

D. Organisation of CESR work

57. Within CESR, the operational group CESR-Fin chaired by John Tiner, Chief Executive Officer of the UK FSA was, through its two sub-committees on endorsement (SISE) and enforcement (SCE) in charge of the EC mandate of equivalence. The SISE is chaired by Mr Paul Koster, Commissioner of the Netherlands Authority of Financial Markets (AFM) and the SCE is chaired by Mr Lars Østergaard, Director at the Finanstilsynet in Denmark (Danish Financial Supervisory Authority - DFSA). These two sub-committees set up ad hoc working groups for the preparation of the draft advice, with the support of CESR Secretariat.

58. As a first step in fulfilling its mandate, CESR published a call for evidence in July 2004 and collected preliminary indications from market participants on this mandate.

59. A second step was the publication for consultation in October 2004 of a draft Concept Paper on Equivalence which set out the basis upon which CESR intended to approach the analysis of equivalence. This paper presented the methodology and the criteria that CESR planned to use for assessing the equivalency between GAAP and for describing enforcement systems. The Concept Paper also included a number of general principles and guidelines relevant for a proper application of equivalency decisions to be taken by the European Commission.

60. The responses and comments received during the consultation on the Concept Paper - which included a public hearing in December 2004 - have informed the finalisation of the Concept Paper which has been published in final form on 3 February 2005, along with a feedback statement of the public consultation[5].

61. As indicated in the Concept Paper, the process followed by CESR for conducting the technical assessment of GAAP equivalence and for obtaining relevant information on enforcement system, initially included information's requests sent to third country standard setters and regulatory agencies. These organisations have been so kind as to reply to all CESR questions. Their valuable responses which have been made available on CESR website[6] formed an essential basis of the technical assessment of equivalence. CESR has also considered additional existing publicly available literature on comparisons of GAAPs with IFRS[7].

62. A Consultative Working Group composed of experts having different background and large experience in accounting, financial reporting and financial analysis has also been set up and largely consulted before the finalisation of this advice[8].

63. Academic research formed an important factor in determining our approach and considerations. Specifically the input and academic guidance in this process provided by C. Leuz has been of significant value to the process.

64. CESR warmly thanks all the persons who have in this way contributed to the preparation and finalisation of this advice.

65. A consultation paper setting out CESR draft technical advice on equivalence had been released on 27 April 2005 for public consultation. The consultation, which closed on 27 May 2005, also included a public hearing on 18 May 2005. The responses received through this consultation have informed the drafting of the final technical advice on equivalence that CESR delivered to the European Commission on …, along with a feedback statement of the public consultation[9].

[5] The responses to the public consultation, the final Concept Paper and the Feedback Statements are available on CESR website (responses to consultation are in the section <Consultation>; other documents are in the section <Operational Groups – Equivalence>).

6 See CESR website at section <Operational Groups – Equivalence>.

[7] See IASPLUS website (http://www.iasplus.com/country/compare.htm); Japanese Ministry of Economy, Trade and Industry (June 2004), "Report on the Internationalization of Business Accounting in Japan" (Study Group on the internationalization of Business Accounting); PricewaterhouseCoopers, "Similarities and Differences – A comparison of IFRS and US GAAP", October 2004; US FASB, "The IASC-U.S. Comparison Project: A report on the Similarities and Differences between IASC Standards and US GAAP", second Edition, 1999.

[8] The list of members of the Consultative Working Group is displayed on CESR website, at section <Operational Groups – Equivalence>.

[9] The responses to the public consultation on the draft technical advice are available on CESR website, in the section <Consultation>

CHAPTER 1 – EQUIVALENCE BETWEEN CANADIAN GAAP, JAPANESE GAAP, US GAAP AND IAS/IFRS

Section 1 - Structure of CESR advice

66. This paper is limited to the elements that are necessary for delivering a coherent and complete advice on GAAP Equivalence and for describing the enforcement mechanisms. It is referred to the Concept Paper for other aspects such as methodology and criteria used for the technical assessment of GAAP equivalence and description of enforcement mechanisms. For instance, the Concept Paper sets out extensive indications on how CESR proposed to define and grasp the concept of Equivalence (paragraph 1 to 16 of the Concept Paper).

67. Important aspects of equivalence and the place of a technical GAAP assessment within the broad framework of investor decision making is described earlier and should be taken into consideration with our conclusions on GAAP equivalence on a GAAP basis.

68. CESR Concept Paper (ref CESR/04-509c) on Equivalence is available on CESR website (section <Operational Groups – Equivalence>). Extracts of the Concept Paper have been introduced in annex 3 of this paper.

69. The idea that equivalent financial statements provide relevant information to investors does not exclude the possibilities of losses from incorrect investment decisions.

70. CESR's proposal to consider that Canadian, Japanese and US GAAP taken as a whole are equivalent to IFRS subject to remedies is based on a threefold approach.

a CESR assessed the technical equivalence of the three third countries GAAP on the basis of specific criteria and following the methodology and philosophy developed in the Concept Paper. This analysis resulted in an overall conclusion that the three GAAP taken as a whole are equivalent to IFRS subject to specified remedies addressing a limited list of significant GAAP differences. As indicated below, this list is upgradeable for taking accounting of future standard changes, notably reflecting efforts of convergence with IASB's standards.

  CESR proposes to consider this **list of significant differences and related remedies** as part of Level 2 measures in the Lamfalussy process, implementing the Transparency Directives and the Prospectus Directive and Regulation, as regards equivalence of financial reporting standards applicable for the preparation and presentation of financial statement in the framework of these European legislations.

  It must be underlined that the criteria referred to by CESR for analysing the significance of GAAP differences have not to be referred to for the application by issuers and auditors of the Level 2 framework on equivalence (see following point). A clear distinction has to be made between CESR technical assessment leading to the advice to the EC on equivalence and the subsequent application of this framework.

b CESR proposes a **principle-based framework for the application of these remedies** by third country issuers and for the assurance expected from the auditor on the proper application of these remedies. CESR also proposes to consider this framework as additional Level 2 measures of the Transparency and Prospectus legislations in the area of GAAP equivalence.

c CESR considers it crucial to have an **early warning mechanism** in place in due time for considering the changes to IAS/IFRS, the changes to third country GAAP and any other elements having an impact on the assessment of GAAP equivalence, in order to make relevant proposals to EU legislative bodies, for upgrade of the Level 2 list of significant GAAP differences and remedies. At this stage, CESR believes that a first review should take place at least for January 2007(end of transitional period), for considering GAAP developments that

will have effectively taken place since 1st January 2005 (date of reference of the present assessment pursuant to the EC mandate).

71. On this basis, the following sections are
- Section 2: the technical assessment as followed by CESR
- Section 3: the proposed Level 2 measures implementing, as regards equivalence of financial reporting standards of Canada, Japan and the US, the Transparency Directives and the Prospectus Directive and Regulation
- Section 4: detailed tables presenting CESR's technical analysis of major differences between Canadian GAAP, Japanese GAAP, US GAAP and IFRS. This section also includes a review of general principles of third Country GAAP and a summary of indications received about expected changes in the three third countries GAAP after 1st January 2005.

Section 2 - CESR assessment of GAAP equivalence

72. The approach followed by CESR was first to collect information on technical differences between third country GAAP and IFRS. An essential source of information has been the responses received from standard setters in the third countries to CESR questionnaires. Due to their size, these responses have not been physically attached to this report. They are incorporated by reference to this report and are available on CESR website (section <Operational Groups – Equivalence>). CESR has also considered additional existing publicly available literature on comparisons of GAAPs with IFRS (see footnote 13).

73. The degree of details of the technical differences as presented by the standard setters in the three countries varied. Where necessary, CESR has used additional sources in order to achieve a consistent approach in the assessment of the significant differences for all three GAAPs. For the sake of consistency and for facilitating the identification of the issues, CESR has also endeavoured to standardise the drafting in the description of these differences. Accounting standards are often complex and include numerous specific provisions, conditions… which have not all been reflected in this paper considering the context of the exercise and obvious practical limitations. For more complete information on GAAP and GAAP comparisons, it should be first referred to the responses received by CESR from third countries standard setters.

74. In addition, CESR has also considered the nature and consequences of the identified technical differences. This analysis has been made progressively at different levels. Technical differences have been considered in isolation (item by item), then standard by standard, and finally GAAP by GAAP, i.e. following a bottom-up approach.

75. In its judgemental exercise, CESR has consistently assessed whether information conveyed by financial statements prepared on the basis of third country GAAP enables investors to take similar decisions (as if they were provided with IFRS financial statements). This implies consideration of potential efforts (i.e. cost) that investors would have to make for obtaining reliable, comparable and understandable financial information because the primary financial statements are prepared under a third country GAAP without additional remedies such as disclosures, reconciliations or even complete restatements.

76. As indicated in the Concept paper, a basic assumption for assessing the equivalence is to consider that investors on European markets will have a reasonable knowledge of both IAS/IFRS. CESR also assumes that rational investors in securities of third country issuers will have a reasonable knowledge of reporting environment of considered third countries as the process of interpretation and application of accounting standards will not yield equivalence unless those who interpreted and apply the standards have appropriate expertise and judgement.

77. As a result of this approach, CESR believes that a list of major differences for each GAAP can be provided, which is less detailed than the one derived from the responses received from third countries. A list of major differences is presented in Section 4of this Chapter, along with an explanation of the reasons why CESR concludes on whether the major difference is significant or not. Accordingly, this list presents the possible remedy applicable for GAAP differences that are

assessed as significant. Leading criteria for proposing to consider a GAAP difference as significant and deserving a remedy included

(i) consideration of whether the difference is commonly found today in practice or known today to be significant as such by the financial and audit community in Europe and in third countries, and

(ii) Consideration of whether the difference has value relevance in relation to the investors' decision making framework.

78. The level of granularity of any GAAP comparison could be more detailed than the list of differences presented in Section 2. The usefulness of a detailed analysis of GAAP differences would not be justified in the framework of the mandate on equivalence. The cost of such a detailed analysis and its continuous updating would probably outweigh the benefits that can be expected.

79. The EC mandate clearly required CESR to perform "A global and holistic assessment of the quality of the financial information provided by the accounting system" and indicated that "The assessment should focus only on the significant differences between IAS/IFRS as endorsed at EU level and the third country GAAP in question".

80. On this basis CESR defined the equivalence as not being identical but instead what is necessary for enabling investors to take similar investment decision. As evidenced by external economic analysis[10], markets respond to accounting differences in sophisticated ways, which means that all accounting differences do not necessarily need to be eliminated because investors and markets do not reflect in the same way all differences.

81. There might be cases where identical principles for recognition and measurement of a defined operation could be sufficient if it is supplemented by disclosure on hypothesis and differences in detailed calculation methods between one GAAP and IFRS.

82. In an equivalence approach it is essential to focus on accounting differences that would imply additional efforts (costs) for investors in terms of (i) having an information (ii) understanding the information and (iii) comparing the trend or message conveyed by that information. It is also essential to avoid information asymmetry between investors who could obtain a better understanding of the financial position and results of companies because they have knowledge and understanding of accounting differences.

83. On this basis, there will inevitably be differences between the list of significant differences proposed by CESR and the list of items set out on the agenda for discussion on the wider matter of convergence of accounting standards. It is important for the reader to keep in mind that convergence projects and equivalence have different philosophical starting points, different objectives and different timeframes for application.

84. It is often acknowledged that inappropriate accounting treatments cannot be soothed by additional disclosures. This principle is fundamental for ensuring a proper and consistent application of accounting standards within one given legal framework. However, it should be reminded that CESR is not mandated to ascertain that any GAAP is better than any other, but to compare third country GAAP with IFRS as endorsed in the EU. International convergence towards one single set of high quality global standards implies that discussions take place as to which accounting treatment is more appropriate, but this is not the purpose of CESR's advice which provides no prejudgement for GAAP convergence solutions.

85. The technical assessment covered the international standards (IAS/IFRS) and interpretations (SIC/IFRIC) applicable to consolidated annual and interim financial statements, as endorsed by the European Union as at 1st January 2005. A list of the standards and interpretations considered is included in annex 4. Assessment of equivalence to SIC/IFRIC interpretations has not been performed

[10] Leuz, C. (2003), "IAS versus US GAAP: Information Assymetry-Based Evidence from Germany's New Market", Journal of Accounting Research. Leuz, C. and R. Verrechia (2000), "The Economic Consequences of Increased Disclosure", Journal of Accounting Research. Pownall, G. and Schipper, K (1999). 'Implications of Accounting research for the SEC's consideration of International Accounting Standards for U.S. securities offerings'.

separately (as shown in section 2), but considered in connection with the assessment of the standards to which these interpretations relate.

86. In the questionnaires sent to the third countries, CESR asked for a description of the third country General Accounting Accepted Principles (GAAP). The purpose was to identify the financial reporting standards that are legally enforceable in these countries (as at 1st January 2005), and which relate to the topics covered by the international standards and interpretations considered (see previous paragraph). **Annex 5** to this paper sets out a list of the enforceable reporting standards in Canada, Japan and USA.

87. Since some of the third country standards to be considered have effective dates later than the inception of the EU's decision process on equivalence, there are no commonly known practices or actual experiences on how differences will affect investors' decisions. The same counts for some more recent endorsed standards of IFRS

Section 3 – CESR advice on equivalence

A. Global and holistic assessment

88. CESR's advice is that the Generally Accepted Accounting Principles (GAAP) in the US, Canada and Japan (together the "third-countries"), each taken as a whole, are equivalent to International Financial Reporting Standards (IFRS), subject to the following remedies corresponding a list of GAAP differences that CESR proposes to consider as significant:

- That companies which have subsidiaries such as Qualifying Special Purpose Entities (SPEs) which are not consolidated for third country GAAP purposes, but are required to be consolidated for the purposes of IFRS, report a pro-forma balance sheet and profit and loss account on their local GAAP basis, but including the unconsolidated subsidiaries .

- That companies reporting under Japanese GAAP which have either accounted for mergers by the pooling of interest method and/or have consolidated subsidiaries on the basis of GAAPs which are not consistent with either IFRS or any of the third country GAAPs, report a pro-forma balance sheet and profit and loss account on the basis of IFRS covering business combinations and consistent accounting policies, respectively.

- That Japanese and US third country issuers adopt accounting policies for the expensing of stock options on a basis equivalent (i.e. not necessarily identical) to IFRS, for implementation on or before 1 January 2007. We understand that Japan is considering proposals to adopt such a standard according to this timetable and that the US has recently adopted such standard that will in most cases be applicable as from 2006.

- That in respect of certain specified IFRS and if applicable, in addition to the above mentioned remedies, there be additional disclosures of sometimes a descriptive nature and sometimes a quantitative nature.

89. A detailed list of the GAAP differences that CESR proposes to consider as significant is included in the following point, along with the corresponding required remedy (see infra point C for the definition of remedies).

90. As indicated in the Concept Paper, general principles of third country GAAP have also been compared with IAS/IFRS general principles. Indications are provided in this regard in section 4 of this Chapter for each third country GAAP, after the detailed tables setting out the GAAP differences.

B. List of significant GAAP differences and corresponding remedies

	Canadian GAAP	Japanese GAAP	US GAAP
DISCLOSURE A	• Share Based Payments (IFRS 2) – current standard • Minority interest at historical cost (IFRS 3) • Step acquisition (IFRS 3) • Employee Benefits (IAS 19) • Reversal of impairment (IAS 36) • Decommissioning costs (IAS 37) • Investment Property (IAS 40)	• Share Based Payments (IFRS 2) – future standard ED 3 Japanese GAAP • Minority interest at historical cost (IFRS 3) • Step acquisition (IFRS 3) • Catastrophic provisions (IFRS 4) • Construction Contracts (IAS 11) • Non performing Loans (IAS 12 & 30) , except if disclosure is already provided • Costs for Assets retirement Obligation (IAS 16) • Employee Benefits (IAS 19) • Translation of goodwill (IAS 21) • Fair Value of derivatives (IAS 32) • Reversal of impairment (IAS 36) • Decommissioning costs (IAS 37) • Investment Property (IAS 40)	• Share Based Payments (IFRS 2) – SFAS 123 R • Minority interest at historical cost (IFRS 3) • Step acquisition (IFRS 3) • Replacement's costs (IAS 16) • Employee Benefits (IAS 19) • Reversal of impairment (IAS 36) • Decommissioning costs (IAS 37) • Investment Property (IAS 40)
DISCLOSURE B	• Date of exchange (IFRS 3) • Negative goodwill (IFRS 3) • Use of LIFO (IAS 2) • Impairment Test - non discounted future cash flows (IAS 36) • Agriculture (IAS 41)	• Share Based Payments (IFRS 2) – current standard • Date of exchange (IFRS 3) • Acquired R&D (IFRS 3) • Negative goodwill (IFRS 3) • Use of LIFO & cost method (IAS 2) • Uniformity of accounting policies (IAS 28) • Impairment Test - non discounted future cash flows (IAS 36) • Capitalisation of development costs (IAS 38) • Agriculture (IAS 41)	• Share Based Payments (IFRS 2) – current standard SFAS 123 • Date of exchange (IFRS 3) • Acquired R&D (IFRS 3) • Negative goodwill (IFRS 3) • Use of LIFO(IAS 2), except if disclosure is already provided • Uniformity of accounting policies (IAS 28) • Impairment Test - non discounted future cash flows (IAS 36) • Capitalisation of development costs (IAS 38) • Agriculture (IAS 41)
SUPLEMENTARY STATEMENTS	• Scope of consolidation (Definition of control- QSPE) (IAS 27)	• Pooling of interests (IFRS 3) • Scope of consolidation (Definition of control - QSPE) (IAS 27) • Uniformity of accounting policies (IAS 27)	• Scope of consolidation (Definition of control - QSPE) (IAS 27)
FUTURE WORK (O/S)	• Financial Instruments (IAS 39): possible Disclosure A	• Financial Instruments (IAS 39): possible Disclosure A	• Financial Instruments (IAS 39): possible Disclosure A

C. Framework for the application of remedies

91. This point sets out proposals for establishing a principle-based framework for the application by third country issuers of the remedies listed above. It also covers minimum audit requirements for the verification of the proper application of these remedies. These measures could be considered as mandatory requirements within the Level 2 measures under the Prospectus and Transparency legislation.

92. Being at this stage principle-based, this framework might need additional guidance that can be developed either on the basis of an additional mandate to CESR or through coordination of regulatory practices of CESR Members, at Level 3 of the Lamfalussy process. The later solution has the advantage of providing the necessary flexibility considering the important and quick changes that are expected to take place in the area of financial reporting over the next few years, and to benefit from experience acquired with application of IFRS in the EU. Whichever approach is adopted, application guidance will need to be consistent with the principle-based approach of this advice.

93. It should be reminded that the criteria referred to by CESR for analysing the significance of GAAP differences (section 2) are not expected to be referred to by issuers and auditors for the application of the proposed framework.

C1. Definition of remedies

General considerations

94. The Concept Paper sets out CESR's proposals as regards the hierarchy of possible remedies applicable in case a third country GAAP is not declared as fully equivalent. The Concept Paper proposed various remedies : disclosure, reconciliation or supplementary statements[11]

95. Academic researches (see footnote 11) suggest that differences in valuation as a result of standards do not necessarily result in differences in investor decision-making. Financial markets are fairly sophisticated in their response to financial statements and research supports that information disclosed is priced by investors. As a result, compared with reconciliation and restatement, there is a preference for disclosure as a remedy in some instances. In general, investors are able to price disclosed information correctly. The higher investor appreciation of reconciliations in relation to disclosures in many cases does not offset the additional costs incurred by companies to prepare such reconciliations. In addition to this, it is noted that in many cases companies' management do not manage their business based on reconciled figures but rather on their primary financial reporting GAAP. The resulting GAAP-reconciliations are based on a strictly technical procedure, often with minor relevance to management. This would than also lead to less relevant information to investors for their decisions making process. We have taken this into consideration for determining the method of suggested remedy.

96. In analysing remedies, one can look at aggregate comparability of net income and shareholders equity or at line item comparability. For the evaluation of the remedies in this advice, CESR looked at the line item adjustments and not to bottom line income or equity comparability with the assumption that line item adjustments in the profit and loss statements are of specific relevance to investor making decisions.

97. As a result of the technical assessment of equivalence of Canadian GAAP, Japanese GAAP and US GAAP, CESR concluded that possible remedies necessary for addressing outstanding significant issues are limited to Supplementary Statements and disclosures. CESR is not proposing any Reconciliation as a remedy in the case of Canadian GAAP, Japanese GAAP and US GAAP. Reconciliations remain however a potential remedy in the possible assessment of equivalence of other third country GAAP, if such assessment has to be delivered in the future.

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[11] CESR draws the attention to the fact that the Prospectus Regulation No 809/2004 does not provide for any remedy other than restatement for non-equivalence (see Annex 1, Item 1 of the Annex to the EC regulation, minimum disclosure requirements for the share Registration Document – schedule[11]). The possibility of having different remedies was however mentioned in the June 2004 mandate of the European Commission to CESR on Equivalence. The Commission might therefore consider whether changes to existing Prospectus Regulation are necessary for ensuring consistency between any legal requirement about equivalence and this Regulation.

The Transparency Directive does not provide an indication on possible remedies in case of non-equivalence. Nevertheless, CESR believes that the approach should be consistent under the two legislative measures, Prospectus and Transparency, in order to have similar financial reporting requirements for prospectus and periodic reporting (Transparency).

98. In this context, CESR felt it was necessary to develop further the description of Disclosures and Supplementary Statements for the purpose of a proper understanding of the appropriate remedies resulting from the equivalence assessment.

Definition of remedies

Additional disclosures

99. Additional disclosures are narrative explanations that fall into one of the following two categories:

a. **Disclosures A. Additional narrative and/or quantitative disclosures** augmenting the disclosures already provided pursuant to third country GAAP. They include elements such as
   - explanation of the relevant transaction(s) and event(s) and the method for accounting this(these) transaction(s) and event(s) under third country GAAP
   - indication of assumptions, valuation methods or hypothesis (e.g. economic data) used for the measurement and recognition of the transaction(s) and event(s) under third country GAAP
   - disclosure of fair value of assets when such information is not already provided pursuant to third country GAAP

   As CESR has not conducted an exhaustive review of disclosure requirements under third country GAAP (compared to IAS/IFRS disclosure requirements), some of these additional disclosures might already be included in the primary financial statements prepared under third country GAAP. In this case, the additional disclosures will not have to be repeated.

   Disclosures A are also relevant for situations where principles for recognition and measurement are broadly similar to IAS/IFRS principles and the difference is at the level of detail.

   For the sake of clarification, it must be underlined that Disclosures A do not imply any re-measurement of transaction(s) and event(s) on the basis of IFRS measurement provisions. They are an extension of disclosures provided under third country GAAP, with the purpose of allowing investors to fully understand the transaction(s) and event(s) and their accounting treatment under these GAAP, so as to reach a level of information that could be afforded under IFRS.

b. **Disclosure B. Quantitative indication of the impact of an event or transaction,** had this event or transaction been accounted for **following IAS/IFRS provisions.** Such quantification should provide the gross and net of tax effect of the difference on the profit and loss or on the shareholders' equity of the issuer, as applicable. The impact has to be presented with relevant accounting entries, as under IAS/IFRS.

Statements of Reconciliations

100. Statements of Reconciliation as remedies are defined in the paragraph 61 of the Concept Paper (see annex 3). Compared with Disclosure B as defined above, a statement of reconciliation would imply the presentation of an additional table showing the cumulated impact of transactions or events restated under IAS/IFRS, with a reconciliation of net income and equity from third country GAAP to IFRS. Where the number of Disclosure B is limited - as for Canadian, Japanese and US GAAP – a statement of reconciliation would be partial by nature. In CESR views, a partial reconciliation would not provide relevant additional information and would even lead to misleading information on the nature and extent of the reconciliation.

Supplementary statements

101. A Supplementary statement is required where the significant differences in measurement or recognition are complicated or numerous, or in cases where a required specific statement might not

be presented. It purposes to facilitate investors' understanding of the full implications of a significant difference in accounting standards.

102. Supplementary Statements are pro-forma statements, prepared and presented on the basis of third country GAAP accounting principles and of the issuer's primary financial statements, but including a limited restatement for taking account of one identified aspect of IFRS requirement that is not present of not fully applied under third country GAAP.

103. Supplementary Statements do not purport to present the financial position and results of the issuer as if all IAS/IFRS had been fully complied with. Indeed, they remain fundamentally third country GAAP statements, with the exception of amendments reflecting specific and limited IFRS requirements.

104. Supplementary statements will at least be presented in the form of condensed income statement, balance sheet and possibly cash flow statement and supported by the range of additional disclosures described above.

C2. Issuer's responsibility in the application of remedies

105. The need to apply these remedies on a company level should be judged by the issuers on the basis of whether they are material to the financial position of the company and so would be significant for the purposes of investors.

Relevance and materiality of significant differences for each issuer

106. All significant GAAP differences listed above will not necessarily be relevant or material for all reporting entities.

107. The significance of any difference between IFRS and third country GAAP to individual entities will vary depending on many factors including the specific industry an entity is in, its specific business operation, and the type of transactions that it enters into, the accounting policies it chooses and the materiality of the relevant items. The significant differences mentioned may therefore not be relevant or material for all individual reporting entity.

108. The judgement for the application of the remedy should be made by the management of the reporting entity.

109. Assessment of <u>relevance</u> is a matter of analysis of the factual elements (e.g. remedies relating to share-based payment accounting do not apply to issuers which did not enter in share-based payment transactions). CESR believes that in a principle-based approach, it is not necessary, yet appropriate, to give more guidance on the meaning of the term "relevant".

110. Assessment of <u>materiality</u> is more complex. For the sake of legal certainty in the EU, CESR believes that Level 2 measures on equivalence should include an ad hoc definition of materiality to be referred to by third country issuers for determining whether to present or not a given remedy. To this end, CESR proposes to be inspired by the definition of materiality of the paragraph 30 of the IAS Framework[12] as follows: *presentation of a remedy is material if its omission could influence the economic decisions of users taken on the basis of the financial statements; materiality depends on the size of the item judged in the particular circumstances of its omission.*

111. When a reporting entity concludes that remedies are not applicable, because they are not relevant or material, this should be stated explicitly.

Additional statement and disclosures

[12] This approach would have the advantage of maintaining some consistency at level of concepts with other financial reporting requirements in the EU.

112. One important consequence of the outcome-based approach CESR has taken to the equivalence assessment is that its advice does not intend to provide an exhaustive list of differences between third country GAAP and IFRS.

113. The list of significant GAAP differences provided for each third country GAAP refers, as indicated above, to the most commonly found situations. The list does not pretend to be exhaustive and remedies based on this list should not be seen as a mean to provide a full reconciliation between third country GAAP financial statements and IFRS financial statements. The reasons for this have largely been explained above and in the Concept Paper. Therefore, entities reporting under equivalent GAAP subject to remedies should be required to make a statement **indicating that remedies do not aim at providing an exhaustive reconciliation of information with IAS/IFRS**.

114. It cannot be excluded that, **in exceptional situation**, a third country issuer would not find in the advice, specific remedies applicable to **other GAAP differences** that appear in their specific case **due to** their particular **business, operations or financial situation**. For the sake of completeness of information given to investors, CESR proposes that, in addition to the remedies required for the identified significant differences, third country issuers provide **additional disclosures** in limited situations resulting from:

a. Transaction(s) or event(s) or accounting treatments that, under third country GAAP are considered as industry specific.

b. Other transaction(s) or event(s) giving rise to an unusual accounting outcome in the context of the application of third country GAAP.

115. So defined, it can actually be expected that these situations will be **exceptional** and will already be addressed by ad hoc disclosures in a reporting based on third country framework.

116. . In the absence of a prescribed remedy in situations as described, **management shall use its judgement in developing and applying a remedy that results in information that is relevant to the economic decision-making needs of users**. Applications of such remedies should result in information that is reliable, in that the remedies represent faithfully the additional information required, reflect the economic substance of transactions, other events and conditions, considering the requirements and guidance of IFRS and concepts used in this advise, dealing with similar and related issues.

117. It should be noted, for information, that enforcement of remedies by competent authorities will be an integral part of overall enforcement practice as applied to prospectuses and periodic financial reporting.

C3. Presentation of remedies by issuers

118. Remedies must always be **presented in a clear and comprehensive way**, using plain language.

119. Remedies can be integrated into third country financial statements **as a note to the financial statements or as a separate statement.** The second solution will be relevant for situations where the third country GAAP financial statements will have been prepared at a time when securities were not yet publicly offered on EU markets. In this case, remedies will be prepared a posteriori, for previous financial years. . When remedies are presented as a separate statement, this statement should be published systematically with the third country GAAP financial statements for all reporting purposes on EU financial markets (under Prospectus and Transparency frameworks).

120. Issuers should be requested to present applicable remedies **with each financial reporting** (annual and interim) published in accordance with Transparency Directive and Prospectus Regulation. Presentation should be consistent over time.

121. Considering the transitional provisions of the Prospectus and Transparency legislations (see annex 1), these level 2 measures on equivalence requirements, if adopted by the EC, will only apply as from 1st January 2007.

122. In the framework of the Transparency Directive, financial statements must include the information for the reported financial year (e.g. 2007) and at least one year of comparative information (e.g. 2006). In application of the previous paragraph, third countries issuers reporting on the basis of Canadian GAAP, Japanese GAAP or US GAAP would have to present remedies for these two financial years (e.g. 2007 and 2006).

123. Pursuant to Prospectus Regulation, equity issuers have to provide historical financial information covering the latest 3 financial years. In the example provided above, this would mean that third country issuers would be required to present remedies also for the third year (2005 in the example). CESR proposes that an exemption be introduced, limiting the requirements for presentation of remedies for the last 2 years only. Such an exemption would be similar to that granted to EU issuers regarding the presentation of IFRS financial statements, under article 35.2 of the Prospectus Regulation.

124. Remedies, in particular disclosure B and supplementary statements, should be applied to all relevant and material present and past transactions and events accounted for in the financial statements of the reporting entity, consistently with the principles stated by IFRS1, First-time Adoption of International Financial Reporting Standards. That means that third-country issuers would also obtain an exemption to the requirement to prepare and present remedies for past transactions[13] that would not have to be restated to IFRS if the reporting entity would be an IFRS reporting entity. Reference is here made to the IFRS1 principles only, as this standard is, as such not applicable to third country issuers reporting under third country GAAP. However, investors will need to have a clear knowledge as to whether remedies are applied retrospectively or not. Therefore, issuers should provide the disclosures required by IFRS as to how exemptions are used.

125. As the application of IFRS in the EU is focused on consolidated financial statements, this evaluation is primarily focused on GAAP aspects related to these consolidated financial statements. It should however be noted that for some investor making decisions, the separate entity accounts do matter, specifically in relation to dividend payouts, which can be considered important information to investors. In this regard, it is referred to the separate CESR's advice on possible implementing measures of the Transparency Directive which has been delivered to the European Commission at the same time as this paper (ref CESR/05-xxx; see more specifically Chapter yyy, section z).

126. Specific attention is to be placed on the aspects of interim financial statements. Indeed, reliance of investors on the relevance of interim information is an essential element in the decision making process. CESR would like to highlight that all identified remedies should also be applicable to interim financial statements provided, in the sense that, when a remedy on a specific item is required, that remedy should also be applied with providing interim financial statements. This is supported by the fact that, pursuant to article 23 of the Transparency Directive, third country issuers are subject to equivalent financial reporting duties as for EU issuers and this advice is related to the equivalence of financial reporting standards.

C4. Auditing aspects

127. In CESR's approach, it is assumed that reporting entities will continue to publish their full financial statements in accordance with third country GAAP, but that these should be supplemented with additional information.

128. CESR advises that auditor's involvement should not be limited to the primary financial statements of third country issuers as prepared under third country GAAP. For ensuring investors' confidence on equivalence of financial information, it is important that auditors be required to express an opinion also on the remedies.

[13] Accounted for under third country GAAP in the financial statements of the reporting entity.

129. CESR proposes that third country issuers should obtain confirmation from their auditors that remedies have been prepared and presented properly, in compliance with the framework set out above.

130. The auditor's opinion on the financial statements and on the remedies will possibly be delivered through two audit reports, especially when remedies are not included in the third country GAAP financial statements (see paragraph 117). It is not excluded that, even when only one audit report is delivered, the auditor might have to present two separate audit opinions (one related to the third country GAAP financial statements and one related to the remedies).

131. CESR is aware that auditing guidance will need to be developed on a timely basis, for determining the nature of the audit/review procedure necessary, the nature of the auditor's expected opinion and the level of expected assurance.

C5. Early warning mechanisms and changes to third country GAAP after 1st January 2005

132. CESR's mandate is to assess GAAP **equivalence as per 1 January 2005**, although the equivalence requirements in the Prospectus Directive and the Transparency Directive allow non-EU listed entities to use their national GAAP until 1st January 2007.

133. CESR asked third countries whether there are additional or different final standards whose dates of application would be after 1st January 2005 and whether there are other changes in GAAP expected to take place before 1st January 2007. It comes out of the responses received that important standards changes have indeed been adopted or are in the process of being adopted, but with date of application that is after 1st January 2005. There are also numerous projects underway, notably in view of promoting convergence with IAS/IFRS. Responses received from third countries on these aspects are incorporated in section 2, in connection with the assessment of each third country GAAP (after the detailed tables setting out the GAAP differences).

134. CESR concluded that consideration of these elements was necessary for developing a technical advice that offers well informed and relevant conclusions, especially considering that any equivalency EU requirement will only impact financial years starting on or after 1st January 2007. In conformity with the EC mandate, the technical differences have been identified on the basis of standards applicable as from 1st January 2005, but when it is clear enough that there will be a new or modified standard applicable at the latest by 1st January 2007, this is mentioned in the list of GAAP differences and considered as part of the global and holistic assessment. Other potential standards' changes that are still under consideration or discussion were not considered for reaching the conclusions mentioned above; they have been mentioned in section 4 for information.

135. CESR considers it crucial to have an **early warning mechanism** in place in due time for considering the changes to IAS/IFRS, the changes to third country GAAP and any other elements having an impact on the assessment of GAAP equivalence, in order to make relevant proposals to EU legislative bodies, for upgrade of the Level 2 list of significant GAAP differences and remedies.

136. CESR's advice on the early warning mechanism was already included in the Concept Paper on Equivalence (see paragraphs 71 and following of the Concept Paper, ref CESR/04-509), advising that this mechanism could take the form of a mandate given to an existing or newly created body, appropriately funded and accountable for this task. Alternatively, Standards Setters concerned might inform the European Commission on an annual or biannual basis whether new standards or interpretations issued by them are diverging or converging.

137. At this stage, CESR believes that a **first review of the list of significant GAAP differences should take place at least for January 2007** (end of transitional period), for considering GAAP developments that will have effectively taken place since 1st January 2005 (date of reference of the present assessment pursuant to the EC mandate). The first result of this re-assessment will probably be that

several significant differences (and subsequently the remedies) will disappear as a result of standards changes[14].

138. Specifically in relation to foreseen changes in IAS 39, Financial Instruments: Recognition and Measurement, and the EU carve-out of the fair value option and interest margin hedging aspects, CESR feels that further investigation is required once a stable position is reached (changes towards 2007 should be taken into consideration).

139. It should be mentioned that CESR has not looked at ED7, Financial Instruments: Disclosure, and has therefore not considered the impact of this future standard on the assessment of equivalence.

SECTION 4 – TECHNICAL ASSESSMENT OF GAAP EQUIVALENCE

140. The tables presented set out the lists of major differences between Canadian, Japanese and US GAAP and IAS/IFRS as of 1st January 2005, together with an analysis of the significance of these differences and indication of remedies for significant differences. The order of presentation of the differences is based on the order of the IFRS/IAS and not on any order of importance.

141. The following tables must be read in connection with all indications provided in the previous sections and in CESR Concept Paper regarding the methodology followed, the assessment criteria used and the meaning of the terminology used.

A. CANADIAN GAAP

142. The approach followed by CESR was first to collect information on technical differences between Canadian GAAP and IFRS. An essential source of information has been the response received from the Accounting Standards Board of Canada (ACSB). Due to its size, this response has not been appended to this report. It is incorporated by reference to this report and is available on CESR website. CESR has also considered additional existing publicly available literature on comparisons of GAAP with IFRS.

143. On the basis of this information, tables summarising the major technical differences identified have been prepared.

[14] It should be noted that future standards changes will have an impact on requirements for remedies only if they become effective at the latest as from 1st January 2007 and are applied retrospectively. Otherwise, remedies' requirements might need to remain for previous transactions or events still treated on the basis of an accounting policy declared as significantly different from IFRS.

CESR

CANADIAN GAAP			
Standard	Description of issue	Assessment of significance	Remedy
IFRS 1	**A.** IFRS requires full retrospective application of all IFRS effective at the reporting date for an entity's first IFRS financial statements, with some optional exemptions and limited mandatory exceptions. Individual Canadian standards specify treatment for first-time adoption of those standards. There is no Canadian standard providing exceptions to the specified basis of application when a new basis of accounting is applied for the first time.	**A.** Third country issuers using Canadian GAAP will not have changed an accounting framework to the extent addressed by IFRS 1 on first-time adoption of IFRS.	**A.** Not applicable
IFRS 2	Share Based Payments **A.** Canadian GAAP requires expensing for stock options on a similar basis to IFRS 2. There are several differences of detail between the standards as outlined in the response from AcSB.	**A.** Whilst there are differences in detail between Canadian GAAP and IFRS 2, both standards have the objective of requiring entities to reflect in profit and loss and financial position the effects of share based payment transactions including expenses associated with transactions in which share options are granted to employees (IFRS 2.1). The differences between the two standards are at the level of detail, or reflect differing national practice. Investors will be expecting the quantum of stock option expense to vary depending on assumptions made by management, and will be looking for disclosures to enable them to understand the basis of the expense that has been recognised. On that basis, we can assume that the difference in detail will not affect investors' decision making as long as there is adequate disclosure of the underlying assumptions.	**A.** Remaining differences between Canadian GAAP and IFRS are considered not significant. However, to the extent that Canadian GAAP does not provide information for investors to be able to compare the basis of the expense, disclosure A is required
IFRS 3	Business Combinations **A. Minority interest** must be recognised as the minority's pro rata portion of the carrying amount of the net assets in the financial statements of the acquired. This treatment is expected to change as a result of the proposals on business combination accounting to published soon by the IASB, the	The objectives of Canadian GAAP and IASs are the same – i.e. all business combinations should be accounted for by applying the purchase method. **A.** Minority interest under IASs is measured at fair value but under Canadian GAAP it is at historical cost.	**A.** Disclosure A

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CANADIAN GAAP			
Standard	Description of issue	Assessment of significance	Remedy
	FSAB and the AcSB. B. Under IFRS, the **acquisition date** is the date on which the acquirer effectively obtains control of the acquiree, however under Canadian GAAP it is required that the date of acquisition is either: (a) the date on which the net assets or equity interests are received and the consideration is given; or (b) the date of a written agreement, or a later date designated therein, which provides that control of the acquired entity is effectively transferred to the acquirer on that date, subject only to those conditions required to protect the interests of the parties involved. C. Under IFRS 3 **negative goodwill** is recognized immediately as a gain. Under Canadian GAAP it is initially allocated on a pro rata basis against the carrying amounts of certain acquired non-financial assets, with any excess recognized as an extraordinary gain. D. **Step acquisitions** under IFRS 3 require revaluation of previous interests at fair value at each acquisition date. Under Canadian GAAP previous interests are not revalued, resulting in an accumulation of fair values at different dates.	B. The different dates for determining fair value on exchange of shares can significantly change the carrying value of goodwill C. The underlying objectives of Canadian GAAP and IFRS are considered to be the same However the direct recognition of gain under US GAAP could lead to material differences having an impact on the investor making decision D. While the accounting is different, there is flexibility in accounting under IASs for step acquisitions and so it is not clear that investors would gain from any form of restatement as long as the basis of accounting is fully disclosed	B. Disclosure B C. Disclosure B D. Disclosure A
IFRS 4	Insurance Contracts IFRS 4 allows in most cases that the entity continues its local GAAP, which therefore may include Canadian GAAP.	IFRS 4 is an interim standard which allows a wide range of accounting treatments. It only prohibits very few accounting policies and none of them conflicts with Canadian GAAP. It is reasonable to assume that the reader of the financial statements understands the status of the interim standard and would not be affected by an entity following Canadian standards.	Not significant
IFRS 5	Non current assets held for Sale and Discontinued Operations The definition of discontinued operation is less restrictive under Canadian GAAP. A discontinued	IFRS 5 is the IASB's first project to converge with US GAAP with which	Not significant

CANADIAN GAAP			
Standard	**Description of issue**	**Assessment of significance**	**Remedy**
	operation may consist of a reportable segment, operating segment, reporting unit, subsidiary, asset group or operation without long-lived or other assets. The net amount of pre-tax and post-tax income or loss from discontinued operations is required to be disclosed on the face of the income statement under Canadian GAAP. IFRS does not require the same information to be presented, however it is not precluded.	Canadian GAAP is harmonised. The remaining differences are on points of detail, and it is reasonable to assume that they would not affect investors' decisions.	
IAS 1	Presentation of financial statements A. If refinancing is completed after the balance sheet date but before the date of issue of the financial statements then a **liability** can be **classified as non-current** under Canadian GAAP. The liability can also be classified as non-current if the lender has granted a 12-month waiver before the date of issue of the financial statements under Canadian GAAP.	A. These differences are addressed by disclosures required under post balance sheet event standards and should not affect the reader of the financial statements.	A. Not significant
IAS 2	Inventories **A.** Use of the **LIFO method** is permitted as an accounting policy choice under Canadian GAAP if it is the method that most clearly reflects periodic income. However, as the use of LIFO is not permitted for taxation purposes, it is rarely used by Canadian entities for accounting purposes. **B.** While impairment is not specifically addressed under Canadian GAAP, entities generally carry inventory at the lower of cost and net realisable value. Canadian GAAP does not prohibit **reversals of write-downs**; it is silent on this issue. A literal application of the commonly used "lower of cost and market" method would result in the	**A.** The difference in use of LIFO is well known to readers of financial statements. However, considering its potential impact on financial statements, appropriate disclosures (of FIFO or other allowed method under IFRS) should be provided. **B.** There is no prohibition to reversals of write downs to net realisable value under Canadian GAAP. Inventory is generally expected to turn over in the subsequent period; therefore this difference is not expected to have any significant impact.	**A.** Disclosure B **B.** Not significant

CANADIAN GAAP			
Standard	Description of issue	Assessment of significance	Remedy
	reversal of a write-down if market values rise above cost following a write-down. NB: the AcSB is presently undertaking a project to replace Canadian Standard with a new standard converged with IAS 2		
IAS 7	Cash Flow Statements **A.** No cash flow statement is required from **investment companies with highly liquid investments** measured at fair value, having little or no debt and providing a statement of changes in net assets.	**A.** This difference is considered not to be significant, as cash flow statements do not provide useful information about the assets and liabilities of investment companies	**A.** Not significant
IAS 8	Accounting policies, changes in accounting estimates and errors **A.** IAS requires the **disclosure of the reason for a change in accounting policy** and **disclosure of the effect of new standards** that have been issued but are not yet effective. Canadian GAAP does not contain similar requirements. However, Canadian regulatory requirements for management's discussion and analysis (MD&A) of financial condition and operating results do require such disclosures. This disclosure has also been proposed in forthcoming Canadian standards on accounting changes.	**A.** Not significant as same disclosure is required by Canadian regulatory requirements for MD&A.	**A.** Not significant
IAS 11	Construction contracts **A.** When the percentage of completion cannot be determined, Canadian GAAP requires use of the **completed contract method;** IASs require the cost recovery method	**A.** The completed contract method applies when revenues are doubtful. It is not clear whether this will give materially different answers in those circumstances, however the uncertainties surrounding revenues will need to be disclosed, providing the investors adequate information for their decision making.	**A.** Not significant
IAS 12	Income taxes **A. Various differences in detail** exist between Canadian GAAP and IFRS as mentioned in the detailed response from AcSB. Basics objectives of the standards are the same in both standards.	**A.** Differences in calculation of tax and deferred tax charges to some extent reflect local tax practice in Canada. Reconciliations of the differences are unlikely to change investors' decisions as long as the basis of the tax charge is fully explained in the notes to the accounts	**A.** Not significant
IAS 14	Segment reporting IAS 14 requires that risks and	As the segment reporting in Canadian	Not significant

CANADIAN GAAP			
Standard	Description of issue	Assessment of significance	Remedy
	returns be considered and require either a business or geographical basis as the primary basis and the other as secondary and Canadian GAAP require that segments should be determined based on the way that management makes operating decisions and assesses performance	GAAP must reflect the actual managerial structure of the business we feel that investors would be provided with sufficient information in Canadian GAAP for investment decision-making, and therefore consider this not to be a significant difference. IAS itself will re-examine this issue in its convergence project with US GAAP.	
IAS 16	Property, Plant and Equipment **A. Revaluation.** Canadian GAAP always requires historical cost and not fair value whereas IAS 16 permits the use of revalued amounts. **B. Initial operating losses** incurred prior to an asset achieving planned performance are expensed under IAS. Canadian GAAP provides that an entity may defer expenditure during the pre-operating period upon specific conditions.	**A.** A Canadian entity would be within the IAS available option. **B.** If an entity defers expenditure during the pre-operating period, the related amount should be visible on the balance sheet as a specific item (accompanied with as hoc disclosures in the notes). Therefore, this should not give rise to a significant difference for investor's decision making.	**A.** Not significant **B.** Not significant
IAS 17	Leases IAS 17 does not recognise leveraged leases. Canadian GAAP has specific recognition and presentation rules. Under 17 third party guarantees are included in minimum lease payments. They are excluded under Canadian GAAP. Finance leases under IAS 17 are determined according to the substance of the transaction under IAS 17 but according to numerical rules under Canadian GAAP. Under IAS 17 the present value of the minimum lease payments is determined by the lower of the incremental borrowing rate and the interest rate implicit in the lease. There are also differing treatments of sale or leasebacks, disclosure of lease maturities, and leasehold interest in land.	Both GAAP have the same objective – to require leases that effectively transfer ownership of assets (usually called finance leases) to be capitalised. Differences of detail, between the standards may give rise to different treatment of the same leases under the two GAAP, but a reasonably knowledgeable investor could be expected to understand that the lease terms will be different if the standards changed.	Not significant

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CANADIAN GAAP			
Standard	Description of issue	Assessment of significance	Remedy
IAS 18	Revenue **A.** There are **some differences of detail** between IAS 18 and Canadian GAAP on timing of revenue recognition. Canadian GAAP includes more detail transaction and issue specific guidance.	**A.** General principles are consistent between the two GAAPs, but there are some differences of detail. Unlikely to affect investors' decision making as long as there is full disclosure of accounting policies and sufficient information provided under Canadian GAAP for investor making decisions.	**A.** Not significant
IAS 19	Employee benefits **A.** Both frameworks require the cost of providing these benefits to be recognised on a systematic and rational basis over the period during which employees provide services to the entity. Both frameworks separate pension plans into defined contribution plans and defined benefit plans, and define them in similar ways. There are however **various differences in the detailed requirements**(as further described in the detailed responses received).	**A.** Both GAAP has the same objectives and follows the same principles. While there are differences, the fact that there are four broad options for defined benefit schemes available under IAS make it difficult to determine which version would be used as the basis for reconciliation, and against that background a reconciliation would not help investors' decisions.	**A.** Disclosure A
IAS 20	Accounting for government grants and disclosure of government assistance No major differences identified.	-	-
IAS 21	The effects of changes in foreign exchange rates No major differences identified.	-	-
IAS 23	Borrowing costs Canadian GAAP does not specify accounting treatments for borrowing costs nor do they specify circumstances in which borrowing cots may be capitalised. Disclosures are made when costs are capitalised.	IAS 23 has two options – to capitalise or expense – with all of the detail describing the basis on which interest can be capitalised. Given the options available under IAS 23 it is reasonable to assume that either treatment would be unlikely to affect the reader of the financial statements as long as there is adequate disclosure of the accounting chosen.	Not significant
IAS 24	Related party disclosures Under Canadian GAAP, there is no requirement to disclose **control relationships** where there have been no transactions between the related parties, nor does it require disclosure of the	Information on related party transactions is by nature relevant for investors and such disclosure can be considered significant. However, the information is expected to be provided elsewhere or will be identifiable from	Not significant

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CANADIAN GAAP			
Standard	Description of issue	Assessment of significance	Remedy
	entity's parent and its ultimate controlling entity.	notifications to be made pursuant to EU Transparency requirements on major shareholdings.	
IAS 27	<u>Consolidated and separate financial statements</u> **A. Scope of consolidation.** Under IAS 27 and SIC 12, the scope of consolidation is determined by reference to the principle of control defined in general terms as the power to govern the financial and operating policies of an entity so as to obtain benefits from its activities (IAS 27.4). Information received from the standard setter and through the consultation indicate that the issue of consolidation of Special Purpose Entities (SPE) in the US is very complex, being based on principles combined with additional guidance that altogether make the third country framework close to IFRS in most cases. The status of **Qualifying SPEs** (QSPEs) is slightly different as being essentially addressed in connection with provisions on derecognition of assets. Exemptions provided in this context for QSPEs could lead, res sic stantibus, to their possible non-inclusion in consolidated balance sheet and income statements. **B.** Canadian GAAP places no specific limit on the extent of **differences between the reporting dates** of a parent and subsidiary, but does require the adjustment of the subsidiary's reported financial information for significant intervening transactions.	 **A.** Experience shows that definition of scope of consolidation is an issue that has far reaching consequences on financial position and results. It could be a significant difference if entities considered as subsidiaries under IAS 27 are excluded from consolidation. The potential impact of differences – when the entity has material assets, liabilities or operations - requires supplementary statements in these exceptional cases, because additional disclosure is not sufficient to enable investors to figure out the pervasive impact of scope exclusion (when QSPE are material – see section 3, point c) **B.** The result is substantially the same as under IAS 27	 **A.** Supplementary Statement for QSPE **B.** -
IAS 28	<u>Investments in Associates</u> **A. Uniformity of accounting policies.** Canadian GAAP requires the investor to determine its equity in the net assets and net income of the investee on the same basis as if it were consolidating the investee.	 **A.** No difference	 **A.** -

CANADIAN GAAP			
Standard	Description of issue	Assessment of significance	Remedy
	Differences in policies between parent company and associates would be acceptable only on grounds of immateriality **B.** Accounting for investments in associates in **parent-company financial statements** –equity method is required under Canadian GAAP	 **B.** As mentioned in paragraph 83 of this draft advice, CESR is primarily concerned with consolidated accounts.	 **B.** Not applicable
IAS 29	Financial reporting in hyperinflationary economics There is no Canadian GAAP guidance on adjustments of an entity that operates in a hyperinflationary economy prior to translating. In addition, an entity translates subsidiary f/s using its currency as the functional currency rather than the subsidiary's local currency.	 For the purpose of our holistic analysis, it is considered not be a significant issue. A knowledgeable investor investigating the background of the company and looking at regional segment reporting aspects would probably be aware of these differences if applicable.	 Not significant
IAS 30	Disclosure in the financial statements of banks and similar financial institutions A. As CESR assessment did not deal with specific industry segments, this standard has not been included in the scope of this exercise..	-	-
IAS 31	Interests in joint ventures **A.** Interest in joint ventures under Canadian GAAP must be accounted for using proportionate consolidation (use of **equity method is not permitted)**. While the use of equity method is allowed, proportionate method is the recommended method under IAS.	 **A.** The method used under Canadian GAAP is an option under IAS, and therefore there is no difference between the two standards.	 **A.** Not significant
IAS 32	Financial Instruments No major difference identified	 No difference	-

CANADIAN GAAP			
Standard	Description of issue	Assessment of significance	Remedy
IAS 33	Earnings per share **Various differences of detail** in the calculation of EPS.	 The objectives of Canadian GAAP and IAS 33 are the same. If we accept some differences between the two GAAPs as being insignificant even though they affect EPS then we are effectively saying that differences in the calculation of EPS are unlikely to be significant.	 Not significant
IAS 34	Interim reporting **A.** Canadian GAAP does not require preparation of separate fourth quarter interim statements. While Canadian GAAP does not require disclosure of significant changes in estimates made in the final interim period, current regulatory requirements call for entities to discuss and analyze fourth quarter events or items that have affected their financial condition, cash flows or results of operations, including year-end and other adjustments (amongst other items) in the MD&A accompanying the annual financial statements.	 **A.** Further discussion required, with specific reference to paragraph 95, in light of future developments regarding equivalence of reporting duties under the Transparency Directive	 **A.** Outstanding

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CANADIAN GAAP			
Standard	Description of issue	Assessment of significance	Remedy
IAS 36	Impairment of assets **A. Impairment test.** Impairments under Canadian GAAP are based firstly on a comparison of carrying amount to the expected future cash flows to be derived from an asset (or asset group) on an undiscounted basis. If the carrying amount is lower the asset (or asset group) is not impaired, if higher then impairment is measured by comparing the carrying amount to the fair value of the asset (or asset group). **B.** Under Canadian GAAP **goodwill** is **allocated to a reporting unit,** which is either an operating segment (as defined for segmental reporting purposes), or one organizational level below an operating segment. **C.** Subsequent **reversal of an impairment loss** is prohibited under Canadian GAAP	**A.** The different approaches to impairment could give rise to major differences that could change decisions **B.** Triggers for impairment of goodwill under both IASs and Canadian GAAP are highly subjective, and will give management a great deal of flexibility. In both cases, goodwill is likely to be deemed to be impaired only when there is major evidence of impairment. The differences are therefore unlikely to be significant in practice **C.** This difference could be significant and a disclosure could be required. The purpose of the disclosure is to allow investors to keep track of past recognised impairment provisions and of subsequent developments in the circumstances that led to impairment and that could warrant a reversal of the provision under IAS 36	**A.** Disclosure B **B.** Not significant **C.** Disclosure A
IAS 37	Provisions, contingent liabilities and contingent assets **A.** Similar criteria apply for the recognition of a loss contingency, however, the **definition of probable** as "likely" sets a higher threshold for recognition than "more likely than not" under IFRS. **B.** If no estimate in a range of estimates is more likely than any other then the **minimum amount** must be used; IAS 37 requires the mid point. Discounting is only permitted when the timing of the cash flows is fixed or determinable.	**A.** While there is a difference, as long as the element of the liability that is contingent (i.e. less than likely) is required to be sufficiently disclosed, investors should still be able to make similar decisions **B.** These are cases where the value of the provision cannot be estimated accurately, and a different basis of estimation is unlikely to materially affect decision making as long as the basis of the provision is fully disclosed	**A.** Not significant **B.** Not significant

CANADIAN GAAP			
Standard	**Description of issue**	**Assessment of significance**	**Remedy**
	C. Under Canadian GAAP an **exit or disposal plan**, by itself, does not create a present obligation to others for costs expected to be incurred under the plan. **D.** Measurement of **decommissioning provisions** – discount rates are not adjusted under Canadian GAAP	**C.** There are differences in the recognition of restructuring provisions, but disclosure should help investors make similar decisions **D.** These provisions are very large and long term. Investors will be most interested in the basis of calculation and their decision making should not be affected by differences in calculation as long as they are fully disclosed	**C.** Not significant **D.** Disclosure A
IAS 38	Intangible assets **A. Revaluation.** Intangibles assets are measured at cost under Canadian GAAP with no alternative treatment to record them at re-valued amounts.	**A.** A Canadian entity would be within the IAS option	**A.** Not significant
IAS 39	Financial Instruments **New rule effective fiscal years beg on or after October 1, 2006** requires all financial instruments including derivatives be included on the b/s and measured either at their fair values or in some circumstances at cost or amortised cost. This new Canadian standard is almost similar to IAS 39. On hedge accounting, current standards only say that hedge accounting is applied only when gains, losses, revenues and expenses on a hedging item would otherwise be recognized in income in a different period than gains, losses, revenues and expenses on the hedged item. New standards effective fiscal years beg on or after October 1, 2006 does specify how hedge accounting should be performed (ie: what the debits and credits are). Reversal of impairment is not permitted under Canadian GAAP whilst it is permitted under IFRS. Key differences that could affect investors decisions are • Derecognition of securitizations	Canadian GAAP and IFRS have the same objectives and both standards address issues that are highly complex. A reasonably knowledgeable investor might not detect specific issues. As the practical appliance of IAS 39 in Europe at the moment does not provide sufficient information on investor making decisions, CESR needs more information to determine whether the identified differences do in fact influence investors' decisions. However remedies in form of disclosures B can be expected. Reference is made to paragraph 138.	To be reconsidered later – possible Disclosure A.

CANADIAN GAAP			
Standard	Description of issue	Assessment of significance	Remedy
	• Reversal of impairments on equity investments		
IAS 40	Investment property **A.** Canadian GAAP does not permit investment property to be measured at **fair value**. A cost-based method of accounting is generally required. However, Section 4210 requires life insurance enterprises to use a moving average market value method to account for property held for investment.	**A.** Fair value information of investment properties is significant to investors	**A.** Disclosure A
IAS 41	Agriculture **A.** Agricultural assets are measured at **fair value** under IAS. While Canadian GAAP does not deal specifically with agricultural assets, the cost basis is used.	**A.** Fair value information could be of significance to the investor.	**A.** Disclosure B

(iii). Review of general principles

144. In its response to CESR questionnaire, the Accounting Standard Board of Canada (AcSB) has indicated that the Canadian conceptual framework, set out in Canadian Handbook Section 1000, "Financial Statement Concepts", is very similar to, and consistent with, the IASB Framework (the two frameworks were developed by the IASC and the AcSB's predecessor in consultation with each other). It also indicated that the development of Canadian financial reporting standards takes into account the four principal characteristics described in the CESR concept paper (understandability, relevance, reliability and comparability), as set out in Handbook Section 1000. Section 1100 also requires that these characteristics be taken into account in the application of Canadian GAAP.

145. Finally, the AcSB confirmed that, under Canadian GAAP, the objective of financial statements is to provide financial information that is useful to a range of users in making economic decisions

(iv). Changes to Canadian GAAP after 1st January 2005

146. In its response to CESR questionnaire, the Canadian Accounting Standards Board (AsCB) indicated that it is continuously developing new standards and amendments to existing standards.

147. As of the date of the response to CESR, the AcSB had:

- approved new standards on financial instruments that correspond generally to IAS 39, Financial Instruments: Recognition and Measurement. These standards may be applied to December 31, 2004 year-ends but will not be mandatorily applicable until fiscal years beginning on or after October 1, 2006.
- proposed amendments to current standards on non-monetary transactions, accounting changes, earnings per share and subsequent events. These amendments are designed to harmonize Canadian GAAP with US GAAP and IFRSs on issues being addressed by the FASB and IASB in their short-term convergence project.

The AcSB provided the following additional indications in its response to the public consultation on the draft advice:

- Amendments concerning non-monetary transactions will be issued on June 1st;
- Amendments concerning accounting changes are expected to be finalised in 2005 (subject to the FASB also completing its project;
- Amendments concerning earnings per share have been delayed because of delays in the corresponding US convergence project (timing is now uncertain)
- Responses to the current re-exposure draft of amendments on subsequent events could delay completion of that project.

It now appears that the changes on topics other than non-monetary transactions are unlikely to have mandatory effect until 2007 fiscal years. Work has recently begun on short-term convergence amendments to the income tax standard to converge with changes presently being considered by the IASB and the FASB.

- Discussed the developing FASB and IASB proposals on business combinations, with a view to adopting the harmonized standard expected to be finalized by the FASB and the IASB in 2005 or 2006. The AcSB has undertaken similar discussions on other joint IASB/FASB convergence projects, such as revenue recognition, performance reporting and insurance, and monitors such other such projects with a view to adopting internationally converged standards.
- Begun developing proposed standards on inventories and internally developed intangibles that are expected to make Canadian GAAP on these topics more consistent with IFRSs.
- Proposed a disclosure standard for rate-regulated operations for application in 2005, and agreed to develop a recognition and measurement standard for these operations.

148. These elements have been considered in the assessment following the principles indicated above in section 1, Chapter 1.

149. In addition, it should be signalled that, on 1 April 2005, The AcSB has issued an Invitation to Comment on its draft strategic plan, Accounting Standards in Canada: Future Directions. The draft plan includes the AcSB's proposal to follow separate strategies for public companies, private businesses, and not-for-profit organisations. Highlights:

- For **public companies**, the AcSB will direct its efforts primarily to participating in the movement toward the global convergence of accounting standards. "The best way to achieve the objective of a single set of globally accepted, high-quality accounting standards is to converge Canadian GAAP with International Financial Reporting Standards (IFRSs) over a transitional period, expected to be five years. At the end of that period, Canadian GAAP will cease to exist as a separate, distinct basis of financial reporting for public companies." The AcSB also acknowledges that US GAAP is an appropriate alternative when regulators and other competent authorities choose to permit its use.

- For **private businesses**, the AcSB will clarify that GAAP applies only to entities that have significant external users of their financial statements. For those entities, the AcSB will undertake a comprehensive examination of their financial reporting needs and determine the most appropriate model for meeting those needs.

- For **not-for-profit organisations**, the AcSB will continue to apply those elements of GAAP for profit-oriented enterprises that are applicable to their circumstances, and develop other standards dealing with the special circumstances of the not-for-profit sector.

B. JAPANESE GAAP

(ii). Significant GAAP differences between Japanese GAAP and IFRS

150. The approach followed by CESR was first to collect information on technical differences between Japanese GAAP and IFRS. An essential source of information has been the responses received from the Accounting Standards Board of Japan (ASBJ), The Japanese Business Federation Nippon Keidanren, The Financial Service Agency Government of Japan (JFSA) and The Japanese Institute of Certified Public Accountants (JICPA) to CESR questionnaires. Due to their size, these responses have not been appended to this report. They are incorporated by reference to this report and are available on CESR website. CESR has also considered additional existing publicly available literature on comparisons of GAAP with IFRS.

151. On the basis of this information, tables summarising the major technical differences identified have been prepared.

152. Japanese GAAP does not cover the topics Financial Reporting in Hyperinflationary Economics (IAS 29) and Agriculture (IAS 41), as included in the list of topics defined by CESR on the basis of the standards endorsed for use at EU level as from 1st January 2005, in the framework of the EC regulation No 1606/2002 of the European Parliament and of the Council of 19 July 2002 on the application of international accounting standards, and on the basis of subsequent endorsement regulations.

153. In Japan, the existence of a large amount of off-balance debts through the use of special entities ("paper companies or so called "Tobashi") was pointed out as one of the causes of the insolvability of the financial conditions of financial institutions and borrower companies in the 1990's, the so called 'non-performing loan problem". In response to the problem, development and improvement of Japanese accounting standards have contributed to ensure the stability of the financial system. Accounting standards improvements of tax effect accounting, consolidated financial statements and financial instruments specifically contributed to the improvements of past inappropriate accounting treatments. Due to large differences in the treatment of corporate accounting and tax accounting, in particular limited tax-deduction of provisions and write-offs in Japan, the amount of deferred tax assets increased. Recognition of deferred tax assets depends on the possibilities to generate future taxable income. Japanese regulators discussed this point from a banking supervision perspective recognizing the appropriateness for the banking regulatory authority to seek compression of deferred tax assets in accordance with banking regulatory standards and the need for proper treatment of capital adequacy regulation. This has resulted in the introduction of a transitional period after the achievement of reducing major banks' Non Performing Loans to an acceptable level by March 2005. We refer to Section 1 questioning whether IFRS as a benchmark would be appropriate for such specific circumstances.

JAPANESE GAAP			
Standard	Description of issue	Assessment of significance	Remedy
IFRS 1	IFRS requires full retrospective application of all IFRS effective at the reporting date for an entity's first IFRS financial statements, with some optional exemptions and limited mandatory exceptions. Individual Japanese GAAP standards specify treatment for first-time adoption of those standards. There is no Japanese GAAP standard providing exceptions to the specified basis of application	Third country issuers using Japanese GAAP will not have changed an accounting framework to the extent addressed by IFRS 1 on first-time adoption of IFRS.	Not applicable

JAPANESE GAAP			
Standard	Description of issue	Assessment of significance	Remedy
	when a new basis of accounting is applied for the first time.		
IFRS 2	Share based payments **A.** Currently, no standard that corresponds to IFRS 2 exists under Japanese GAAP. With **current Japanese GAAP,** compensation costs for share based payments are measured at an amount equal to the consideration received at grant date if any. No expense is usually recognised at a time when stock options are granted to employees. **B.** The Accounting Standards Board of Japan (ASBJ) issued an **Exposure Draft of Accounting Standard No.3, "Accounting Standards for Stock Options and others"** ("ED3"). The standard, effective for the fiscal years beginning on or after April 1, 2006, will take away many differences. Differences will remain as ED3 proposes to present stock options as "stock acquisition rights", classified as a mezzanine between liability and equity in the balance until exercised. ED3 covers equity-settled share-based payment transactions but does not cover cash-settled share-based payment transactions. Further ED3 proposes an exceptional treatment for unlisted companies, which cannot reliably estimate the fair value of their stock options, i.e. ED3 permits usage of intrinsic value instead.	**A.** The differences between the current practises of share-based payments in Japan can considered to be significantly different from IFRS for the purpose of equivalence. **B.** While there are differences in detail between Japanese GAAP ED 3 and IFRS 2, both standards have the objective of requiring entities to reflect in profit and loss and the effect of share based payment transactions including expenses associated with transactions in which share options are granted to employees. The differences between Japanese GAAP ED3 and IFRS 2 are at the level of detail, or reflect differing national practise (like treatment for unlisted companies). Basics are that share-based payments shall be measured at fair value and expensed at grant date. On that basis, we can assume that the difference in detail will not affect investors' decision making as long as there is adequate disclosure of the underlying assumptions	**A.** Current practise of share-based payments would require a remedy of Disclosure B. **B.** Remaining differences between Japanese GAAP ED3 and IFRS 2 are considered not significant. However, to the extent that Japanese GAAP does not provide information for investors to be able to compare the basis of the expense, Disclosure A should be required as a remedy.
IFRS 3	Business combinations **A.** Accounting treatments for business combinations of Japanese GAAP requires the purchase method application in principle; however, the **pooling-of-interest method** shall be required as an exception, when continuity of shareholders' interest in merging entities is assumed by criteria commonly referred as "mergers of equals".	**A.** The basics of accounting treatment for business combinations of Japanese GAAP and IFRS are the same. However the required application of pooling-of-interest method would create differences in the financial reporting, which by no means available to the investor could create comparable information on the financial position and performance of the merged entity For	**A.** Applying the pooling-of-interest by entities in those mentioned circumstances creates a significant difference that will affect probably all line items on the balance sheet and profit and loss statement. Those

JAPANESE GAAP			
Standard	Description of issue	Assessment of significance	Remedy
	The Japanese Delegation also orally indicated that this method is also required for the purpose of avoiding abuse for offsetting losses.	this reason, this difference is considered to be significant for the purpose of equivalence. It is important to notice that this use of the pooling method is only required in those specific circumstances that meet the criteria of "mergers of equals". We understand that this is expected to be applied in very rare circumstances.	circumstances would require Supplementary Statement.
	B. Under Japanese GAAP, **minority interest** can be measured the same way as IFRS <u>or</u> as the minority's portion of the pre-acquisition historical book value of the identifiable net assets acquired.	**B.** Measurement of the minority's portion under historical book value would be a difference that could affect investors' perceptions as the amounts cannot be derived from other information by investors, we identify this as a significant difference	**B.** Disclosure A
	C. Japanese GAAP requires **amortization of goodwill** on a straight-line basis within 20 years.	**C.** For investors' perception, we consider the amortization, in combination with the required impairment testing under Japanese GAAP, as comparable to IFRS, not to be a significant difference for the purpose of equivalence.	**C.** Not significant.
	D. Japanese GAAP recognises **negative goodwill** as a liability and amortised on a straight-line basis within 20 years.	**D.** Negative goodwill is immediately recognised in profit and loss under IFRS 3. This difference in accounting treatment creates in our view a significant difference affecting the investors' perceptions.	**D.** Disclosure B
	E. Step acquisitions under IFRS 3 require revaluation of previous interests at fair value at each acquisition date. Under Japanese GAAP previous interests are not revalued, resulting in an accumulation of fair values at different dates	**E.** While the accounting is different, there is flexibility in accounting under IASs for step acquisitions and so it is not clear that investors would gain from any form of restatement as long as the basis of accounting is fully disclosed	**E.** Disclosure A
	F. Date of exchange. Under Japanese GAAP shares issued as consideration are measured at their market price over a reasonable period of time (a few days) before the parties reach an agreement on the purchase price and the transaction is announced. Under IFRS 3 shares issued as consideration are measured at their fair value on the date of the exchange	**F.** The different dates for determining fair value on exchange of shares can significantly change the carrying value of goodwill	**F.** Disclosure B

JAPANESE GAAP			
Standard	Description of issue	Assessment of significance	Remedy
	transaction. G. Under IFRS 3, **in-process R&D** is recognized as an acquired intangible asset if it meets the definition of an intangible asset and its fair value can be measured reliably. If it is not recognized separately it is subsumed within goodwill. Under Japanese GAAP any portion of the cost of acquisition that is allocated to in-process R&D as part of purchase accounting is immediately expensed.	G. In process R&D is capitalised under IFRS but usually expensed under Japanese GAAP	G. Disclosure B
IFRS 4	<u>Insurance contracts</u> **A.** Japanese GAAP requires insurance companies to account for **catastrophe provisions**. The degree of disclosure in relation to this varies in practice. It is to be noted that the amount of catastrophe provisions is not systematically disclosed.	**A.** IFRS 4 is considered to be an interim standard that allows a wide range of accounting treatments. IFRS 4 allows in most cases that the entity continues its local GAAP. IFRS 4 prohibits is the recognition of catastrophe provisions as a liability. Requirement of such a provision for insurance companies under Japanese GAAP creates a major difference. In addition, the variety in practise of disclosing these provisions systematically creates further uncertainty for investors in order to make similar decisions. This difference can therefore be considered significant for the purpose of equivalence	**A.** Disclosure A
	B. Japanese GAAP does not specifically require **unbundling of deposit components** from insurance contract	**B.** Under IFRS unbundling is, depending on cases, permitted, required or prohibited. As unbundling refers to specific circumstances and leaves room for optional usage, we see that this difference will not be significant	**B.** Not significant
IFRS 5	<u>Non-current assets Held for Sale and Discontinued Operations</u> **A.** For Japanese GAAP, non-current assets are not classified as a category of held for sale, even if management intends to sell them. Impairment test is required for non-current assets to be sold; however, it is measured at fair value less cost to sell, if its value	**A.** There is no specific standard in Japanese GAAP for the presentation of discontinued operations and held-for-sale assets. It can be argued that since such assets will be subject to impairment testing, it will result in a similar treatment to IFRS. Information related to discontinued operations are expected to be	**A.** Not significant

JAPANESE GAAP			
Standard	**Description of issue**	**Assessment of significance**	**Remedy**
	is significantly declined and not recoverable. Depreciation will be continued, regardless of plans to sell Gains and losses on disposal of non-current assets are ordinarily recognised as separate line items of extraordinary gains or losses, and comparative figures are not restated.	disclosed in MD&A. For the purpose of equivalence, it is reasonable to assume that the identified difference would not affect investors' decisions.	
IAS 1	Presentation of financial statements A. **Classification of deferred tax assets and liabilities** as current / non-current under Japanese GAAP as opposed to non-current under IFRS Presentation of **exceptional items** in income statement is allowed under Japanese GAAP B. Neither details of **changes** in relation **to fair valuation** of financial instruments nor cumulative foreign exchange differences are required to be disclosed in the statement of changes in capital surplus or in other parts of the financial statements C. The information regarding **proposed dividends** is available in the separate financial statements of the parent company filed with the JFSA. D. **True and fair view override** is not allowed under Japanese GAAP	A. These differences should normally be easily identified and dealt with by knowledgeable investors, and these differences are therefore considered not to be significant for the purpose of equivalence. B. Details on fair valuation of assets are important to investors for investment making decisions and should be available under Japanese GAAP. Financial instruments are measured at fair value (or amortised cost for bonds) depending on category, under Japanese GAAP. Hence, changes should be accessible from the face of the balance sheet. C. As mentioned in paragraph 125 CESR is primarily concerned with consolidated accounts. Information of proposed dividends in available to investors in the separate financial statements in Japan. D. True and fair override in practice is only allowed in very rare circumstances under IFRS	A. Not significant B. Not significant C. Not significant D. Not significant
IAS 2	Inventories A. The **cost method** is allowed under Japanese GAAP as an alternative to lower of cost or market. This has been proposed as a possible area for convergence between ASBJ and IASB.	A. Although Japanese GAAP requires recognition of significant decline in value to be recognised, we feel that it is not appropriate to conclude that rules requiring write-downs when there is a permanent diminution will achieve the same results as the lower-of-cost and net realizable value. We conclude that this difference can be significant that it	A. Disclosure B

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Standard	Description of issue	Assessment of significance	Remedy
		would change the investors' decision, additional disclosures (of FIFO or other allowed method under IFRS) would than be required	
	B. Japanese GAAP permits the use of **LIFO** stock valuation. However, in practise the usage of LIFO for Japanese entities is relatively rare.	**B.** Use of LIFO is not permitted under IFRS. Usage of LIFO in the Japanese practise is rare. However, considering its potential impact on financial statements, appropriate disclosures should be provided.	**B.** Disclosure B
IAS 7	<u>Cash Flow Statement</u> **A.** There are differences in the manner in which certain items are classified under Japanese GAAP: - Cash advances and receipts under operating - Dividends paid under financing (allowed under IFRS)	**A.** These differences in the cash flow statement classifications are unlikely to change investors' decisions as all relevant information is available to the investor. Knowledgeable investors could reconcile the presented figures.	**A.** Not significant
IAS 8	<u>Accounting policies, changes in accounting estimates and errors</u> **A.** When an entity changes an accounting policy, it is presented prospectively, but the resulting effects by the changes in accounting policy shall be disclosed in the notes of the consolidated financial statements. Material prior period errors are adjusted through profit or losses as separate line items of extraordinary gains or losses in current year's consolidated income statements	**A.** As most of the relevant information is made available to the investor either as disclosure or separate presentation in the profit and loss statement, these differences are considered not to be significant.	**A.** Not significant
IAS 11	<u>Construction contracts</u> **A.** Contract revenue and costs associated with the short-term contracts are recognised when constructions are to be completed ("completed contract method"). Under the **long-term contracts,** both percentage of completion method and **completed construction method are permitted**. Many companies adopting the percentage of completion method do not apply it to all contracts but under certain conditions only, partially influenced by taxation rules.	**A.** The option available under Japanese GAAP for revenue recognition of contract revenue and expenses is not consistent with IFRS. A knowledgeable investor should be made able to recognise the difference in approach of the mentioned methods. For the purpose of equivalence, this different could be considered to be significant, for long term contracts and material differences due to influence of tax rules.	**A.** Disclosure A

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JAPANESE GAAP			
Standard	Description of issue	Assessment of significance	Remedy
IAS 12	Income taxes **A.** Deferred tax assets and liabilities related to inter-company profits or losses shall be initially measured at the seller' tax rates, and deferred until transferred assets are sold to unrelated third parties, without any need for adjustment of tax rates and reassessment of recoverability in computing the deferred tax assets at the balance sheet date.	**A.** Differences in calculation of tax and deferred tax charges to some extent reflect local tax practice. Reconciliations of the differences are unlikely to change investors' decisions as long as the basis of the tax charge is fully explained in the notes to the accounts, and therefore considered to be not significant. In addition, in relation to the specific Japanese circumstances related to the treatment of deferred tax assets and **non performing loan** issue as described in paragraph 153 disclosure of the amount related to this tax asset is required, specifically in relation to the financial institutions and borrower companies, in relation to the banking supervisory act on capital adequacy. As indicated by the JFSA and the ASBJ components of deferred tax assets are to be disclosed under Japanese GAAP and banking institutions have already disclosed detailed non-performing loans related information.	**A.** Disclosure of **non performing loan effects** is considered not significant. However to the extend that companies do not provide sufficient information to investors as indicated by JFSA and ASBJ, disclosure A should be required as a remedy.
IAS 14	Segment reporting **A.** Segment liabilities are not required to be disclosed for each reportable segment. Business and geographical segment information is provided. Business segments shall be recognised based upon lines of products or services entities provide. Management shall identify business segments, and determine those by aggregating any lines of products or services that diversities in business will be best reflected.	**A.** In practice, statistical data shows that about 40% of Japanese larger companies disclose more that 4 business segments, this is an indication that much information is provided within the segment reporting disclosure. Segment reporting had been proposed as one of the potential areas that the ASBJ may seek convergence with IASB, but is now likely to be delayed in view of the fact that IAS itself will re-examine this issue in its convergence project with US GAAP. As the segment reporting in Japanese GAAP reflects the actual managerial structure in the general context of the particular business we feel that investors would be provided with sufficient information in Japanese GAAP for investment decision-making, and therefore consider this not to be a significant difference.	**A.** Not significant

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JAPANESE GAAP			
Standard	Description of issue	Assessment of significance	Remedy
IAS 16	Property, plant and equipment A. Estimated **costs for asset retirement obligations**, such as dismantling and removing costs and site restoration costs, are not commonly capitalized at initial measurement under Japanese GAAP. Recognition of restoration costs (under the definition of IAS 37 for the recognition of provisions) is required under IFRS, whereas recognition is limited to certain industries only, under Japanese GAAP. Under these limited circumstances, the treatment would normally be different from that of IFRS, as under Japanese GAAP, recognition of such provision is required to be built up towards the realisation of the eventual obligation. B. In practice, the **definition of useful lives**, residual values or choice of depreciation method of PPE may be affected by tax considerations. C. **Revaluation** Japanese GAAP generally required historical cost and not fair value whereas IAS 16 permits the use of revalued amounts. D. To CESR knowledge, there is no specific guidance on accounting for **exchange of dissimilar assets**.	 A. Insight in the existence of possible future payments for such obligations is known to be important to investors. However as the actual amount in many cases is highly uncertain, we feel that for the investor it is important to know whether there is such an obligation, and whether there are changes in circumstances that would significantly change the expectations of such obligation (timing, amount). The fact that these obligations are normally not recognised under Japanese GAAP can be considered as a significant difference. B. Concerns have been raised by the JICPA in the past, and audit guidance prescribes that reference to useful lives in accordance with tax rules can only be made if they are reasonable. It can generally be said that the tax regime in this respect is quite conscious of fair presentation for financial reporting purposes. If the tax rules deviate significantly from the economic substance, tax rules cannot be adopted for financial reporting purposes. We feel that under the circumstances described above, this difference can be classified as not significant C. A Japanese entity would be within the IAS available option. D. Japanese issuers can therefore follow IFRS requirements in this regard and recognise gains or losses on such operations. .	 A. Disclosure A B. Not significant C. Not significant D. Not significant
IAS 17	Leases A. Various points of differences between Japanese GAAP and IFRS are known in practice, however	 A. As Japanese GAAP and IFRS in concept have the same objective of capitalizing finance leases	 A. Not significant

JAPANESE GAAP			
Standard	**Description of issue**	**Assessment of significance**	**Remedy**
	conceptually both IFRS and Japanese GAAP adopt the same basic approach for lease accounting. It should be noted that under Japanese GAAP, specifically defined finance leases (without transfer of legal title) can be accounted for as operating leases. However the information necessary to reconcile the effect is provided in the footnote disclosure. The liability at balance sheet date disclosed may be presented at nominal amount or with future interest. The standard for leasing under Japanese GAAP is brought forward as a potential item for convergence with IFRS	differences of detail between the standards may give rise to different treatment of the same leases under the two GAAPs. However, we feel that a reasonably knowledgeable investor could be expected to understand that the lease terms would be different if the standards change. In combination with the fact that additional information to reconcile these differences is available in the footnotes to Japanese GAAP, we feel that this would not lead to a significant difference as defined in our concept paper.	
IAS 18	Revenue **A.** This is an area where **practical differences are likely to arise**, even though the rules may be similar. Since there is very little guidance under Japanese GAAP in relation to revenue recognition, there may be more flexibility. In practice, instalment method is used in specific industries. **B. Rebates and discounts** are not presented under Japanese GAAP as a reduction of revenue but as expenses (shown as a separate line item when material)	 **A.** General principles are consistent, but there are some differences in detail. Under the assumption that applicable accounting policies are disclosed, it is unlikely that these differences affect investors' decisions. **B.** A knowledgeable investor should recognise this difference as they should obtain the information from the face of the P&L when material.	 **A.** Not significant **B.** Not significant
IAS 19	Employee benefits **A. Various differences of detail** between Japanese GAAP and IFRS(as further described in the detailed responses received) **B.** There is a continuing effect of	 **A.** Japanese GAAP and IFRS have the same objective and follow the same principles. While there are differences that to some extent are derived from specific local circumstances the fact that there are four broad options for defined benefit schemes available under IAS 19 would make it difficult to determine to which version the amounts should be reconciled. Although specific differences can be classified as significant, a disclosure remedy would in our view probably be most logical for the investor. **B.** IAS 19 itself has a similar	 **A.** Disclosure A **B.** Not significant

JAPANESE GAAP			
Standard	Description of issue	Assessment of significance	Remedy
	amortization of "transitional obligation" following the implementation of the new pension accounting standard under Japanese GAAP in 2000. This effect may last until 2015. Several Japanese companies have opted to either accelerate amortisation or even recognise the entire amount immediately. Disclosure of the unrecorded transition is available in the footnotes.	transitional rule for implementing IAS 19 that may last until 5 years after adoption). Although a difference in amortization period appears, the disclosures provide sufficient information to the investor for decision-making. Therefore we consider the difference of transitional obligation not significant.	
	C. There is no **corridor approach** under Japanese GAAP but it includes consideration of materiality as regards to assumptions to determine past benefit obligations and therefore the resulting recognition of actuarial differences.	**C.** IFRS allows not using the corridor approach. In that case, Japanese GAAP and IFRS can lead to a similar outcome	**C.** Not significant
	D. Following the implementation of the transfer to the Government of certain employee benefit obligations and related assets known as the **"return of substitutional portion"**, Japanese GAAP allows retention of certain actuarial differences and different timing for the recognition of the related settlement.	**D.** This is a difference related to the specific local situation and regulation of Japan. The issue was taken to IFRIC in April 2003. The IFRIC agreed that this issue did not have widespread and practical relevance in an IFRS context and noted that IFRIC was not aware of any interpretative questions that have arisen on this issue in practise. It is foreseen that this issue may become a non-major difference by 2007 since the residual effect of past accounting treatments will normally be immaterial by then. However the situation is to be monitored on an ongoing basis until 2007. For these reasons we feel that if differences still appear material in 2007, however as indicated by JFSA, additional disclosures are required to adequately inform investors for this specific aspect of Japanese GAAP	**D.** Not significant
	E. The **rate used to discount** benefit obligations may be determined by reference to average interest rates of a certain period and need not necessarily be the rate prevailing on balance sheet date. This introduces a smoothing effect that is not accepted under IFRS.	**E.** Since interest rates have remained both low and stable in the Japanese market for the last few years, the effect may not be significant at this point of time, but potentially could be, if volatility becomes higher in the interest rate market. It is therefore considered to be potentially a significant difference that might	**E.** Disclosure A

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JAPANESE GAAP			
Standard	Description of issue	Assessment of significance	Remedy
		need additional disclosure requirements if becoming material.	
	F. Holiday pay. Liabilities connected with **paid vacation** are not recognised under Japanese GAAP	**F.** Although in specific circumstances this might lead to a material amount, we do not consider it to be so significant that it would lead to different investment decision, as the amounts are considered to be relatively stable over the years, the impact on the P&L would normally be immaterial.	**F.** Not significant
IAS 20	Accounting for government grants and disclosure of government assistance **A.** Although the comments received indicate that Japanese GAAP is not different from IFRS, in practice, accounting treatments may be influenced by specific tax rules that could lead to differences in the timing of recognition of grants.	**A.** This aspect is not expected to have an impact on investors' decision.	**A.** Not significant
IAS 21	The effects of changes in foreign exchange rates **A.** Under Japanese GAAP **goodwill** shall be translated by using the historical rate at the time of initial consolidation **B.** Disclosure of reconciliation of net exchange differences classified in a separate component of equity (**"translation adjustments"**) is not required as with IFRS	**A.** Investors would be able to make similar decisions if they are provided with foreign currency cost and historical exchange rate disclosed **B.** Investors would need the amount disclosed for decision making, but as the amount is separately disclosed as a line item in balance sheet, only the movement as such is not separately disclosed.	**A.** Disclosure A **B.** Not significant
IAS 23	Borrowing costs **A.** Under IFRS, borrowing cost should be recognised as an expense in the period in which they are incurred, or under the allowed alternative treatment capitalized. The adopted accounting policy shall be disclosed. To CESR knowledge, a similar optional treatment is also possible in practice for companies applying Japanese GAAP.	**A.** As IFRS allows both expensing and capitalization we would expect that, as long as the applied method is properly disclosed, investors should be able to make similar decisions	**A.** Not significant
IAS 24	Related party disclosures **A.** Disclosure of **key management**	**A.** Directors and other officers'	**A.** Not significant

JAPANESE GAAP			
Standard	Description of issue	Assessment of significance	Remedy
	personnel compensation is not required in the notes of consolidated financial statements. **B.** Under Japanese GAAP, there is no requirement to disclose **control relationships** where there have been no transactions between the related parties, nor does it require disclosure of the entity's parent and its ultimate controlling entity.	compensation are disclosed in total amounts under other regulations for reporting in Japan, outside the scope of financial statements. **B.** Information on related party transactions is by nature relevant for investors and such disclosure can be considered significant. However, the he information is expected to be provided elsewhere in the annual report, or will be identifiable from notifications to be made pursuant to EU Transparency requirements on major shareholdings	 **B.** Not significant
IAS 27	<u>Consolidated and separate financial statements</u> **A. Scope of consolidation.** Under IAS 27 and SIC 12, the scope of consolidation is determined by reference to the principle of control defined in general terms as the power to govern the financial and operating policies of an entity so as to obtain benefits from its activities (IAS 27.4). Information received from the standard setter and through the consultation indicate that the issue of consolidation of Special Purpose Entities (SPE) in Japan is very complex, being based on principles combined with additional guidance that altogether make the third country framework close to IFRS in most cases. The status of **Qualifying SPEs** (QSPEs) is slightly different as being essentially addressed in connection with provisions on derecognition of assets. Exemptions provided in this context for QSPEs could lead, res sic stantibus, to their possible non-inclusion in consolidated balance sheet and income statements. **B. Uniform accounting policies** are required for similar transactions and events under similar circumstances, in principle. However it is permitted to use financial	 **A.** Experience shows that definition of scope of consolidation is an issue that has far reaching consequences on financial position and results. It could be a significant difference if entities considered as subsidiaries under IAS 27 are excluded from consolidation. The potential impact of differences – when the entity has material assets, liabilities or operations - requires supplementary statements in these exceptional cases, because additional disclosure is not sufficient to enable investors to figure out the pervasive impact of scope exclusion (when QSPE are material – see section 3, point c) **B.** This difference can be considered significant. As Japanese GAAP and auditing guidelines leave room for not unifying accounting principles for consolidation of subsidiaries, a material and significant difference in	 **A.** Supplementary statement for QSPE **B.** Supplementary statement

JAPANESE GAAP			
Standard	**Description of issue**	**Assessment of significance**	**Remedy**
	statements prepared in accordance with local GAAP of foreign subsidiaries, unless the difference in accounting policies will lead to unreasonable consequences.	consolidated accounts could appear. Unification of accounting standards for consolidated accounts is a basic concept for European investors. As it may hit many line items of the financial statements, without the additional available information to the investor of the possible effect of use of different GAAP supplementary statements would be required. ASBJ has launched a project to consider tightening this rule, and a draft could be issued on this topic before the end of this year. It is also proposed as an item for the convergence project. In addition, it should be noted that, going forward, not necessarily all Japanese companies would consolidate their European operations using IFRS as the underlying GAAP used for these entities are likely to remain being the current local GAAP (non-listed entities).	
	C. **Minority interest** shall be **presented** between liabilities and shareholders' equity on the consolidated balance sheet.	C. As minority interests are clearly disclosed, investor will be able to adjust if required.	C. Not significant
IAS 28	Investments in Associates A. When applying the equity method, the **latest financial statements** of the relevant associated companies are to be used.	A. The three-month period used in IFRS is not equal to the last financial statements available, requirement under Japanese GAAP. However, material transactions or events occurring during the period between fiscal year-ends where associates have different reporting date, can be covered either by adjustments in the consolidated accounts or by a description in the notes.	A. Not significant
	B. **Uniformity of accounting policies.** In principle there is the requirement for unification of accounting policies, however reference is made to the previous aspect mentioned under IAS 27 B, although having a different impact on the investors' decision	B. This could affect decisions as different policies could materially affect profits. As it only affects a limited number of line items, it can be dealt with by disclosure, or by adjustments to conform the associate's accounting policies to those of the investor when the associate's financial statements are used by the investor in applying the equity method	B. Disclosure B

JAPANESE GAAP			
Standard	Description of issue	Assessment of significance	Remedy
IAS 29	Financial reporting in hyperinflationary economics **A.** Japanese GAAP does not have a specific standard that deals with reporting under hyperinflationary environment. This might be an issue when the reporting entity has subsidiaries in countries that are in hyperinflationary situations	**A.** For the purpose of our holistic analysis, it is considered not be a significant issue. A knowledgeable investor investigating the background of the company and looking at regional segment reporting aspects would probably be aware of these differences if applicable.	**A.** Not significant
IAS 30	Disclosure in the financial statements of banks and similar financial institutions **A.** As CESR assessment did not deal with specific industry segments, this standard has not been included in the scope of this exercise. However reference is made to paragraph 138, in order to make notice of specific circumstances related to the financial industry sector in Japan, in relation to the non-performing loan issue, as mentioned under IAS 12 in this table.	-	**A.** Disclosure of the specific aspects related to the non- performing loan aspects related to the financial industry sector (disclosure A)
IAS 31	Interests in joint ventures Proportionate consolidation is not permitted, as an accounting method for interests in joint ventures. **Equity method is required** in all situations.	This should not create a significant difference, as equity method is an allowed treatment under IFRS	Not significant
IAS 32	Financial Instruments: Disclosures and Presentation Various differences in detail exist: **A. Convertible bonds** are classified as liability, and either presented in aggregate or in two parts (split between the bond and option portion, but both under liabilities) **B.** Under Japanese GAAP, **fair value of derivatives and investments** in securities shall be disclosed in comparison with their carrying amounts.	**A.** Although this has a direct impact on the presented total equity figure, a knowledgeable investor would be able to reconcile these amounts. As the separate option feature is also disclosed separately, it is expected that investors would be able to make similar decisions **B.** Under IFRS the disclosure requirement covers all financial instruments, not limited to derivatives and investments in securities. Since interest rate has	**A.** Not significant **B.** Disclosure A

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Standard	Description of issue	Assessment of significance	Remedy
	In addition, fair value disclosure of derivative instruments which are used for hedging purposes is not required. **C.** Issuers' financial instruments are determined as liabilities or equity, in accordance with their legal forms. Therefore **preference shares** are usually included in equity.	been both low and stable in recent years for the Yen currency, there is not a significant difference for financial instruments (debt or loan). However Japanese entities that have significant financial debts or loans expressed in other currencies may need to be analysed in more depth. Also future changes in interest rate for the YEN might become significant. For these facts under these circumstances the difference is considered to be significant, and additional disclosure on fair values of all financial assets and liabilities is required **C.** In respect of certain preference shares, the issuer may not have an unconditional right to refuse redemption, which are classified as equity under Japanese GAAP, and may be classified under liabilities under IFRS. As relevant information is normally adequately disclosed, a knowledgeable investor will identify relevant instruments for reconciliation, this is not considered to be a significant difference	 **C.** Not significant
IAS 33	Earnings per share Various differences in detail exist. **A.** Japanese GAAP does not require disclosure of EPS from continuing operations as Japanese GAAP does not have a standard that requires discontinued operations to be distinguished. **B.** Dilutive net loss per share need not be disclosed under Japanese GAAP. **C.** If there were to be a share split during the period, under Japanese GAAP, restatement of prior year EPS (restatement of prior year footnote disclosure) would not be required, but the same information would be disclosed as additional information to the current year's footnotes.	 **A.** The objectives of Japanese GAAP and IAS 33 are the same. If we accept some differences between the two GAAPs as being insignificant even though they affect EPS then we are effectively saying that differences in the calculation of EPS are unlikely to be significant. It can be argued that EU investors will gain from having the EPS numbers that drive the share price in the home country, and consider this difference not to be significant	 **A.** Not significant

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JAPANESE GAAP			
Standard	Description of issue	Assessment of significance	Remedy
IAS 34	Interim reporting A. Quarterly reporting is required in Japan.	A. Further discussion required, with specific reference to paragraph 95, in light of future developments regarding equivalence of reporting duties under the Transparency Directive	A. Outstanding
IAS 36	Impairment of assets A. **Impairment test.** When amounts of undiscounted future cash flows of long-lived assets are less than their carrying amounts, the difference between the carrying amounts and the recoverable amounts are recognised as impairment losses.	A. This means that Japan uses a two-step approach in terms of accounting for impairment (similar to the US GAAP requirements). The different approaches to impairment between Japanese GAAP and IFRS could give rise to significant differences, as impairment information by nature is important for investor decision making.	A. Disclosure B
	B. Guidance to Japanese GAAP stipulates that a **"significant" decline** in an asset's market value which constitutes an indication of an asset's impairment should be interpreted as a 50% decrease in value. The requirement is to look at other indicators as well, but such a "rule base" indicator might be used as the most significant indicator for impairment	B. It is still early in practice, as actual experiences on application of impairment under IFRS need to determine whether or not this will result in a significant difference. As indicated by the JFSA and ASBJ all indicators are given equal attention, in practice. This leading to immaterial differences for specific entities	B. Not significant
	C. Under Japanese GAAP, there is no obligation to perform annual impairment tests on **intangible assets, not yet available for use and intangible assets with indefinite useful lives**	C. Triggers for impairment both under Japanese GAAP and IFRS are highly subjective, and based on management assumptions. In both cases, goodwill is likely to be impaired only when there is a major evidence of impairment. Under Japanese GAAP the prudential approach of amortization might therefore also lead to lower impairments in time, as part of the amount is already amortized. From the investors' point of view, we feel that this difference in practice will not be considered to be significant.	C. Not significant
	D. **Reversal of impairment loss** is prohibited under Japanese GAAP. Reversal of impairment loss on goodwill is prohibited under both standards.	D. This difference could be significant and calls for disclosure remedy. The purpose of the disclosure is to allow investors to keep track of past recognised impairment provisions and of	D. Disclosure A

JAPANESE GAAP			
Standard	Description of issue	Assessment of significance	Remedy
		subsequent developments in the circumstances that led to impairment and that could warrant a reversal of the provision under IAS 36	
IAS 37	Provisions, contingent liabilities and contingent assets A. Under Japanese GAAP, a provision shall be recognised when: - It is probable that expense or loss will be incurred as a result of past transactions or events, and - A reliable estimate can de reasonably made A provision shall be measured at best estimate of an amount that is attributable to the current period. There is no specific standard or guidance for restructuring provisions, however such a provision is set up under the general recognition and measurement guidance referred above.	A. The wording of both standards is almost similar; however practical difference may arise in timing of recognition and measurement, as Japanese GAAP does not specifically prescribe expected values to be used for measurement of provisions. Definition of the wording "probable" and the concept of "reasonable availability of a reliable estimate" can be interpreted differently. We note that under Japanese GAAP, provisions for restructuring may be recognised earlier under Japanese GAAP than would be the case under IFRS. In general we feel that although practical differences exists, for the investor these differences will not be considered significant as the elements disclosed should help the investor in making the decision.	A. Not significant
	B. **Discounting of long-term provisions** is not required under Japanese GAAP.	B. Investors will be most interested in the basis of calculation and their decision-making should not be affected by differences in calculation as long as they are fully disclosed.	B. Not significant
	C. The concept of **constructive obligation** is not specifically prescribed under Japanese GAAP, which may result in a difference in the timing of recognition and measurement of provisions.	C. Without specific prescription of this issue, the underlying principle within Japanese GAAP is the same. We consider this not to be a significant difference on a the basis of a broad and holistic assessment	C. Not significant
	D. Estimated **costs for asset retirement obligations**, such as dismantling and removing costs and site restoration costs, are not commonly capitalized at initial measurement under Japanese GAAP. Recognition of restoration costs (under the definition of IAS 37 for the recognition of provisions) is required under IFRS, whereas recognition is limited to certain industries only, under Japanese GAAP. Under these limited circumstances, the	D. Insight in the existence of possible future payments for such obligations is known to be important to investors. However as the actual amount in many cases is highly uncertain, we feel that for the investor it is important to know whether there is such an obligation, and whether there are changes in circumstances that would significantly change the expectations of such obligation (timing, amount). The fact that these obligations are normally not recognised under	D. Disclosure A (see also IAS 16)

JAPANESE GAAP			
Standard	Description of issue	Assessment of significance	Remedy
	treatment would normally be different from that of IFRS, as under Japanese GAAP, recognition of such provision is required to be built up towards the realisation of the eventual obligation. (see also IAS 16)	Japanese GAAP can be considered as a significant difference. (see also IAS 16)	
IAS 38	Intangible assets **A. Capitalisation of development costs.** Costs incurred during development phase shall be expensed when incurred. The total R&D expenditure itself is disclosed, but there is no requirement for detailed disclosure. **B. Revaluation**. Intangibles assets are measured at cost with no alternative treatment to record them at re-valued amounts	 **A.** Mandatory capitalization of development costs is required under IFRS versus expensed as incurred under Japanese GAAP. From the disclosure of the R&D costs, the investor would not be able to understand the split between the capitalized portion under IFRS and the expenditures that would be recorded in the income statement as immediate expense. This difference can be considered significant. Information should be made available, due to the cumulative impact on these amounts during different periods and the related amortization under IFRS. **B.** A Japanese entity would be within the IAS option	 **A.** Disclosure B **B.** Not significant
IAS 39	Financial Instruments Exemptions to the application of hedge accounting exist for certain hedge relationships where interest rate and/or foreign currency derivatives are used as the hedging instrument (referred to as "synthetic instrument approach" or "direct translation method"). Japanese GAAP might be more lenient in terms of its requirements towards fair valuation of available for sale that are not traded on a market The conditions for derecognising of financial assets differ between IFRS and Japanese GAAP Although gains arising from change in fair value of available	 Japanese GAAP and IFRS have the same objectives and both standards address issues that are highly complex. A reasonably knowledgeable investor might not detect these specific issues. CESR needs more information to determine whether the identified differences do in fact influence investors' decisions. Reference is made to paragraph 138	 To be reconsidered later – possible Disclosure A

JAPANESE GAAP			
Standard	Description of issue	Assessment of significance	Remedy
	for sale instruments are always recognised directly in equity, Japanese GAAP also allow the option to recognise losses through the profit and loss account.		
IAS 40	Investment property A. **Fair value** of investment properties is not required to be disclosed.	A. Fair value information of investment properties is significant to investors	**A.** Disclosure A
IAS 41	Agriculture A. Differences in **fair value** of specific agriculture items. There is no specific standard for agriculture under Japanese GAAP	**A.** Fair value information could be of significance to the investor	**A.** Disclosure B

(iii). Review of general principles

154. The ASBJ released a discussion paper "Conceptual Framework of Financial Reporting" in July 2004, summarizing the basic philosophy underlying the current Japanese accounting standards.

155. The Japanese discussion paper "Conceptual Framework of Financial Reporting" takes the four characteristics described in the CESR concept paper (understandability, relevance, reliability and comparability) into consideration. As a result of organizing these discussions, Relevance and Reliability are placed at the highest level. Comparability is considered to be under the concept of Representational Faithfulness (i.e. the concept that different accounting treatment shall be applied to different facts, and consistent accounting treatments shall be applied to same facts), which is the lower-level characteristics that support Reliability. While Understandability is also considered to be important, it is explained as a self-evident characteristic in describing the premise in the Japanese discussion paper that financial reporting is considered to be provided for sophisticated investors in certain level.

156. The purpose of the Japanese Securities and Exchange Law is to accomplish the fairness in issuance, trading and other transactions of securities related transactions, in order to protect investors. For that purpose, public companies are required to disclose financial reporting mainly on consolidated basis. Therefore, the primary objective of financial reporting which is a measure to accomplish the ultimate objective above is to provide investors with information that is useful in anticipating future cash flows of entities, in other words, information useful in expecting performance of entities, and estimating values of entities. The response from Japan indicates that the objective of financial reporting is consistent with that under IAS/IFRS framework which defines the objective of financial statements to provide information about the financial position, performance and changes in financial position of entities that is useful to a wide range of users in making economic decisions. Accordingly, financial statements prepared under the basis of Japanese GAAP pursue the same objective with financial statements prepared under IAS/IFRS. This discussion is explicitly stated under "Objectives of Financial Reporting" in the discussion paper above.

157. The allowance and use of several options and alternative treatment possibilities that the Japanese accounting standards provide, might give rise to concerns about the comparability of financial statements for the purpose of comparing the financial statements of different enterprises in order to evaluate their relative financial position. The proposed remedies, in combination with a reasonable knowledge of business and economic activities and accounting in Japan and a

willingness to study the information with reasonable diligence, are believed to provide sufficient additional information.

158. Japanese GAAP may permit sufficient choice that firms seeking listing in the EU can make choices within Japanese GAAP to minimize reconciliation or supplementary financial statement frequencies. Practice shows that listed companies seek to minimize the reconciliation effects if possible (although it must be recognised that for consistency under local GAAP changes in earlier chosen options might not be allowed.)

(iv). Changes to Japanese GAAP after 1st January 2005

159. Continuing efforts are made in the development of Japanese accounting standards towards more internationalised accounting standards. These efforts were initiated in 1998. However as to be expected, such developments take considerable time, as a due process is essential in obtaining solid and adequate standards. Several standards are still in the process of development.

160. On December 28, 2004, the ASBJ issued an Exposure Draft of Accounting Standard No. 3, Accounting Standard for Stock Options and others ("ED 3"). The standard will be effective for the fiscal year beginning on or after April 1, 2006. Like IFRS 2 (share based payments), ED 3 requires an entity to expense stock option compensation to its employees.

161. On 21 January 2005, the International Accounting Standards Board (IASB) and the Accounting Standards Board of Japan (ASBJ) announced their agreement to launch a joint project to reduce differences between International Financial Reporting Standards (IFRSs) and Japanese accounting standards (see press release published by IASB and ASBJ at that occasion). On March 11, the ASBJ reported on further progress made in relation to the project of convergence with IAS/IFRS. In particular, it indicated five topics that will be considered in the first phase of convergence: measurement of inventories (IAS 2), segment reporting (IAS 14), related party disclosure (IAS 24), unification of accounting policies applied to foreign subsidiaries (IAS 27) and investment properties (IAS 40).

C. U.S. GAAP

162. The approach followed by CESR was first to collect information on technical differences between US GAAP and IFRS. An essential source of information has been the response received from the Financial Accounting Standards Board (FASB). Due to its size, this response has not been appended to this report. It is incorporated by reference to this report and is available on CESR website. CESR has also considered additional existing publicly available literature on comparisons of GAAP with IFRS.

163. On the basis of this information, tables summarising the major technical differences identified have been prepared.

164. CESR notes that, besides disclosures' requirements imposed by US GAAP, companies listed on US exchanges are also required complying with additional disclosure requirements of the SEC. It is possible that these additional disclosures will go some way to providing the information set out in the remedies proposed in this paper.

US GAAP			
Standard	Description of issue	Assessment of significance	Remedy
IFRS 1	There is no comparable guidance to IFRS1 for the first time application of U.S. GAAP; however, accounting principles must be consistent for comparative financial information presented in financial statements.	There is no US standard on First Time Adoption, and third country issuers using US GAAP will not have changed an accounting framework on the basis envisaged under IFRS 1.	Not applicable
IFRS 2	Share based payments **A.** With **current US GAAP**, compensation costs for share based payments are measured at an amount equal to the consideration received at grant date if any. US GAAP has an option to expense share-based payments, but in practise no expense are usually recognised at a time when stock options are granted to employees. **B.** A **new accounting standard (FAS 123R)** will be applicable for fiscal years starting after 15 June 2005 (or 15 December 2005 for small enterprises), i.e. in most cases as from 2006. FAS 123R will require expensing stock options on a similar basis to IFRS 2. There are several differences of detail between the standards as outlined in the response from FASB.	**A.** The differences between the current practises of share-based payments in US can considered to be significantly different from IFRS for the purpose of equivalence. **B.** While there are differences in detail between US GAAP and IFRS 2, both standards have the objective of requiring entities to reflect in profit and loss and financial position the effects of share based payment transactions including expenses associated with transactions in which share options are granted to employees (IFRS 2.1). The differences between the two standards are at the level of detail, or reflect differing national	**A.** Current practice of share-based payments would require a disclosure of the expense if it is not recoded in the income statement. Disclosure type B. **B.** Remaining differences between US GAAP (FAS 123R) and IFRS 2 are considered not significant. However, to the extent that US GAAP does not provide information for investors to be able to compare the basis of the expense, disclosure A should be required as a remedy. For all periods between

US GAAP			
Standard	Description of issue	Assessment of significance	Remedy
		practice. Investors will be expecting the quantum of stock option expense to vary depending on assumptions made by management, and will be looking for disclosures to enable them to understand the basis of the expense that has been recognised. On that basis, we can assume that the difference in detail will not affect investors' decision making as long as there is adequate disclosure of the underlying assumptions	date of application of IFRS 2 and later application of FAS 123R, the remedy set out in point A will apply
IFRS 3	<u>Business combinations</u> **A.** Under US GAAP, the **acquisition date** is ordinarily the date on which consideration passes and the acquired (net) assets are received. That is, the date on which the transaction closes. However, if the parties agree in writing that effective control passes to the acquirer at an earlier date then that earlier date is the acquisition date. Under IFRS3 the acquisition date is the date on which the acquirer effectively obtains control of the acquiree. Under US GAAP shares issued as consideration are measured at their market price over a reasonable period of time (a few days) before and after the parties reach an agreement on the purchase price and the transaction is announced. Under IFRS 3 shares issued as consideration are measured at their fair value on the date of the exchange transaction. **B.** Under IFRS 3, **minority interest** is measured as the minority's proportion of the net fair value of the identifiable net assets acquired. This means that the	As for IFRS 2 above, the objectives of US GAAP and IFRS are the same – i.e. all business combinations should be accounted for by applying the purchase method. Most of the differences are marginal and will probably be resolved in Business combinations Phase II. **A.** The different dates for determining fair value on exchange of shares can significantly change the carrying value of goodwill **B.** Minority interest under IFRS is measured at fair value but under US GAAP it is at historical cost.	**A.** Disclosure B **B.** Entities measuring the minority portion at historical cost under US GAAP would need to provide disclosure

US GAAP			
Standard	Description of issue	Assessment of significance	Remedy
	acquired identifiable net assets will always be recorded based on their fair value at the acquisition date regardless of whether a minority interest exists. Authoritative U.S. GAAP is silent on this issue. Minority interest can be measured in the same way as IFRS or as the minority's proportion of the pre-acquisition historical book value of the identifiable net assets acquired. The latter method is more prevalent in practice. This means that, when a minority interest exists, the acquired identifiable net assets are generally recorded based partially on their fair values and partially on historical book value. **C. Step acquisitions** under IFRS 3 require revaluation of previous interests at fair value at each acquisition date. Under US GAAP previous interests are not revalued, resulting in an accumulation of fair values at different dates **D.** Under IFRS 3, **in-process R&D** is recognized as an acquired intangible asset if it meets the definition of an intangible asset and its fair value can be measured reliably. If it is not recognized separately it is subsumed within goodwill. Under US GAAP it must be included in the determination of the fair values of the net assets acquired. If in-process R&D has no alternative future use then it is immediately expensed, otherwise it is recognized as an intangible asset. **E.** Under IFRS 3 **negative goodwill** is recognized immediately as a gain. Under US GAAP it is initially allocated on a pro rata basis against the carrying amounts of certain acquired non-financial assets, with any excess recognized as an extraordinary gain.	 **C.** While the accounting is different, there is flexibility in accounting under IFRS for step acquisitions and so it is not clear that investors would gain from any form of restatement as long as the basis of accounting is fully disclosed **D.** In process R&D is capitalised under IFRS but usually expensed under US GAAP **E.** The underlying objectives of US GAAP and IAS are considered to be the same. However the direct recognition of gain under US GAAP could lead to material differences having an impact on the investor making decision	explaining the basis of calculation – Disclosure A **C.** Disclosure A **D.** Disclosure B **E.** Disclosure B

US GAAP			
Standard	**Description of issue**	**Assessment of significance**	**Remedy**
	F Under US GAAP, **contingent consideration** is part of the purchase price when additional consideration is issued o becomes issuable whereas under IFRS 3 it is part of the purchase price at the date of acquisition if payment is probable and can be measured reliably	**F** The difference in timing of recognition of contingent consideration could have a significant effect on investors if the terms and conditions of the contingent consideration are not fully disclosed	**F** Disclosure A
IFRS 4	Insurance contracts On rights and obligations under insurance contracts, there may be differences in those cases where IFRS 4 has explicit guidance that conflicts with the choice made by the entity under US GAAP. IFRS 4 allows in most cases that the entity continues its local GAAP, which therefore may include US GAAP. Under IFRS, an embedded derivative whose characteristics and risks are not closely related to the host contract and whose value is interdependent with the value of the insurance contract need not be separated out and accounted for as a derivative. Under US GAAP such derivatives must be accounted for separately	IFRS 4 is an interim standard which allows a wide range of accounting treatments, and only prohibits a very few policies which in any event are not part of US GAAP. It is reasonable to assume that an investor in an insurance company will be aware of the status of IFRS 4 and so would not change investment decisions if a US company were required to follow IFRS 4 instead of US GAAP	Not significant
IFRS 5	Non-current assets Held for Sale and Discontinued Operations Cumulative foreign exchange differences that have been recognized in equity (other comprehensive income) are reclassified from equity to the asset held for sale when it is first classified as held for sale under IFRS 5. Under US GAAP they are reclassified from equity to the asset for sale when it is first classified as held for sale. A component of an entity that has been disposed of or is classified as held for sale has a less restrictive definition under US GAAP than under IFRS 5. The net amount of pre-tax and post-tax income or loss is	IFRS 5 is the IASB's first project to converge with US GAAP. The remaining differences are on points of detail, and it is reasonable to assume that they would not affect investors' decisions	Not significant

US GAAP			
Standard	Description of issue	Assessment of significance	Remedy
	required to be disclosed on the face of the income statement. No further disaggregating is required under US GAAP, whereas IFRS 5 permits further disaggregating in the notes.		
IAS 1	Presentation of financial statements A. If **refinancing** is completed **after the balance sheet** date but before the date of issue of the financial statements then the liability can be classified as non-current under US GAAP whereas IAS 1 requires refinancing to be completed before the balance sheet date Under US GAAP a liability is classified as non-current if the lender has granted a 12-month waiver before the date of issue of the financial statements. Under IAS 1 the cut off is the balance sheet date.	A. These differences should be addressed by disclosures under post balance sheet event standards and so should not affect investors' decision making.	**A.** Not significant
IAS 2	Inventories A. Use of the **LIFO method** is permitted as an accounting policy choice under US GAAP if it is the method that most clearly reflects periodic income. LIFO is prohibited under IAS 2. **B.** Inventory is generally stated at the **lower of cost and market value** under US GAAP. Market value is the current replacement cost except that it should not be greater than net realizable value and should not be less than net realizable value reduced by a normal profit margin. IAS 2 requires the lower of cost or net realisable value. C. **Reversal of write-down.** Under US GAAP once an item of inventory has been written down below cost (from cost to market	**A.** US GAAP permits the use of LIFO stock valuation. However, the SEC requires companies using LIFO for their inventory valuation to disclose the FIFO value in the notes. On this basis, It will not be a significant issue. However, if the reporting entity is not SEC registrant, disclosure of FIFO (or other allowed method under IFRS) information should be required. **B.** Not a significant difference. C. There are no reversals of write downs to NRV under US GAAP, however as inventories are expected to turn over frequently, in	**A.** Not significant for entities complying with SEC disclosure requirement – otherwise, Disclosure B. **B.** Not significant C. Not significant

US GAAP			
Standard	**Description of issue**	**Assessment of significance**	**Remedy**
	value) that new amount is regarded as the new cost and any subsequent reversal of the write-down is prohibited. Under IAS 2 the reversal of inventory write-downs (from cost to net realizable value) is required in the period the reversal occurs.	practice it is unlikely to create reversal of impairments. For this reason we consider it not significant.	
IAS 7	<u>Cash Flow Statement</u> **A.** Certain **investment entities with** substantially all of their investments in **highly liquid investments** that are carried at market value are exempt from the requirement to present a cash flow statement. There are no exemptions under IAS 7. **B. Taxes paid** must be classified as an operating activity under US GAAP. Under IAS 7 they can be classified as financing or investing activities. Bank overdrafts are excluded from cash under US GAAP. They can be included in cash under IAS 7.	**A.** This difference is considered not to be significant, as cash flow statements do not provide useful information about the assets and liabilities of investment companies **B.** Differing treatments in the cash flow statement are unlikely to change investors' decisions for either of these issues	**A.** Not significant. **B.** Not significant
IAS 8	<u>Accounting policies, changes in accounting estimates and errors</u> **A.** Under US GAAP, generally, must include the **cumulative effect of the change in accounting policy** as a separate component of net income in the year of change without restating prior years. **B. Changes in depreciation method** treated as a change in accounting policy under US GAAP (cumulative effect shown separately as a component of net income in the current year).	**A.** The difference is clearly identified and unlikely to change investors' decisions. **B.** Differences in depreciation recognition unlikely to affect investors' decisions as long as there is adequate disclosure as a change in policies.	**A.** Not significant **B.** Not significant
IAS 11	<u>Construction contracts</u> **A.** Under US GAAP SOP 81-1 contains a rebuttable presumption that a **single contract** is the appropriate unit of measure. Contracts may be combined and segmented when specified criteria are met that are similar to those in IAS 11.	**A.** This is under review at IFRIC. The differences are only relevant in a limited range of circumstances and are unlikely to affect investors' decisions	**A.** Not significant

US GAAP			
Standard	Description of issue	Assessment of significance	Remedy
	However, combination and segmentation of contracts is permitted when those criteria are met, but not required. Under IAS 11 Contracts must be combined and a contract must be segmented when certain specified criteria are met. **B.** When the percentage of completion cannot be determined, US GAAP requires use of the **completed contract method;** IASs require the cost recovery method	**B.** The completed contract method applies when revenues are doubtful. It is not clear whether this will give materially different answers in those circumstances, however the uncertainties surrounding revenues will need to be disclosed, providing the investors adequate information for their decision making.	**B.** Not significant
IAS 12	Income taxes **A. Various differences in detail** exist between US GAAP and IFRS as mentioned in the detailed response from FASB. Basics and objectives of the standards are the same in both standards.	**A.** Differences in calculation of tax and deferred tax charges to some extent reflect local tax practice in the US. Reconciliations of the differences are unlikely to change investors' decisions as long as the basis of the tax charge is fully explained in the notes to the accounts	**A.** Not significant
IAS 14	Segment reporting **A.** IFRS require that risks and returns be considered and require either a business or geographical basis as the primary basis and the other as secondary and US GAAP require that segments should be determined based on the way that management makes operating decisions and assesses performance	**A.** As the segment reporting in US GAAP must reflect the actual managerial structure of the business we feel that investors would be provided with sufficient information in US GAAP for investment decision-making, and therefore consider this not to be a significant difference despite the convergence process between US GAAP and IFRS. It should be noted that IAS itself will re-examine this issue in its convergence project with US GAAP.	**A.** Not significant
IAS 16	Property, Plant and Equipment **A. Revaluation** US GAAP generally required historical cost and not fair value whereas IAS 16 permits the use of revalued amounts	**A.** A US entity would be within the IAS available option.	**A.** Not significant

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US GAAP			
Standard	Description of issue	Assessment of significance	Remedy
	B. On gains or losses on **non-monetary exchanges** prior to adoption of FAS 153 recognition of any gain or loss is prohibited. After adoption of FAS 153 the accounting is similar to IAS 16. **C. Costs of replacing component parts** of an asset and planned major maintenance activities may be capitalized or expensed. The deferral method which is specified under IFRS is one of four possible methods under US GAAP. **D. Initial operating losses** incurred prior to an asset achieving planned performance are expensed under IAS.	**B.** Not a difference once US GAAP changes (15 June 2005) **C.** Only a difference if the option is applied under US GAAP, and should be dealt with through disclosure **D.** If an entity defers expenditure during the pre-operating period, the related amount should be visible on the balance sheet as a specific item (accompanied with as hoc disclosures in the notes). Therefore, this should not give rise to a significant difference for investor's decision making.	**B.** Not significant **C.** Disclosure A (if option is applied) **D.** Not significant
IAS 17	<u>Leases</u> **A.** IAS 17 does not recognised **leveraged leases.** US GAAP has specific recognition and presentation rules. B. Under 17 **third party guarantees** are included in minimum lease payments in the lessor's calculation. They are excluded under US GAAP. **C. Finance leases** under IAS 17 are determined according to the substance of the transaction under IAS 17 but according to **numerical rules** under US GAAP. **D.** Under IAS 17 the present **value of the minimum lease payments** is determined using the interest rate implicit in the lease. Under US GAAP it is the incremental borrowing rate **E.** There are also differing treatments of **sale or leasebacks,** disclosure of lease maturities, and leasehold interest in land	IAS 17 and US GAAP have the same objective – to require leases that effectively transfer ownership of assets (usually called finance leases) to be capitalised. Differences of detail, between the standards may give rise to different treatment of the same leases under the two GAAPs, but a reasonably knowledgeable investor could be expected to understand that the lease terms will be different if the standards changed	Not significant

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US GAAP			
Standard	Description of issue	Assessment of significance	Remedy
IAS 18	Revenue **A. Various differences of detail** between IAS 18 and US GAAP on timing and incidence of revenue recognition. US GAAP include more detail transaction and issue specific guidance.	 **A.** General principles are consistent between the two GAAPS, but there are some differences of detail. Unlikely to affect investors' decision making as long as there is full disclosure of accounting policies and sufficient information provided under US GAAP for investor making decisions.	 **A.** Not significant
IAS 19	Employee benefits **A. Various differences of detail** between US GAAP and IFRS (as further described in the detailed responses received)	 **A.** US GAAP and IAS 19 have the same objectives and follow the same principles. While there are differences, the fact that there are four broad options for defined benefit schemes available under IAS make it difficult to determine which version would be used as the basis for reconciliation, and against that background a reconciliation would not help investors' decisions. The key point is to have adequate disclosures to enable investors to make decisions	 **A.** Disclosures A
IAS 20	Accounting for government grants and disclosure of government assistance Under US GAAP, **non-monetary government grants** must be fair valued and recognised	 Non-monetary government grants are rare. In any case, disclosure of grants received would be sufficient	 Not significant
IAS 21	The effect of changes in foreign exchange rates **No major differences identified**	 -	 -
IAS 23	Borrowing costs **A. Some differences of detail** on the basis on which costs can be capitalised	 **A.** IAS 23 has two options – to capitalise or expense – with all of the detail describing the basis on which interest can be capitalised. Broadly speaking, US GAAP is within the IAS options, and given the binary nature of IAS 23 it would be unlikely to affect decision making as long as there is adequate disclosure	 **A.** Not significant
IAS 24	Related party disclosures **A.** Under US GAAP, there is no requirement to disclose **control relationships** where there have been no transactions between the	 **A.** Information on related party transactions is by nature relevant for investors and such disclosure can be considered significant.	 **A.** Not significant

US GAAP			
Standard	Description of issue	Assessment of significance	Remedy
	related parties, nor does it require disclosure of the entity's parent and its ultimate controlling entity.	However, the he information is expected to be provided elsewhere in the annual report, or will be identifiable from notifications to be made pursuant to EU Transparency requirements on major shareholdings	
IAS 27	<u>Consolidated and separate financial statements</u> **A. Scope of Consolidation.** Under IAS 27 and SIC 12, the scope of consolidation is determined by reference to the principle of control defined in general terms as the power to govern the financial and operating policies of an entity so as to obtain benefits from its activities (IAS 27.4). Information received from the standard setter and through the consultation indicate that the issue of consolidation of Special Purpose Entities (SPE) in the US is very complex, being based on principles combined with additional guidance that altogether make the third country framework close to IFRS in most cases. The status of **Qualifying SPEs** (QSPEs) is slightly different as being essentially addressed in connection with provisions on derecognition of assets. Exemptions provided in this context for QSPEs could lead, res sic stantibus, to their possible non-inclusion in consolidated balance sheet and income statements. **B.** Under US GAAP where **subsidiaries have different reporting dates,** difference cannot be more than three months. Must disclose any significant intervening transactions (including any significant effects of foreign exchange rate movements.) but do not have to adjust **C. Presentation of minority interests.** As part of the joint Business Combinations project	 **A.** Experience shows that definition of scope of consolidation is an issue that has far reaching consequences on financial position and results. It could be a significant difference if entities considered as subsidiaries under IAS 27 are excluded from consolidation. The potential impact of differences – when the entity has material assets, liabilities or operations - requires supplementary statements in these exceptional cases, because additional disclosure is not sufficient to enable investors to figure out the pervasive impact of scope exclusion (when QSPE are material – see section 3, point c) **B.** As long as the differences are disclosed, investors will be able to adjust their decisions **C.** As minority interests are clearly disclosed, investors will be able to adjust	 **A.** Supplementary statement for QSPE **B.** Not significant **C.** Not significant

US GAAP			
Standard	Description of issue	Assessment of significance	Remedy
	the FASB has tentatively decided that equity interests of non-controlling shareholders would be accounted for and presented in equity, separately from parent shareholders' equity. This tentative decision eliminates this difference and converges with IAS 27. Until then minority interests are presented between liabilities and equity		
IAS 28	Investments in Associates **A.** As for IAS 27, no requirement under US GAAP to adjust where **associates have a different reporting date** **B.** No requirement to **conform accounting policies** where associate's policies are different. **C.** Accounting for investments in associates in **parent-company financial statements** –equity method is allowed under US GAAP	**A.** As long as the differences are disclosed, investors will be able to adjust their decisions **B.** This could affect decisions if changed policies could materially affect profits. Only affects a limited number of line items, so could be dealt with by disclosure **C.** We are primarily concerned with consolidated accounts. Differences in accounting at the holding company level are unlikely to affect investors' decisions	**A.** Not significant **B.** Disclosure B **C.** Not significant
IAS 29	Financial reporting in hyperinflationary economics **A.** An entity that operates in a hyperinflationary economy must use the functional currency of its parent, rather than its own hyperinflationary currency, to prepare its financial statements.	**A.** For the purpose of our holistic analysis, it is considered not be a significant issue. A knowledgeable investor investigating the background of the company and looking at regional segment reporting aspects would probably be aware of these differences if applicable.	**A.** Not significant
IAS 30	Disclosure in the financial statements of banks and similar financial institutions **A.** As our assessment did not deal with specific industry segments, this standard has not been included in scope of this exercise..	-	-
IAS 31	Interests in joint ventures No significant difference	-	-
IAS 32	Financial Instruments: Disclosures and Presentation		

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US GAAP			
Standard	Description of issue	Assessment of significance	Remedy
	There are some differences in detail: A. **Convertible bonds** are classified as liability, and either presented in aggregate or in two parts (split between the bond and option portion, but both under liabilities) B. Issuers' financial instruments are determined as liabilities or equity, in accordance with their legal forms. Therefore **preference shares** are usually included in equity.	A. Although this has a direct impact on the presented total equity figure, a knowledgeable investor would be able to reconcile these amounts. As the separate option portion is also disclosed separately, it is expected that investors would be able to make similar decisions B. In respect of certain preference shares, the issuer may not have an unconditional right to refuse redemption, which are classified as equity under US GAAP, and may be classified under liabilities under IFRS. The opposite may be the case for certain unsubordinated debt with perpetual features.. As relevant information is normally adequately disclosed, a knowledgeable investor will identify relevant instruments for reconciliation, this is not considered to be a significant difference	A. Not significant B. Not significant
IAS 33	Earnings per share A. **Various differences of detail** in the calculation of EPS	A. The objectives of US GAAP and IAS 33 are the same. If we accept some differences between the two GAAPs as being insignificant even though they affect EPS then we are effectively saying that differences in the calculation of EPS are unlikely to be significant. It can be argued that EU investors will gain from having the EPS numbers that drive the share price in the home country	A. Not significant
IAS 34	Interim reporting A. While APB 28 does contain some requirements for the content of interim reports of publicly traded companies they are not comprehensive. SEC Rules and Regulations include specific requirements for the structure and content of interim financial reports and related disclosures that apply only to SEC Registrants.	A. Further discussion required, with specific reference to paragraph 126, in light of future developments regarding equivalence of reporting duties under the Transparency Directive	A. Outstanding

US GAAP			
Standard	**Description of issue**	**Assessment of significance**	**Remedy**
	B. Interim period is an integral part of the full year (with certain exceptions) under US GAAP but a discrete period under IASs.	**B.** Difference could have a material effect on investors' decisions. As above, one for the Commission ultimately	**B.** See above
IAS 36	Impairment of assets **A. Impairment test.** Impairments under US GAAP are based firstly on a comparison of carrying amount to the expected future cash flows to be derived from an asset (or asset group) on an undiscounted basis. If the carrying amount is lower the asset (or asset group) is not impaired, if higher then impairment is measured by comparing the carrying amount to the fair value of the asset (or asset group). **B.** Under US GAAP **goodwill** is **allocated to a reporting unit,** which is either an operating segment (as defined for segmental reporting purposes), or one organizational level below an operating segment. **C.** Subsequent **reversal of an impairment loss** is prohibited under US GAAP	 **A.** The different approaches to impairment could give rise to major differences that could change decisions **B.** Triggers for impairment of goodwill under both IASs and US GAAP are highly subjective, and will give management a great deal of flexibility. In both cases, goodwill is likely to be deemed to be impaired only when there is major evidence of impairment. The differences are therefore unlikely to be significant in practice **C.** This difference could be significant and a disclosure could be required. The purpose of the disclosure is to allow investors to keep track of past recognised impairment provisions and of subsequent developments in the circumstances that led to impairment and that could warrant a reversal of the provision under IAS 36	 **A.** Disclosure B **B.** Not significant **C.** Disclosure A
IAS 37	Provisions, contingent liabilities and contingent assets **A.** Similar criteria apply for the recognition of a loss contingency, however, the **definition of probable** as "likely" sets a higher threshold for recognition than "more likely than not" under IFRS. **B.** If no estimate in a range of	 **A.** While there is a difference, as long as the element of the liability that is contingent (i.e. less than likely) is required to be sufficiently disclosed, investors should still be able to make similar decisions **B.** These are cases where the value	 **A.** Not significant **B.** Not significant

US GAAP			
Standard	Description of issue	Assessment of significance	Remedy
	estimates is more likely than any other then the **minimum amount** must be used; IAS 37 requires the mid point. Discounting is only permitted when the timing of the cash flows is fixed or determinable. C. Under US GAAP an **exit or disposal plan**, by itself, does not create a present obligation to others for costs expected to be incurred under the plan. D. Measurement of **decommissioning provisions** – discount rates are not adjusted under US GAAP	of the provision cannot be estimated accurately, and a different basis of estimation is unlikely to materially affect decision making as long as the basis of the provision is fully disclosed C. There are differences in the recognition of restructuring provisions, but disclosure should help investors make similar decisions D. These provisions are very large and long term. Investors will be most interested in the basis of calculation and their decision making should not be affected by differences in calculation as long as they are fully disclosed	 C. Not significant D. Disclosure A
IAS 38	Intangible assets A. Under US GAAP intangibles are capitalized, except where the intangible assets acquired are to be used in R&D activities and have no "alternative future use" in which case they are expensed. B. **Capitalisation of development costs.** Development costs and purchased IPR&D are expensed under US GAAP (with some exceptions) C. **Revaluation**. Intangibles assets are measured at cost with no alternative treatment to record them at re-valued amounts	 See below on R&D B. Mandatory capitalization of development costs is required under IFRS versus expensed as incurred under US GAAP. From the disclosure of the R&D costs, the investor would not be able to understand the split between the capitalized portion under IFRS and the expenditures that would be recorded in the income statement as immediate expense. This difference can be considered significant Information should be made available, due to the cumulative impact on these amounts during different periods and the related amortization under IFRS. C. A US entity would be within the IAS option	 B. Disclosure B C. Not significant
IAS 39	Financial Instruments **Various issues of detail** on the	 US GAAP and IFRS have the same	 To be considered later

US GAAP			
Standard	Description of issue	Assessment of significance	Remedy
	two standards Key differences that could affect investors decisions are • Derecognition of securitizations • Split accounting on convertible bonds • Reversal of impairments on equity investments	objectives and both standards address issues that are highly complex. A reasonably knowledgeable investor might not detect specific issues. As the practical appliance of IAS 39 in Europe at the moment does not provide sufficient information on investor making decisions, CESR needs more information to determine whether the identified differences do in fact influence investors' decisions. However remedies in form of disclosures can be expected. Reference is made to paragraph 138.	– possible Disclosure A
IAS 40	Investment property **A.** US GAAP does not permit property to be measured at **fair value**. A cost based method of accounting is generally required	 **A.** Fair value information of investment properties can be considered significant for investors	 **A.** Disclosure A
IAS 41	Agriculture **A.** Differences in **fair value** of specific agriculture items	 **A.** Fair value information could be of significance to the investor	 **A.** Disclosure B

(iii). Review of general principles

165. In its response to CESR questionnaire, the FASB indicated that the conceptual frameworks of the FASB and IASB are equivalent in all significant respects; however, their existing frameworks are neither identical nor complete.

166. At their October 2004 joint meeting, the FASB and IASB decided to add to their respective technical agendas a joint project to develop a common conceptual framework—a single framework that is based on and builds on their existing frameworks. Please refer to the December 28, 2004 issue of The FASB Report for a fuller discussion of the FASB's conceptual framework and the joint project to revisit the conceptual frameworks of the FASB and IASB

167. As regards the general principles, the FASB indicated that its standard-setting process takes into consideration each of the four characteristics—(a) understandability, (b) relevance, (c) reliability, and (d) comparability—as well as other factors. The FASB's Concepts Statement No. 2, Qualitative Characteristics of Accounting Information (May 1980), discusses each of the characteristics of accounting information (information provided by financial reporting) that make that information useful, with usefulness for decision making of most importance. Figure 1 of that Concepts Statement represents a hierarchy of accounting qualities.

168. FASB Concepts Statement No. 1, Objectives of Financial Reporting by Business Enterprises (November 1978), establishes the objectives of general purpose external financial reporting by business enterprises. As summarized in paragraph 32 of that Statement.

169. the objectives begin with a broad focus on information that is useful in investment and credit decisions; then arrow that focus to investors' and creditors' primary interests in the prospects of receiving cash from their investment in or loans to business enterprises and the relation of those prospects to the enterprise's prospects; and finally focus on information about an enterprise's resources, the claims to those resources, and changes in them, including measures of the enterprise's performance, that is useful in assessing the enterprise's cash flow prospects.

170. On this basis, FASB believes those objectives are equivalent to the focus on investors in EU financial markets and those identified in paragraph 12 of the IAS Framework. (Refer to paragraphs 29–32 of the concept paper released by CESR.).

(iv). Changes to US GAAP after 1st January 2005

171. As at December 31, 2004 the FASB had issued the following category (a) GAAP pronouncements which have an effective date after January 1, 2005:

(1) Statement 123 (revised 2004), Share-Based Payment, which is similar to IFRS 2, was issued in December 2004 and has an effective date of June 15, 2005 for public entities and December 15, 2005 for public entities that are small business issuers and for non-public entities. All public entities must apply the Statement for interim or annual reporting periods and non-public entities for annual reporting periods beginning after the effective date. Earlier adoption is encouraged.

(2) Statement 151, Inventory Costs, an amendment of ARB No. 43, Chapter 4, was issued in November 2004 and is effective for fiscal years beginning after June 15, 2005. Earlier application is permitted for inventory costs incurred after the date of issue. This Statement is part of the FASB's short-term convergence project and removes certain differences between US GAAP and IFRS relating to the measurement of inventory costs.

(3) Statement 152, Accounting for Real-Estate Time-Sharing Transactions, an amendment of FASB Statements No. 66 and 67, was issued in December 2004 and is effective for fiscal years beginning after June 15, 2005. This Statement deals with consequential amendments to FASB pronouncements arising from the issuance of AICPA SOP 04-02, Accounting for Real-Estate Time-Sharing Transactions. This is an area not dealt with explicitly by IFRS.

(4) Statement 153, Exchanges of Nonmonetary Assets, an amendment of APB Opinion No. 29, was issued in December 2004 and is effective for fiscal periods (interim or annual) beginning after June 15, 2005. This Statement is part of the FASB's short-term convergence project and removes certain differences between US GAAP and IFRS relating to the measurement of exchanges of non-monetary assets.

172. Further details regarding all FASB pronouncements can be found on the FASB website at www.fasb.org.

It is possible that there will be significant changes in US GAAP before January 1, 2007. The FASB has an active technical agenda with numerous projects at various stages of completion and many more vying for inclusion on that agenda. Details of the FASB's technical agenda and updates on the progress of each FASB project can be obtained from the Project Updates and Technical Plan area of the FASB website at www.fasb.org/project/index.shtml.

CHAPTER 2 – DESCRIPTION OF ENFORCEMENT MECHANISMS IN CANADA, JAPAN, AND USA

Section 1 - General principles for description of enforcement mechanisms

173. The mandate requires CESR "to describe the mechanisms (outside the areas of audit and of corporate governance) provided for at least in the US, Canada and Japan ensuring that the third country GAAP mentioned are respected".

174. The description of certain third country mechanisms of enforcement of financial information is based upon the written responses to a questionnaire from the relevant regulatory authorities in Canada, Japan and the US. From Canadian side the response was provided by the Ontario Securities Commission (OSC). From Japan, the Japanese Financial Services Authority (FSA) coordinated the responses to the questionnaire with other involved parties as the Securities and Exchange Surveillance Commission (SESC), Local Financial Bureau (LBF) and the different stock exchanges. From the USA, it is the US Securities and Exchange Commission (SEC) who responded to the questionnaire.

175. As announced in the Concept Paper, the principles of CESR Standard No 1 on Enforcement of Financial Information[15] served as benchmark for describing the possible relevant third country mechanisms. Questionnaires sent to third countries and responses received were all articulated on the outline/format of this Standard No 1.

176. As for the comparability, the description provided in Section 2 of this Chapter is based on the outline/format on the Standard No 1. A pure descriptive comparison of three different nations' enforcement systems along the lines of a table or a similar format has proven to be difficult. The responses have been different at the level of substance and details and the national enforcement mechanisms are different.

177. Responses received from third countries have been posted on CESR website (section <Operational Groups – Equivalence>). These responses supplemented by existing literature and verbal exchanges with representatives of the regulatory agencies of these countries, is the background for the description of enforcement mechanisms as provided in Section 2.

178. There has been conducted no external verification of the responses received and, hence of the different national enforcement mechanisms. This report is therefore only reliant upon the responses and the informal consultation in order to best describe the different national set-ups adequately and sufficiently.

179. As mentioned earlier, the task of CESR is not to make an assessment of the effectiveness and efficiency of such mechanisms. However, the quality of enforcement systems is a key factor for building and maintaining the confidence of investors in financial reporting and, more generally, in financial markets.

180. CESR is convinced that accounting and financial reporting requirements applicable to third country issuers have to be backed and supplemented by other regulatory guarantees for obtaining long-term beneficial effects on market confidence. This includes issues such as the regulation of audit practice, corporate governance, transparency requirements and enforcement of financial information. CESR draws the attention to this observation because, as for EU reporting companies, it would be illusory to believe that accounting and financial reporting requirement alone will meet markets' expectations, even if they play an important role in the whole picture.

181. As regards more specifically the enforcement aspects, co-ordinating the approach of EU National Enforcers to the enforcement of financial statements of third country issuers (as for EU issuers) remains an important future area of activity for CESR. It is important for EU National Enforcers to consider how they can cooperate with third country enforcement mechanisms for the

[15] The CESR Standard No 1 on Enforcement of Financial information is available on CESR website (under "operational groups", "CESR-Fin").

enforcement of third country issuers. As IFRS are by definition global standards, convergence in enforcement practice is also an important area for consideration.

182. It has to be reminded that, in conformity with the mandate received from the European Commission, the description of enforcement mechanisms as presented in this advice does not cover the areas of audit and of corporate governance.

Section 2 - Description of enforcement mechanisms in Canada, Japan and US

A. Canada

Introduction

183. Canada has thirteen securities regulatory authorities, one located in each province and territory. Each jurisdiction differs slightly in its methods of enforcement of Canadian Generally Accepted Accounting Principles (GAAP) and securities laws (which also differ in each jurisdiction).

184. The enforcement description detailed below relates to that operated in Ontario by the Ontario Securities Commission which we are informed is generally representative of the Canadian Securities Regulatory Authorities ("SRAs") in the largest jurisdictions that account for the vast majority of the market capitalisation of reporting issuers in Canada.

185. Appendix B sets out indicative information on the number of reporting issuers in Canada analyzed by principal regulator which is generally determined by the location of an issuer's head office.

186. Coordination amongst the 13 regulatory authorities is achieved through the Canadian Securities Administrators (CSA) which is a council of Canadian Securities Regulatory Authorities. The CSA's objective is to improve, coordinate and harmonize regulation of the Canadian capital markets.

187. The CSA is a council of the thirteen provincial and territorial securities regulatory authorities (SRAs) in Canada (see Appendix A for a list). It has no statutory regulatory responsibility or authority. The CSA functions through meetings, conference calls and day-to-day cooperation among the SRAs. Funding and support resources are drawn from within Commission operating budgets on a voluntary basis.

188. In 2003, the CSA established the Policy Coordination Committee (PCC) to be responsible for oversight and coordination of all CSA projects, and to facilitate decision-making among jurisdictions. The PCC consists of six member jurisdictions drawn from the CSA who serve for a two year term and may be reappointed. The PCC seeks to ensure that new policy initiatives have a common content, understanding and implementation among the jurisdictions.

189. Also in 2003, the CSA established a permanent Secretariat located in Montreal, Quebec. The Secretariat consists of three full time staff who assist with the coordination and delivery of all CSA projects. The Secretary-General of the secretariat reports to the Chair of the CSA.

190. In some jurisdictions, SRAs are self-funding agencies or crown corporations. In others, they operate within Ministries of provincial governments. Each SRA: formulates policy; makes rules; sits as an administrative tribunal in hearings on securities-related matters; and hears appeals from decisions made by SRA staff or Self-Regulatory Organizations.

191. The SRAs share a mandate of providing protection to investors from unfair, improper or fraudulent practices while fostering fair and efficient capital markets and confidence in them. The SRAs accomplish this through activities including reviewing prospectuses; reviewing continuous disclosure documents; conducting compliance reviews of registrants; granting discretionary exemptions from registration and prospectus requirements; educating industry and investors;

investigating possible violations of provincial securities laws; and commencing proceedings before the Commission or applicable Provincial Courts of Justice.

192. Uniformity between jurisdictions' regulatory requirements dealing with financial reporting and disclosure is achieved as follows:

- there is a single national rule that addresses the accounting and auditing standards required to be applied with respect to the financial statements of an issuer and a single national rule setting out continuous disclosure requirements for both financial and non-financial information, including MD&A.
- there is a single national rule dealing with the content of a short form prospectus and a project is under way currently to complete a single national rule dealing with the content of a long form prospectus. The long form prospectus rule is expected to convert into a national rule the existing Ontario rule which is currently the de facto national standard.

193. We are informed that the principles of the regulatory approach towards ensuring compliance with disclosure obligations are essentially similar across the different jurisdictions. The main components of the approach are described in CSA Staff Notice 51-312 . As described in this Notice, the main jurisdictions have agreed on the key elements of a harmonized program for continuous disclosure review. However, we are informed that some differences remain in the details of how this program is applied in different jurisdictions. Ongoing discussion and information sharing, particularly through the medium of the CSA Committee for Continuous Disclosure Review, are designed to promote consistency in key areas.

194. Generally, public offerings in Canada tend to be made across all of the jurisdictions. All jurisdictions, in which the offering is made, have to approve the prospectus relating to the offer before the offering can take place. This is accomplished through the System for Electronic Document Analysis and Retrieval (SEDAR). We are informed that even though all jurisdictions in which the offering is made approve the prospectus, the review of the prospectus document is completed by the principal jurisdiction.

195. The Canadian Depository for Securities, with the support and direction of the CSA, operates an electronic filing system, namely the System for Electronic Document Analysis and Retrieval (SEDAR). One aspect of SEDAR is that it allows each SRA to post its correspondence with issuers during the prospectus approval process. Each of the SRAs has access to this correspondence, one aim being to improve efficiency and consistency.

Definition of enforcement

> **Principle 1**
> The purpose of enforcement of standards on financial information provided by the issuers mentioned by principle 9 is to protect investors and promote market confidence by contributing to the transparency of financial information relevant to the investors' decision making process.
> With regard to financial statements, the above implies that enforcement contributes to a consistent application of the IFRSs in the EU financial regulated markets.

196. The OSC enforces securities legislation in Ontario as set out in the *Securities Act* (Ontario) ("the Act"). The purposes of the Act, as defined in section 1.1 are to:

(a) provide protection to investors from unfair, improper or fraudulent practices; and
(b) foster fair and efficient capital markets.

> **Principle 2**
> For the purpose of this standard enforcement may be defined as:
> - monitoring compliance of the financial information with the applicable reporting framework;
> - taking appropriate measures in case of infringements discovered in the course of enforcement
> The reporting framework includes the accounting and disclosure standards adopted by the EU.

197. In pursuing these purposes defined under the securities legislation the OSC has developed a review program for reporting issuers in Ontario. This review program includes within its scope documents such as prospectuses and financial statements and is designed to enforce compliance with GAAP, securities laws and timely disclosure requirements by requiring corrective action where infringements are identified.

Enforcers

Principle 3 Competent independent administrative authorities set up by member States should have the ultimate responsibility for enforcement of compliance of the financial information provided by the issuers identified by Principle 9 with the reporting framework.

198. Enforcement of compliance with GAAP for companies that are reporting issuers in Ontario is ultimately the responsibility of the OSC. This responsibility derives from the purposes and principles set out in the Act as well as specific provisions (e.g., Section 20.1(1)) providing the OSC or its staff with the authority to review disclosures that have been, or ought to have been, made by a reporting issuer.

199. In general, National Instrument 52-107 – Acceptable Accounting Principles, Auditing Standards and Reporting Currency provides that financial statements are to be prepared in accordance with Canadian GAAP, (defined by the Act as the principles recommended in the Handbook of The Canadian Institute of Chartered Accountants). However, in certain limited circumstances, financial statements may be prepared in accordance with US GAAP or International Financial Reporting Standards.

200. The approach to enforcement of compliance with financial reporting requirements is independent of whether financial statements are prepared in accordance with Canadian GAAP or another acceptable accounting framework such as US GAAP or IFRS. When another acceptable accounting framework is used the OSC takes steps to bring to bear particular expertise by using, for example, accountants who have greater knowledge and experience with that framework. In the case of reporting issuers that use US GAAP and are also SEC registrants, the OSC is experimenting with conducting joint reviews with the SEC.

Principle 4 Other bodies might carry out enforcement on behalf of the competent administrative authorities, provided that these bodies are supervised by and responsible to the relevant competent administrative authority.

201. The OSC does not delegate to other bodies its authority for enforcement of compliance with financial statement reporting requirements for Ontario reporting issuers.

202. The only other regulator that plays any role in enforcing the application of financial reporting standards for external reporting to shareholders is the Office of the Superintendent of Financial Institutions (Canada). The OSFI's primary concern is with prudential regulation and hence its role in enforcement of compliance with financial reporting standards is limited.

Principle 5 Irrespective of who carries out enforcement any standard on enforcement established by CESR should be complied with.

Not relevant

Principle 6 Competent administrative authorities shall have adequate independence from government, and market participants, possessing the necessary powers and having sufficient resources.

Independence

203. The OSC is established by the Act as the body with responsibility for administration and enforcement of securities legislation in the Province of Ontario. The OSC is accountable under the Act to the assigned minister in the provincial government and the accountability relationship is set out in a memorandum of understanding that is a matter of public record.

204. The management of the OSC's financial and other affairs is overseen by an independent board and operations are funded from the fees established by the OSC and charged to market participants. The powers and duties of the OSC, which include the ability to hold hearings and impose penalties against market participants, are assigned under the Act.

205. By employing a highly qualified, full-time professional staff with sufficient powers to meet their responsibility to investors and the public in the operation of the securities markets in Ontario, the OSC aims to ensure that it operates independently from market participants, issuers and auditors.

206. Commissioners and staff of the OSC are subject to the terms of a code of conduct that requires them to act at all times with honesty, integrity and impartiality. Each Commissioner and employee must confirm annually in writing that they have complied with the code of conduct. Rulemaking processes are subject to formal requirements that ensure transparency and the opportunity for broad public input independent of special interest groups.

207. The Commission is made up of at least 9 and not more than 14 members. The Chair, who is also the Chief Executive Officer of the Commission, is required to devote his or her full time to the work of the Commission. There are also currently 2 Vice-chairs who serve on a full time basis and the balance of the Commissioners is part-time members. Under the Act, the members of the Commission are not its employees.

208. The Commissioners as a group perform a policy-making function and also serve as the Board of Directors responsible for overseeing the management of the financial and other affairs of the Commission. The responsibilities of the Board do not extend, however, to directing the staff in the normal course exercise of their assigned regulatory powers and responsibilities. A strict separation is maintained between the Commissioners and staff with respect to decisions on matters such as restatement of financial statements. This is designed to ensure that a panel of Commissioners is able to make an objective assessment of staff decisions in, for example, a public hearing in which staff is seeking an order requiring an issuer to restate its financial statements or other disclosure. In such a setting, staff is required to argue their case to the panel of Commissioners and the issuer has a full opportunity to argue its position.

Resources

209. Ontario has approximately 5,320 reporting issuers of which they are principal for 1650. There are approximately 1,300 companies listed on the TSX and approximately 2,150 companies listed on the TSX-Venture Exchange. All entities with securities listed on the TSX or TSX-V are reporting issuers. In addition, a substantial number of entities that do not have listed securities are reporting issuers by virtue of having filed a prospectus and obtained a receipt.

210. The OSC assesses the resources required to meet its objectives through a business planning process that identifies the number of issuers expected to be reviewed, the nature of those reviews and the number of staff and balance of skills required. Further, through an ongoing evaluation of resources and the use of a risk-based approach they prioritize among many possible activities to ensure resources are most effectively employed and objectives are achieved.

211. There are approximately 44 professional staff (lawyers, accountants, etc.) working in the OSC's Corporate Finance Branch which is the group having primary responsibility for review of prospectuses and continuous disclosure documents for issuers other than investment funds.

212. Staff at the OSC is experienced in the application and enforcement of securities law and the application of accounting principles. A majority of the staff working with enforcement have a professional designation in their respective field. In addition, the OSC has an Enforcement Branch that investigates and prosecutes breaches of the Act of all types, including in appropriate circumstances matters relating to failure to comply with GAAP.

Principle 7 The necessary powers – which may be delegated to those acting on behalf of the competent independent administrative authority – should at least include power to monitor financial information, require supplementary information from issuers and auditors, and take measures consistent with the purposes of enforcement.

213. The Act gives the OSC the authority to conduct reviews of disclosure documents of reporting issuers in Ontario. If during the course of a review the OSC requests additional information or documents, section 20.1 of the Act requires the reporting issuer to provide such documents or information. In addition, section 11(1) of the Act provides the OSC with broad powers to investigate any matters deemed necessary for the due administration of the Act.

214. If during the course of a review or investigation, significant deficiencies are noted, the most relevant power available to the Commission is the ability to issue an order requiring a market participant to amend a document (including Financial Statements and Management Discussion & Analysis). Examples of deficiencies would be when the document has not complied with GAAP or any other aspect of Ontario securities law.

215. This power enables the OSC to order a reporting issuer to provide public correction and restatement concurrently through the filing of a press release describing the correction and by filing the document as 'amended'. In practice, achieving correction and re-filing of a deficient document is usually achieved through staff discussions with the issuer without the need for recourse to a Commission order.

216. If a reporting issuer does not comply with an OSC order to amend a document, or contravenes Ontario securities law in any way, section 127(1) of the Act enables the Commission to impose any of the following sanctions:

- cease the trading in securities of a company or by a person;
- forbid a company or person to rely on any exemptions contained in Ontario securities law;
- require a market participant to submit its practices and procedures for review;
- reprimand a person or company;
- require a person to resign from one or more positions as an officer or director of an issuer;
- prohibit a person from becoming or acting as director or officer of any issuer;
- require a person or company who has not complied with Ontario securities law to pay an administrative penalty of not more than $1 million for each failure to comply;
- require a person or company who has not complied with Ontario securities law to disgorge to the OSC any amounts obtained as a result of the non-compliance.

217. Alternatively, the OSC may also refer matters to the Provincial Court where, if convicted, a person or company may be liable for a fine of not more than $5 million or imprisonment for a term of five years less a day, or both.

218. Provincial and territorial securities commissions across Canada have a broadly comparable range of powers.

Principle 8 The competent administrative authorities should be responsible for: - the setting up of an appropriate due process of enforcement consistent with the application of the principles hereby stated; - the implementation of that due process.

219. The OSC has responsibility for both consistency of application and due process. See below under coordination.

Issuers and Documents

Principle 9
The principles for enforcement here identified should apply to financial information provided by issuers: a) whose securities are admitted to trading on a regulated market; b) that applied for admission to trading of their securities on a regulated market.

220. All entities that are reporting issuers in Ontario, (which include those listed on the Toronto Stock Exchange and the TSX Venture Exchange), are subject to the requirements of the Act and are therefore subject to review. A company conducting an initial public offering of securities is also subject to review before it is permitted to offer its securities to the market.

Principle 10
The principles for enforcement here identified should apply to financial information provided by all harmonized documents, including annual and interim financial statements and reports, prepared on individual and consolidated basis as well as prospectuses and equivalent documents.

221. OSC reviews include an examination of financial and non-financial information made available in the public domain. This information may be reviewed in the context of prospectuses, annual reports, annual financial statements, quarterly financial statements, annual information forms, information circulars, press releases, material change reports and other continuous disclosure documents. In many cases, the financial information included in these documents has been audited or reviewed.

222. The financial information prepared and presented by a reporting issuer is normally presented on a consolidated basis only. There is no requirement under GAAP or the Act to present separate unconsolidated financial statements for a parent company.

Methods of enforcement

Principle 11
For financial information other than prospectuses ex-post enforcement is the normal procedure, even if pre-clearance is not precluded.

223. In general, reviews of financial statements for compliance with GAAP are conducted after those statements have been filed with the OSC and made available on the public record. In the case of a prospectus, the approach differs slightly. In almost all cases, a preliminary version of a prospectus (including the financial statements) is made available in the public domain prior to regulatory review. The OSC always conducts and completes a review of a prospectus before issuing a final receipt and permitting sales to the public to proceed. In addition, the OSC may reopen or conduct a separate review of that prospectus while sales are being made or after sales have been made.

224. The OSC encourages issuers to seek pre-clearance of the accounting treatment proposed for a specific transaction where there are unique or complex issues involved. This practice is not used extensively.

Principle 12
For prospectuses ex-ante approval is the normal procedure as specified by the EU directives, which also identify the nature of the approval. Ex-post enforcement of financial information provided by prospectuses is possible as a supplementary measure.

225. See principle 11 above

Principle 13
Enforcement of all financial information is normally based on selection of issuers and documents to be examined. The preferred models for selecting financial information for enforcement purposes are mixed models whereby a risk based approach is combined with a rotation and/or a sampling approach.

However, an approach based solely on risk may be an acceptable selection method.

A pure rotation approach as well as a pure reactive approach is not acceptable. However, indications of misstatements provided by auditors or other regulatory bodies as well as well grounded complaints should be considered for enforcement investigations.

226. The OSC utilizes a risk-based approach to selecting reporting issuers for review. This approach is discussed in *OSC Staff Notice 11-719 – A Risk-based Approach to More Effective Regulation*. The approach is designed to enable the OSC to target those activities and market participants where they believe problems are more likely to arise. The types of risk that they attempt to mitigate through this focused approach include the risk that the issuer's regulatory filings and other public disclosure do not comply with applicable requirements and the risk that market participants will materially breach securities laws.

227. To determine which activities and market participants are considered 'high risk', OSC staff have developed detailed sets of criteria through previous experience, data analysis and awareness of best practices. Each criterion carries a weighting reflecting its overall importance in determining the risk rating. Issuers may be selected for a basic review, a full review or an issue oriented review focusing on particular accounting issue.

228. Prospectus review criteria include: issuers' corporate structure and underlying business; issuers' financial condition or results; nature of the offering; and corporate governance.

229. Continuous disclosure review criteria include: issuers' financial condition or results; stock trading activity; accounting methods and practices; auditor related issues; prior regulatory scrutiny; and any other factors that might impact market confidence.

230. If an initial assessment of an issuer identifies sufficient indicators of risk, the matter is selected for further review or investigation. The initial risk review is not determinative of the final outcome, however, as staff will neither initiate nor avoid regulatory action based solely on the results obtained through the initial application of the risk criteria.

231. OSC does not disclose why it selected a particular market participant or activity for detailed review.

232. The OSC believes its risk-based approach is an effective tool for selection, but point out that there are situations where they select activities or market participants for detailed review that may not meet the published criteria. For example, some reviews are undertaken on a random basis, partially to assist in assessing the effectiveness of the selection criteria and also to ensure that all market participants are subject to some regulatory review at least once every four years.

233. Some reviews are undertaken based purely upon discretion or judgement or as a result of a complaint.

Principle 14
In order to allow enforcers to adopt gradually the selection methods provided for by Principle 13, a mixed selection technique based on a combination of a random selection and rotation is considered a workable transitional step. However, such a methodology should be designed to give an adequate level of detection risk.

234. See principle 15 below.

Principle 15 Methods of enforcement on selected information cover a wide spectrum of possible checking procedures, ranging from pure formal checks to in-depth substantive in-nature checking. The level of risk should normally determine the intensity of the review to be performed by the enforcers. The type of document to be examined and the level of information available on the issuer is also to be taken into consideration.

235. The review process, as formally documented in a number of OSC Staff Notices, and most recently in *OSC Staff Notice 51-715 Corporate Finance Review Program Report – October 2004*, consists of routine formal checks for the general completeness and timeliness of filings for all issuers as well as more in-depth review for specific issuers as selected through the risk-based approach.

236. In applying the risk-based approach, an initial risk assessment is completed through a basic review, and the results are used to determine the level (or intensity) of further review that will be applied to the issuer. Typically, issuers with more risks or a higher risk profile are selected for full review while those with lower or less risk(s) are not reviewed further or are selected for issue-oriented review.

237. A basic review consists of an evaluation of areas of obvious concern in significant documents such as the annual financial statements and annual management's discussion and analysis. A full review consists of a detailed investigation of the issuer's full disclosure record. In general, at least a basic review is completed for all prospectuses filed by entities for which Ontario is the principal regulator. Also, a basic review of continuous disclosure documents is completed for all reporting issuers at least once during a four year period.

238. When an issuer's prospectus is selected for full review, OSC staff will perform a complete review of the document itself and documents incorporated by reference. When an issuer is selected for full review of continuous disclosure documents, OSC staff will complete a detailed review of the issuer's disclosure record for at least the past year, which will include regulatory filings, trading activity, industry data and analyst reports.

239. An issue-oriented review will be completed when the level of risk assessed does not warrant full review but a specific legal or accounting issue(s) is identified that warrants further detailed consideration. In this case, the review will focus primarily on the issue identified.

240. When an issuer is identified as higher-risk, either as a result of an initial risk review or a subsequent full review, OSC staff may undertake a "real-time" review of the reporting issuers' disclosure documents. A real-time review is a continuous monitoring of an issuer's regulatory filings as and when they are made, as well as media coverage, trading patterns and other ongoing disclosure documents. This approach is designed to facilitate prompt identification and resolution of issues.

241. In all cases, where problems are identified as a result of any particular form of review, staff will communicate with the issuer and both parties work to resolve the issues promptly.

Actions

Principle 16 Where a material misstatement in the financial information is detected enforcers should take appropriate actions to achieve an appropriate disclosure and where relevant, public correction of misstatement (in line with the requirements of the reporting framework). Non-material departures from the reporting framework will not normally trigger public correction even though they normally deserve an action as well. Materiality should be assessed according to the relevant reporting framework.

242. The objective of OSC reviews is to identify and correct material misstatements, or material non-compliance with GAAP, in the disclosure documents of reporting issuers. For this purpose, an item would be considered material if its omission or correction could change the decision of a user of financial statements or other financial information.

243. If staff establish that there is a misstatement but conclude that it is not material, staff may agree to allow correction of the error on a prospective basis. In these circumstances, the issuer would not be required to explain the correction. It is, however, common practice for an issuer to provide some discussion of the nature of the change in order to provide an accurate reflection of its substance.

244. As set out in *OSC Staff Notices 51-715 and 51-712 – Corporate Finance Review Program Report*, October 2004 and August 2003, the OSC has completed the following reviews in corporate finance in the past two years:

	April 1, 2003 to March 31, 2004	April 1, 2002 to March 31, 2003
Prospectuses, rights-offering documents	274	217
Continuous Disclosure reviews	361	194
	635	411

245. These reviews resulted in a number of outcomes such as disclosure enhancements, changes in the offering structure, additional legal requirements, re-filing of a document (see below), placement on the default list (see below) or referral for a more detailed investigation that may result in penalties.

246. The increase in the number of reviews between the two periods is primarily a result of refinements in the risk based selection criteria resulting in an improvement in the selection process and hence a more efficient allocation of resources to specific, identified problem areas, primarily through basic reviews.

247. Outcomes for the past two years in relation to the reviews set out above are as follows:

	April 1, 2003 to March 31, 2004	April 1, 2002 to March 31, 2003
Refilings, Retroactive Accounting Changes	75	82
Disclosure Enhancements	285	201
Placed on the default list	15	24
Additional legal requirements or change in the structure of the offering	14	26
	389	333

248. The outcomes relate to both financial and non-financial information in both prospectus and continuous disclosure documents. The majority of re-filings relate to financial information issues in continuous disclosure documents.

Principle 17
Actions taken by the enforcers should be distinguished from sanctions imposed by the national legislation. Actions are measures generally aimed at improving market integrity and confidence.

249. See actions below.

Principle 18
Actions should be effective, timely enacted and proportional to the impact of the detected infringement.

250. When a potential material misstatement is identified in a disclosure document such as the financial statements, staff will investigate the matter to determine whether there is in fact a misstatement and whether it is material. If staff establishes that there is in fact a material misstatement, staff will request that the issuer amend and re-file the document. If a resolution between staff and the issuer cannot be achieved, then staff will seek an order from the Commission requiring the issuer to amend and re-file the document.

251. By amending and re-filing the document, the issuer is acknowledging that the original filing was not prepared in accordance with the *Securities Act* (Ontario), and this material event is required to be clearly and broadly disclosed to the market in a timely manner.

252. As outlined in *OSC Staff Notice 51-711- List of Refilings and Corrections of Errors as a Result of Regulatory Reviews*, the OSC believe that this disclosure should be in the form of a publicly disseminated news release that clearly describes the changes and the reasons for them.

253. A copy of the news release is required to be provided to the OSC and is placed on the Re-filings and Errors list and maintained on the OSC web site (*www.osc.gov.on.ca*) for a period of three years from the date of re-filing. The Re-filings and Errors list provides transparency to the disclosure process and helps to maintain investor confidence.

254. In addition to the Re-filings and Errors list, the OSC also maintains on its website a list of defaulting issuers. These are issuers that are in default of their obligations under the Act. An issuer may be considered in default, for instance, if it is found to have filed and not corrected financial statements that are determined to be materially non-compliant with GAAP. Once the deficiency is corrected, the issuer's name will be removed from the list. This list provides further transparency to the disclosure process.

255. In addition to the actions described above that are intended to correct deficiencies in financial statements or other disclosure on a prompt and transparent basis, the OSC also has the power to take actions such as imposing a cease trade order. For example, in cases of failure to make timely filings of financial statements, it is staff's practice to seek from the Commission a management and insider cease trade order that will continue for the period until filings are brought up to date. In addition, while the cease trade order is in place, the issuer is required to provide regular bi-weekly updates to the market on current developments and progress in preparing the filings that are in arrears.

Principle 19
A consistent policy of actions should be developed, whereby similar actions are adopted where similar infringements are detected

256. See below.

Coordination in enforcement

Principle 20
In order to promote harmonization of enforcement practices and to ensure a consistent approach of the enforcers to the application of the IFRSs, coordination on ex-ante and ex post decisions taken by the authorities and /or delegated entities will take place.

Material controversial accounting issues will be conveyed to the bodies responsible for standard setting or interpretation.

No general application guidance on IFRSs will be issued by the enforcers.

257. Consistent decisions on the application of GAAP are achieved internally through the review of controversial issues by branch level management and the Office of the Chief Accountant. Consistency in the actions taken and outcomes achieved is facilitated through collective decision-making, with significant input from both groups. The review of prospectus and continuous disclosure documents is carried out by staff of the Corporate Finance Branch. The Branch is headed by the Corporate Finance Director who reports to the Executive Director of the OSC. Within the Corporate Finance Branch, there are 3 teams comprised of primarily lawyers and accountants. Each of these teams is led by a Manager and an Assistant Manager. Issues identified by reviewers on individual files are escalated within the Branch and to the Office of the Chief Accountant depending on their seriousness, level of complexity and hence need for specialised expertise and whether they are novel or unusual.

258. Coordination among the thirteen provincial and territorial securities regulators in Canada is achieved through the cooperation of the SRA's in the Canadian Securities Administrators. Consistency in decisions on the application of GAAP and in actions taken in response to infringements is promoted through joint projects, joint reviews and round table discussions at all levels of management and staff.

259. As set out in section 143(1) of the Act, the OSC has the ability to issue guidance that defines the "accounting principles and auditing standards acceptable to the [OSC]". The OSC has generally not relied on this power, but instead relied on the Accounting Standards Board and the Auditing and Assurance Standards Board of the Canadian Institute of Chartered Accountants (CICA) to set the accounting and auditing standards in Canada. However, in limited circumstances, when it is determined that timely guidance is needed, the OSC will issue staff notices, setting out staff's view on the appropriate application of accounting principles. Such staff guidance does not have legal force but has significant persuasive impact.

260. The OSC has a number of formal and informal communication channels with the standards-setting committees of the CICA, which is an independent arm's length body. In addition, the CSA has appointed the Chief Accountant of the OSC to participate as an observer on the Emerging Issues Committee (EIC), a sub-committee of the Accounting Standards Board of the CICA. The EIC provides published guidance on emerging accounting issues that are likely to receive divergent treatment in practice. Through participation on the EIC, the Chief Accountant of the OSC provides direct input into the standards-setting process relating to emerging accounting issues.

Reporting

Principle 21
Enforcers should periodically report to the public on their activities providing at least information on the enforcement policies adopted and decisions taken in individual cases including accounting and disclosure matters.

261. The OSC publishes annually a staff notice which summarizes the activity of the corporate finance branch for the year. The most recent publication, *OSC Staff Notice 51-715 – Corporate Finance Review Program Report – October 2004*, covers the fiscal period from April 1, 2003 to March 31, 2004. The staff notice discusses the type of reviews completed and the outcomes achieved. The staff notice also discusses significant accounting and legal issues noted during the year. Issues identified and the surrounding circumstances are always discussed in an anonymous form.

Appendix A

Members of the Canadian Securities Administrators
PROVINCE OR TERRITORY
(In alphabetical order)
CSA MEMBER
Alberta Securities Commission
British Columbia Securities Commission
Manitoba Securities Commission
Nova Scotia Securities Commission
Nunavut Department of Justice, Legal Registries Division
Ontario Securities Commission
Prince Edward Island Securities Section, Office of the Attorney General
New Brunswick Office of the Administrator of Securities
Securities Commission of Newfoundland and Labrador
Securities Registry, Department of Justice, Government of Northwest Territories
Québec L'Autorité des Marchés Financiers
Saskatchewan Financial Services Commission
Yukon Registrar of Securities, Government of Yukon

B. JAPAN

Definition of enforcement

Principle 1 The purpose of enforcement of standards on financial information provided by the issuers mentioned by principle 9 is to protect investors and promote market confidence by contributing to the transparency of financial information relevant to the investors' decision making process. With regard to financial statements, the above implies that enforcement contributes to a consistent

262. The Japanese Securities and Exchange law (SEL) states that the objective of enforcement is "to contribute to the proper operations of the national economy and protection of investors." The Japanese enforcement system[16] regards the first scope as a result of achieving the latter scope.

263. From the different annual reports Financial Services Agency (FSA) and Securities and Exchange Surveillance Commission (SESC) defines their role and scope on enforcement as:

- FSA is "responsible for ensuring the stability of the financial system in Japan, protection of depositors, insurance policy-holders and securities investors…"
- SESC has to "ensure fair trading in securities and financial future markets and maintain the confidence of investors in those markets."

264. SESC mandate is to focus on market fairness and will be a player where accounting standards are important to market fairness.

Principle 2

For the purpose of this standard enforcement may be defined as: • monitoring compliance of the financial information with the applicable reporting framework • taking appropriate measures in case of infringements discovered in the course of enforcement The reporting framework includes the accounting and disclosure standards adopted by the EU.

265. The definition of enforcement is to review documents, from the viewpoint of compliance with the GAAP and etc., and to take appropriate actions when improper treatments are found in the review process, in order to ensure proper disclosures.

266. FSA, through the delegation to LFBs, examines the compliance with the GAAP, see principle 3 and 4. Measures are described under principles 16-19 later in this paper.

Enforcers

Principle 3

Competent independent administrative authorities set up by member States should have the ultimate responsibility for enforcement of compliance of the financial information provided by the issuers identified by Principle 9 with the reporting framework.

Principle 4

16 See section on enforcers.

CESR

Other bodies might carry out enforcement on behalf of the competent administrative authorities, provided that these bodies are supervised by and responsible to the relevant competent administrative authority.

267. The ultimate responsibility for enforcing financial reporting and prospectuses is with the FSA and FSA is to be regarded as the competent administrative authority in this regard. The review task itself is delegated to the Local Financial Bureaus (LFBs are eleven different offices at this moment, by July the delegation as regards to part of the review task such as carrying out examination and demanding submission of reports regarding the statutory disclosure documents to Kanto LFB (Tokyo) will be transferred to SESC) . At this stage, it is too early to say anything about the details of future arrangement between Kanto LFB and SESC. FSA will give directions and take the role as policymaker for the LFBs. FSA also contributes as regards to selection by indicating different risk areas etc. to the LFBs.

268. The LFBs will review registration filings and any financial reporting (annual and semi annual accounts), including listed banks and insurance companies from the viewpoint of investor protection purposes. In addition, the LFBs will review banks that are regarded as small and/or regional from the viewpoint of prudential purposes. The major banks and all insurance companies will be handled from the viewpoint of prudential purpose by the different prudential departments in FSA, regardless of whether they are listed or not. There are different departments in FSA (financial markets and prudential supervision (banks division and insurance business division) that would possibly be involved in cases that includes banks and insurance entities.

269. The Kanto bureau is the bureau that mainly handles the large companies with their capital over 5 billion yen, and foreign companies as well as companies in the Tokyo area and is the bureau that has the most resources as regard to accounting expertise.

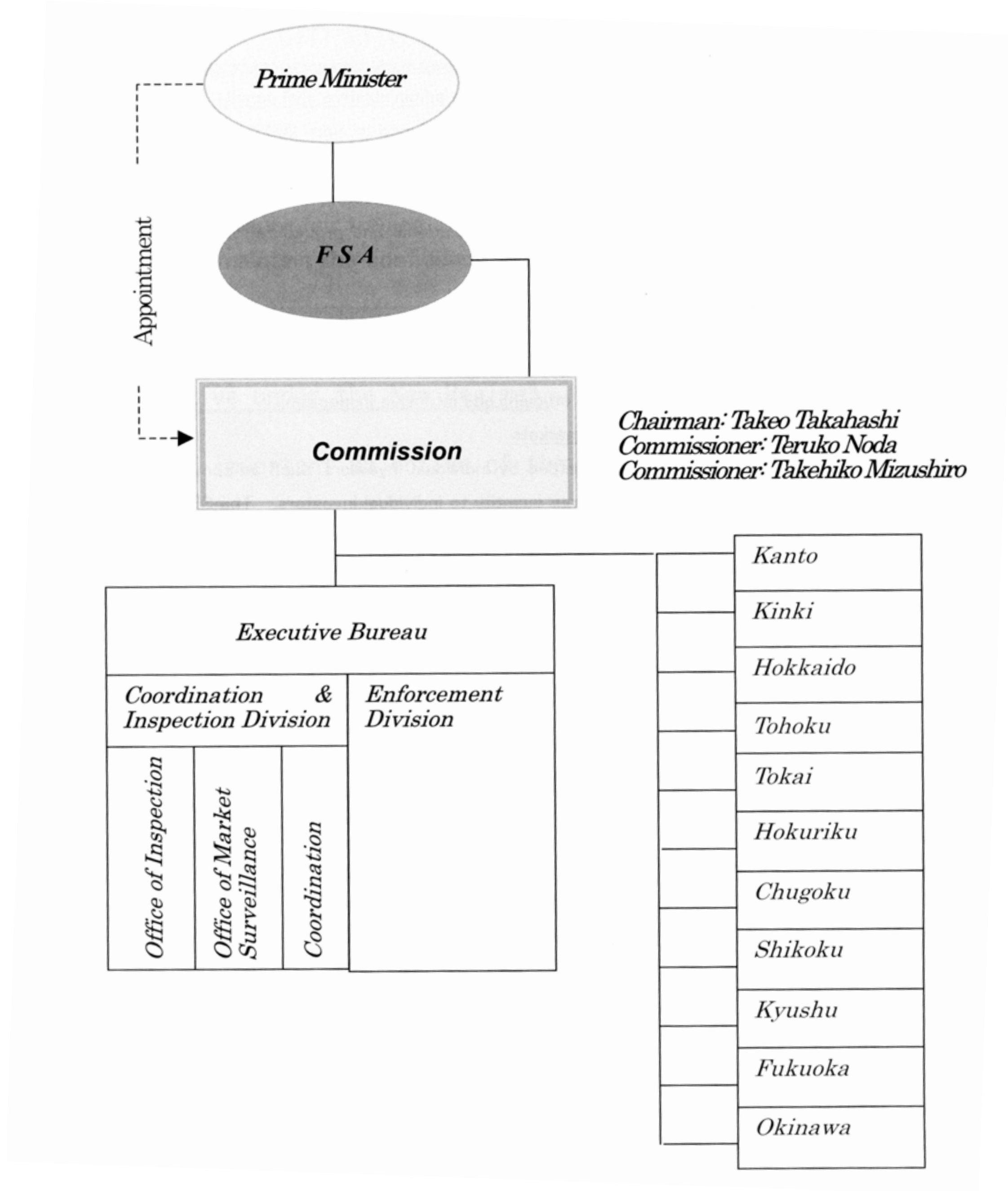
270. SESC plays a role in dealing with criminal offence cases, and sometimes work with securities surveillance officials placed under LFB chiefs. SESC receives information from FSA and LFBs when there is a suspicion as to a material misstatement which may fall within the scope of a criminal offence in one of the documents mentioned above. SESC has the authority to conduct criminal investigation, and if it is convinced that there is an illegal act involving submitting financial reports containing material false information, such material misstatements are sent to public prosecutors for indictments. The two divisions Coordination/Inspections and Enforcement have different roles. The enforcement division investigates criminal cases (or cases regarded as a possible criminal offence) and SESC has the power to send cases to public prosecutors. A number of cases are referred to SESC by the different LFBs. The coordination/inspection division conducts on-sight inspections on broker dealers, to check their compliance with securities laws and regulations, and the SESC would recommend any use of disciplinary actions against securities companies to FSA.

271. Furthermore the FSA supervises the stock exchanges and approve their listing rules. The exchanges are membership organisations, privately owned companies and a listed company.

272. The securities exchanges, as market operators, have their own roles in performing self-regulatory functions such as listing examinations of applicants under their listing rules, and oversight of the timely disclosure(including releases of financial results), and delisting of listed companies in such cases of material misstatements of periodic statutory disclosure documents.

273. FSA also supervises the auditors and Certified Public Accountants and Auditing Oversight Board ("CPAAOB") recommends disciplinary actions against auditors to FSA. FSA participates as an observer in the Japanese accounting standard board.

Organisation of SESC



Principle 5

Irrespective of who carries out enforcement any standard on enforcement established by CESR should be complied with.

274. (not relevant)

Principle 6

Competent administrative authorities shall have adequate independence from government, and market participants, possessing the necessary powers and having sufficient resources.

Independence

275. FSA regard themselves as a part of the Japanese government, and therefore the independence from market participants is secured.

276. The chairman and two commissioners of the SESC are appointed by the Prime Minister with the consent of both Houses. They are guaranteed to exercise their authority independently, and the decision of the commission is taken by a simple majority. They cannot be dismissed against their will during their tenure of 3 years to ensure their independence. They must not take a position of an officer in any political organisation nor actively involved in political activities. And they must not engage in other occupation for monetary rewards, operate commercial businesses, nor any other operations for the purpose of financial profit.

277. The staffs of the LFBs and the SESC is national government officials, and their independence from market participants, issuers, auditors and other stakeholders is required, pursuant to the National Public Employee Ethics Rules. Independence from the market is regarded as established by their governmental role, see above.

278. The stock exchanges are membership organizations, privately owned companies and a listed company.

Resources

279. FSA and SESC have its own budget set by the government. LFB's budget are a integrated part of the budget of the Ministry of Finance since the LFBs also do surveillance of financial stability and other macro economic tasks for the Ministry of Finance. Basically, the budget is separately managed by objectives. SESC has approximately 148 persons (including officials of LFBs, in-charge of criminal investigations) in their staff dedicated to investigate criminal cases including financial reporting issues(as of 31 March 2004), and LFBs have approximately 56 persons in their staff dedicated to financial reporting issues (as of 30 November 2004). The securities exchanges employ 163 persons performing self-regulatory functions such as listing examinations but not all of this work with examinations on financial reporting other than timely disclosure (as of 30 November 2004). The number of issuers in Japan is approximately 4,500 (as of 31 December 2003).

Powers

280. See below.

Principle 7

The necessary powers – which may be delegated to those acting on behalf of the competent independent administrative authority – should at least include power to monitor financial information, require supplementary information from issuers and auditors, and take measures consistent with the purposes of enforcement.

281. FSA has delegated their powers to the LFBs. The LFBs have powers to review disclosure documents, order any parties involved in public offering or public selling including auditors to report or submit written materials, and inspect financial records and other documents. If material misstatements are found, the LFBs have the powers under the SEL to require issuers to file the corrected disclosure documents or to suspend effect of the registration documents at any time as necessary.

282. The SESC has the powers of interrogations and inspections, in order to investigate criminal offences such as material misstatements. In addition, staff of the SESC may conduct spot inspections, investigations and seizures, with written permission issued by a judge. Furthermore, if existence of criminal offences is confirmed during their investigation, the SESC shall file complaints with public prosecutors.

283. Pursuant to the listing rules, the securities exchanges have the following powers in listing examinations, timely disclosures, and delisting listed companies from the securities exchanges:

- To approve listing on exchanges, when companies applying for listings are confirmed to meet the listing criteria approved by the FSA.
- To receive prior explanation from listed companies, and make inquiries to them for necessary information of timely disclosure.
- To take actions, such as ordering submission of reports which explain how to improve their disclosure ("improvement reports"), if timely disclosures made are inappropriate.
- To delist listed companies, if necessary, when periodic reports have been materially corrected.

Principle 8

The competent administrative authorities should be responsible for:

- the setting up of an appropriate due process of enforcement consistent with the application of the principles hereby stated;
- the implementation of that due process.

284. FSA has the responsibility for both consistency of application and the due processes. See below on coordination.

Issuers and documents

Principle 9

The principles for enforcement here identified should apply to financial information provided by issuers:
a) whose securities are admitted to trading on a regulated market;
b) that applied for admission to trading of their securities on a regulated market.

285. All issuers of securities that are admitted to trading on a regulated market are within the scope of the Japanese enforcers. Furthermore, applicants for admission to such market are within the

scope of the enforcement through registration documents. The Stock Exchanges conduct examinations in accordance with the listing rules approved by FSA.

Principle 10

The principles for enforcement here identified should apply to financial information provided by all harmonized documents, including annual and interim financial statements and reports, prepared on individual and consolidated basis as well as prospectuses and equivalent documents.

286. The issuers will include all listed issuers of equity and debt instruments, such as shares and bonds. All issuers are subject to the same enforcement regardless of instrument issued/listed.

287. Disclosure documents are defined as statutory documents required by law such as registration statements and continuous documents that would include annual, semi annual and current reports and non-statutory documents such as the listing documents. Corrective information as required by LFB are published and on the EDINET.

288. Registration documents are filed to the LFBs, and after the filing an issuer issues prospectuses for a public offer.

289. An improvement report to the securities exchanges would include a description of what was regarded as improper and what measures are taken to improve the improper practice. The report is then published on the securities exchanges' websites.

METHODS OF ENFORCEMENT

Principle 11

For financial information other than prospectuses ex-post enforcement is the normal procedure, even if pre-clearance is not precluded.

Principle 12

For prospectuses ex-ante approval is the normal procedure as specified by the EU directives, which also identify the nature of the approval. Ex-post enforcement of financial information provided by prospectuses is possible as a supplementary measure.

290. For annual reports, semi-annual reports, and registration statements, ex-post enforcement (i.e. after a statement has been published) is the normal procedure. For registration statements, however, enforcement is normally performed before a statement is made effective, since registrations are normally effective fifteen days after the day when the LFB accepts registration statements. Enforcement procedure by the SESC is ex-post.

291. Examination of registration documents of companies applying for listing is ex-ante, and the normal procedures to determine whether timely disclosures are made appropriately is both ex-ante and ex-post. Actions taken by the securities exchange, when annual reports, semi-annual reports or registration statements have been materially corrected, are ex-post.

292. The Japanese enforcement mechanism does not offer pre-clearances.

Principle 13

Enforcement of all financial information is normally based on selection of issuers and documents to be examined.

The preferred models for selecting financial information for enforcement purposes are mixed models whereby a risk based approach is combined with a rotation and/or a sampling approach.

However, an approach based solely on risk may be an acceptable selection method.

A pure rotation approach as well as a pure reactive approach is not acceptable. However, indications of misstatements provided by auditors or other regulatory bodies as well as well grounded complaints should be considered for enforcement investigations.

Principle 14

In order to allow enforcers to adopt gradually the selection methods provided for by Principle 13, a mixed selection technique based on a combination of a random selection and rotation is considered a workable transitional step. However, such a methodology should be designed to give an adequate level of detection risk.

293. For registration statements, the LFBs mainly examine those of new issuers (i.e. issuers who file registration statements for the first time).

294. For periodic filing statements, the LFBs select disclosure documents to be examined based on their risks and timings of rotations. When the LFBs adopt a risk-based approach, the financial conditions of issuers, auditors' opinions, and other factors are considered. The other factors considered can be information from the volunteer "disclosure hotline", media attention, complaints received etc. Auditors are not required to, but possibly, file information to the enforcers if they suspect any misstatement etc. They would of course sign an auditor's opinion with reservation if signed at all. The auditor first responsibility are toward the issuer and the auditor will, if improper accounting practices are found, tell the issuer to send corrective information to the LFBs.

295. In addition, target reviews, which are chosen in accordance with the policies set in advance for each reporting period, such as newly introduced accounting standards and disclosure items are examined. LFBs use a rotation based approach as well to ensure that all issuers are reviewed regularly.

296. The SESC actively makes use of information collected through telephone calls, mails, personal visits, news reports, contents of disclosure documents, and information communicated from the LFBs; and if such information implies possible material misstatements in disclosure documents, detailed investigation is conducted as necessary.

297. The securities exchanges examine all issuers applying for listing. Examinations of whether listing requirements are met are based on listing application documents.

298. If annual reports, semi-annual reports or registration statements have been materially corrected, the documents of all such listed companies are subject to examinations by the securities exchanges in terms of whether their issues are appropriate for listing. The contents of corrections are examined by in-charge staff at the securities exchanges by reviewing such corrected filing statements, and requiring explanations for the reason and the process of the corrections from the issuers as necessary.

Principle 15

Methods of enforcement on selected information cover a wide spectrum of possible checking procedures, ranging from pure formal checks to in-depth substantive in-nature checking. The level of risk should normally determine the intensity of the review to be performed by the enforcers. The type of document to be examined and the level of information available on the issuer is also to be taken into consideration.

299. LFBs usually do review that are desk based but are also able to conduct inspections onsite. If the level of risk indicates a criminal offence of substance the case is referred to SESC for further investigations. If existence of criminal offences are confirmed based on its investigation, the SESC shall file complaints with public prosecutors.

Actions

Principle 16

Where a material misstatement in the financial information is detected enforcers should take appropriate actions to achieve an appropriate disclosure and where relevant, public correction of misstatement (in line with the requirements of the reporting framework). Non-material departures from the reporting framework will not normally trigger public correction even though they normally deserve an action as well.

Materiality should be assessed according to the relevant reporting framework.

300. "Material misstatements" are considered to be the case where misstatements will have significant impact on investors' decision making. This may not necessarily be a criminal offence as defined in SEL, but would lead to enforcement decisions. A possible criminal offence would lead to the national court.

Principle 17

Actions taken by the enforcers should be distinguished from sanctions imposed by the national legislation. Actions are measures generally aimed at improving market integrity and confidence.

Principle 18

Actions should be effective, timely enacted and proportional to the impact of the detected infringement.

Principle 19

A consistent policy of actions should be developed, whereby similar actions are adopted where similar infringements are detected.

301. If material misstatements are found, the LFBs have the powers to require issuers to file corrected disclosure documents and suspend the effects of the registration statements, if considered necessary. If inappropriate accounting treatments are found in the review process of the LFBs, and they may fall within the scope of criminal offences to be investigated by the SESC, the relevant information are provided to the SESC. The SESC shall file complaints with public prosecutors, when the SESC confirms possible criminal offences in their investigation. If a possible criminal offence is

investigated with the SESC and considered not material, information on the case is possibly sent to the LFBs.

302. LFB can also ask for corrected documents for periodic disclosure documents, and these documents are then filed on the EDINET and made available to all investors. In cases of registration filings, the LFB can also ask for a corrected filing.

303. The securities exchanges require the issuers to disclose the content of the corrections, when corrections of timely disclosure documents are necessary. The securities exchanges order submissions of improvement reports, and make such reports public, if timely disclosures made by listed companies are inappropriate, and if necessary. If annual reports, semi-annual reports or registration statements have been materially corrected, the securities exchanges require the listed companies to disclose the contents and the reasons of the corrections to the public. The securities exchanges assign stocks of such companies to the "supervision post", where investors are warned that companies might fall under the delisting criteria, and the securities exchanges examine the necessity of delisting. If the effects of the corrections made are considered material, the securities exchanges delist such companies.

304. The supervision post is a list of securities that are subject to investigation etc for delisting. Securities assigned the supervision post can be traded like usual securities, but the list will inform investors that they are taking risk as regard to a possible delisting or other measures taken. The exchange is responsible for delisting based on its delisting criteria. FSA may order the exchanges to delist a particular security if the securities exchanges do not take appropriate measures.

Coordination in enforcement

Principle 20

In order to promote harmonization of enforcement practices and to ensure a consistent approach of the enforcers to the application of the IFRS's, coordination on ex-ante and ex-post decisions taken by the authorities and /or delegated entities will take place.

Material controversial accounting issues will be conveyed to the bodies responsible for standard setting or interpretation.

No general application guidance on IFRS's will be issued by the enforcers.

305. The Kanto LFB acts as the coordinator amongst the different LFBs and ensures consistency between the LFBs' decisions and actions. FSA will co-ordinate in their role as competent administrative authority for both the SESC and the different LFB, mainly the Kanto LFB. The LFBs shall report enforcement cases including controversial ones to the FSA, as delegated bodies. The LFBs shall consult with the FSA which directs the LFBs, when interpretations of accounting standards are ambiguous.

306. FSA has an observer status in the deliberations of ASBJ (Japanese accounting standard setter) and issues notes that standards issued by ASBJ is to be regarded as Japanese GAAP. There is, however, not much direct cooperation and communication between other enforcers and the standard setter as regard to enforcing financial reporting. Auditors may have a contact with the standard setter in order to consult etc. FSA has, as an observer, thorough information an insight in both recent standards and other developing issues.

307. FSA (or other of the above mentioned organizations) does not issue general interpretation guidance in accounting matters.

REPORTING

Principle 21

Enforcers should periodically report to the public on their activities providing at least information on the enforcement policies adopted and decisions taken in individual cases including accounting and disclosure matters.

308. All involved parties publish reports that describe the work and highlights particular points of interest. The Kanto LFB publishes analysed results of their review on selected target items such as newly introduced accounting standards and disclosure items to the public. SESC in their annual report highlight cases that are sent to public prosecutors.

309. Both FSA and SESC publish annual reports that include reports of their activities and responsibility. In SESC's annual report there is an annex outlining the main cases in the previous year.

C. UNITED STATES

Definition of enforcement

Principle 1

> The purpose of enforcement of standards on financial information provided by the issuers mentioned by principle 9 is to protect investors and promote market confidence by contributing to the transparency of financial information relevant to the investors' decision making process.
>
> With regard to financial statements, the above implies that enforcement contributes to a consistent application of the IFRS's in the EU financial regulated markets.

310. Following the U.S. stock market crash of 1929, Congress passed the Securities Act of 1933 and the Securities Exchange Act of 1934, which established the U.S. Securities and Exchange Commission to enforce the new securities laws and regulatory scheme, promote stability in the markets, and protect investors.

311. The SEC's enforcement of compliance with US GAAP takes place within the context of the SEC's enforcement of the United States federal securities laws and the related SEC regulations prescribing full and fair disclosure to investors.

Principle 2

> For the purpose of this standard enforcement may be defined as:
>
> - monitoring compliance of the financial information with the applicable reporting framework
> - taking appropriate measures in case of infringements discovered in the course of enforcement
>
> The reporting framework includes the accounting and disclosure standards adopted by the EU.

312. The Securities and Exchange Commission (SEC) enforces compliance with US GAAP in the financial statements of public companies.

313. The SEC's Divisions of Corporation Finance and Investment Management[17] staff regularly review issuer filings of all types for the purpose of improving disclosure to investors, including clear explanations of accounting policies, financial events and conditions, and proper application of US GAAP.

314. The Commission's Enforcement Division conducts investigations into possible violations of the federal securities laws, and when authorized by the Commission, files the Commission's civil suits in the federal courts as well as in administrative proceedings. Investigative actions of the Enforcement Division can be initiated at any time when there is a suspected violation of the US securities laws. The Commission can institute other proceedings as needed.

315. Through the review and other enforcement activities, the staff seeks to ensure that investors are provided with material information that is of high quality and to deter and punish fraud and misrepresentation related to the public offering, trading, voting and tendering of securities.

Enforcers

[17] The SEC's Division of Investment Management reviews the annual and periodic reports and other filings of registered investment companies such as mutual funds and other pooled investment entities and public utility holding companies

Principle 3

Competent independent administrative authorities set up by member States should have the ultimate responsibility for enforcement of compliance of the financial information provided by the issuers identified by Principle 9 with the reporting framework.

316. The SEC is the ultimate enforcer of US GAAP for companies whose securities are traded in the US capital market and directly enforces the application of US GAAP by issuers filing documents with the SEC.

Principle 4

Other bodies might carry out enforcement on behalf of the competent administrative authorities, provided that these bodies are supervised by and responsible to the relevant competent administrative authority.

317. The SEC's responsibilities for enforcement of proper application of US GAAP are not delegated to any other body, although there are other participants and factors in the US capital market that also enforce or promote issuers' compliance with GAAP and high quality disclosure to investors.

318. The US Department of Justice may bring criminal actions against issuers for fraudulent financial statements and other violations of law, thereby providing a further enforcement of proper application of US GAAP. (If a violation of US GAAP is of a nature that criminal penalties would be triggered, the SEC may refer the case to the Department of Justice. The Department of Justice may also develop an independent interest in a matter and commence a criminal prosecution.).

319. Other US financial regulators, which are concerned primarily with the safety and soundness of financial institutions, also have requirements for financial statements prepared in accordance with US GAAP. These regulatory organizations may initiate questions and request corrective actions with respect to their regulated entities. Such regulators would typically consult with the SEC when a matter of GAAP application in public company financial statements is challenged but disputed by the reporting company and its auditor.

320. Section 241 of the Graham-Leach-Bliley Act requires that the SEC consult with the appropriate banking agency before taking any action regarding the reporting or disclosures of loan loss allowances in the financial statements of depository institutions. Such requirement is for an informal consultation to occur, not a prescribed outcome. If the accounting in question is GAAP for a public listed company, this would fall under the SEC's authority. (Banking regulators would of course have principal responsibility for enforcing any special regulatory accounting they may impose in addition to GAAP.).

Principle 5

Irrespective of who carries out enforcement any standard on enforcement established by CESR should be complied with.

321. (not relevant)

Principle 6

Competent administrative authorities shall have adequate independence from government, and market participants, possessing the necessary powers and having sufficient resources.

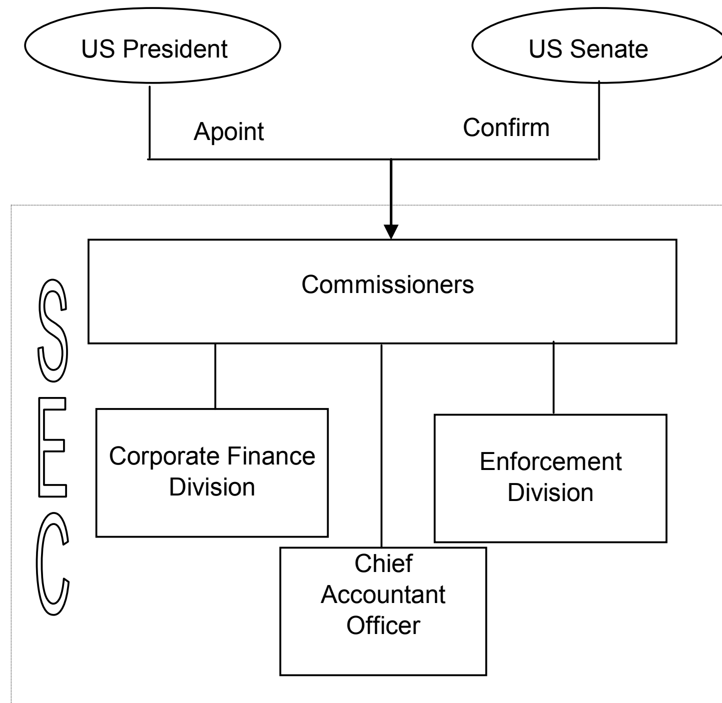
Independence

322. The SEC operates under a bipartisan Commission composed of five Commissioners appointed by the President and confirmed by the US Senate. One of the Commissioners is designated as the Chairman by the President. A Commissioner may only be removed for cause. If the Commissioner opposed removal, it would require impeachment by Congress.

323. The SEC's status aims to ensure a protection from political interference that might arise from special interest by giving a full authority to regulate and enforce the securities laws and states a legal requirement to have no more than three Commissioners drawn from any one political party, and other protections

324. The SEC has professional staff that is a mix of long-time career government employees, formal academic and professional fellowship positions typically of one to two years, and persons spending portions of their careers at the SEC (e.g. three to ten years) in SEC work.

325. SEC employees are subject to ethics requirements that are designed to promote objectivity and independence including restrictions on ownership and trading of securities, outside employment, compensation and gifts from outside organizations, personal financial disclosure requirements and other matters18.



Resources

326. The SEC has approximately 4100 employees located in 4 Divisions and 20 Offices and deployed at 11 regional and district office locations throughout the United States.

[18] For the most part, the financial disclosure data that SEC staff employees must provide each year is used only for internal control purposes and is not released to the public. The information for senior officials and certain other designated individuals on the staff does get published in the US Federal Register

327. Approximate number of people devoted to review of issuer filings in the SEC's Division of Corporation Finance is 500. The number of Investment Management Division employees involved in reviewing accounting and financial reporting matters is 60 and staff that advise on financial reporting matters in the SEC's Office of the Chief Accountant is 60.

328. The SEC Enforcement Division has approximately 935 employees, some of which are specialists devoted to enforcement cases related to accounting and financial reporting matters. In 2004, approximately 28% of the cases were related to accounting and financial reporting matters.

329. Each year the SEC budget is prepared according to program needs and submitted by the President to the US Congress for approval. The 2005 budget for the agency was $913 million dollars, a 30% increase over the 2004 budget of $700 million, and the proposed budget for 2006 is $888 million. At the $888 million level, the level of funding is more than double the level of funding in 2002 ($438 million).

330. The number of issuers that filled annual reports at SEC as for 31 December 2003 were 12 830.

Powers

See below.

Principle 7

The necessary powers – which may be delegated to those acting on behalf of the competent independent administrative authority – should at least include power to monitor financial information, require supplementary information from issuers and auditors, and take measures consistent with the purposes of enforcement.

331. The SEC' staff 19 has the power to:

- requesting explanations and justifications of accounting treatments therein that appear questionable or incomplete
- engage in conference calls and meetings with issuers and auditors on such matters;
- take testimony from issuers and auditors and others.;
- subpoena documents and testimony from issuers, auditors, third parties, and generally undertakes a comprehensive and thorough investigation into allegations of financial fraud when this is warranted.;
- undertake on site inspections;
- requests issuers to restate results or make corrective disclosures when needed;
- suspend trading and deregister a security. In the case of delisting, the action would be carried out by the relevant exchange.

332. Under the securities laws the Commission can bring enforcement actions20 either in the federal courts or internally before an administrative law judge. The factors considered by the Commission in deciding how to proceed include: the seriousness of the wrongdoing, the technical nature of the matter, tactical considerations, and the type of sanction or relief to obtain. Often, when the misconduct warrants it, the Commission will bring both proceedings.

[19] It could be done by Corporate Finance Division, Accounting Officer or, under an investigative procedure, Enforcement Division, depending on circumstances as described under "Methods of Enforcement".
[20] The distinction between actions and sanctions relates with US legislation which can differ from the distinction states on principle 17 of Standard n.º 1.

- **Civil action:** The Commission files a complaint with a U.S. District Court that describes the misconduct, identifies the laws and rules violated, and identifies the sanction or remedial action that is sought. Typically, the Commission asks the court to issue an order, called an injunction, that prohibits the acts or practices that violate the law or Commission rules. A court's order can also require various actions, such as audits, accounting for frauds, or special supervisory arrangements. In addition, the SEC often seeks civil monetary penalties and the return of illegal profits, known as disgorgement. The courts may also bar or suspend an individual from serving as a corporate officer or director. A person who violates the court's order may be found in contempt and be subject to additional fines or imprisonment.
- **Administrative action:** The Commission can seek a variety of sanctions through the administrative proceeding process. Administrative proceedings differ from civil court actions in that they are heard by an administrative law judge (ALJ). The administrative law judge presides over a hearing and considers the evidence presented by the Division staff, as well as any evidence submitted by the subject of the proceeding. Following the hearing the ALJ issues an initial decision in which he makes findings of fact and reaches legal conclusions. The initial decision also contains a recommended sanction. Both the Division staff and the defendant may appeal all or any portion of the initial decision to the Commission. The Commission may affirm the decision of the ALJ, reverse the decision, or remand it for additional hearings. Administrative sanctions include cease and desist orders, suspension or revocation of broker-dealer and investment adviser registrations, censures, bars from association with the securities industry, and payment of civil monetary penalties, and return of illegal profits.

333. The SEC has civil enforcement authority, but it works closely with various criminal law enforcement agencies throughout the country to assist with criminal cases when the misconduct warrants more severe action.

Principle 8

The competent administrative authorities should be responsible for: • the setting up of an appropriate due process of enforcement consistent with the application of the principles hereby stated; • the implementation of that due process.

334. SEC has the responsibility for both consistency of application and the due process.

Issuers and documents

Principle 9

The principles for enforcement here identified should apply to financial information provided by issuers: a) whose securities are admitted to trading on a regulated market; b) that applied for admission to trading of their securities on a regulated market.

335. All issuers offering securities under the 1933 Act or listing on U.S. exchanges and all entities that issue publicly traded debt (US domestic and foreign private issuers that are registered with the SEC) come under the SEC staff's regular review and enforcement processes.

Principle 10

The principles for enforcement here identified should apply to financial information provided by all harmonized documents, including annual and interim financial statements and reports, prepared on individual and consolidated basis as well as prospectuses and equivalent documents.

336. The SEC staff reviews and enforces the application of US GAAP in prospectuses, listing documents, registration statements, periodic reports and ongoing reports filed with the SEC. Periodic and ongoing reports include annual and quarterly reports and reports of material developments.

337. For many issuers, SEC staff reviews include all forms and data required when shareholders must vote on proposed acquisitions, disposals, and other material corporate events.

338. All information supplied to the SEC and to the public is subject to the relevant provisions of the securities laws and is subject to SEC enforcement, including investigations and enforcement proceedings, without any distinction between securities or nationality of the issuer.

Methods of enforcement

Principle 11

For financial information other than prospectuses ex-post enforcement is the normal procedure, even if pre-clearance is not precluded.

Principle 12

For prospectuses ex-ante approval is the normal procedure as specified by the EU directives, which also identify the nature of the approval. Ex-post enforcement of financial information provided by prospectuses is possible as a supplementary measure.

339. All registration statements for initial public offerings are reviewed ex ante before the securities to be offered may be sold to the public; however, in these cases the financial statements involved have been filed with the SEC and are already publicly available through the EDGAR system, and are therefore available to any investor or prospective investor while the review is going on. Changes may occur in these documents as a result of the review effort. Exchange Act registration statements for a first-time filer are also reviewed.

340. Subsequent registration statements and prospectuses are reviewed if they meet certain internal criteria that are set by the SEC staff. A few registration statements, such as Form 8-A (registration of certain classes of securities under the Exchange Act by a reporting issuer) and Form S-8 (registration statement for securities to be offered under any employee benefit plan by a reporting issuer), and similar forms for investment companies, become effective immediately without staff review. However, these registration statements are still subject to ex-post review and enforcement action.

341. All quarterly and annual reports are subject to ex-post review and enforcement action. Periodic reports are selected for review if they meet certain internal staff criteria. Under the Sarbanes-Oxley Act, all reporting companies must be reviewed by the SEC staff at least once every 3 years.

342. In meantime, SEC Enforcement Division may commence an investigation at any time that a violation of the securities laws is reported or suspected.

343. The SEC offer pre-clearances. In fact, issuers and their auditors are encouraged to and do bring inquiries regarding unusual transactions and proposed treatments to the SEC staff in the Office of the Chief Accountant and do so frequently (getting the pre-clearance facility). The SEC Divisions of Corporation Finance and Investment Management also respond to questions in advance of securities filings.

Principle 13

Enforcement of all financial information is normally based on selection of issuers and documents to be examined.

The preferred models for selecting financial information for enforcement purposes are mixed models whereby a risk based approach is combined with a rotation and/or a sampling approach.

However, an approach based solely on risk may be an acceptable selection method.

A pure rotation approach as well as a pure reactive approach is not acceptable. However, indications of misstatements provided by auditors or other regulatory bodies as well as well grounded complaints should be considered for enforcement investigations.

Principle 14

In order to allow enforcers to adopt gradually the selection methods provided for by Principle 13, a mixed selection technique based on a combination of a random selection and rotation is considered a workable transitional step. However, such a methodology should be designed to give an adequate level of detection risk.

344. The SEC staff uses a variety of approaches that include risk-based assessments, regular rotating review of all issuers at various intervals using size and frequency criteria, special topical review of selected subject areas, and both full review and partial review approaches.

345. The risk factors considered includes whether the issuer has issued material restatements of financial results, whether the issuer has experienced significant volatility in its stock price compared to other issuers, the size of the issuer's market capitalization, whether the issuer is an emerging company and has disparities in its price-earnings ratio, and whether the issuer's operations affect any material sector of the economy, among other factors.

346. As a result of the Sarbanes-Oxley Act, every reporting issuer will be subject to a review at least once every 3 years.

347. SEC Enforcement Division investigations may be triggered by employee whistleblower complaints or anonymous tips to an SEC hotline as listed on the SEC website.

Principle 15

Methods of enforcement on selected information cover a wide spectrum of possible checking procedures, ranging from pure formal checks to in-depth substantive in-nature checking. The level of risk should normally determine the intensity of the review to be performed by the enforcers. The type of document to be examined and the level of information available on the issuer is also to be taken into consideration.

348. Once a filing is selected for a full review, attorneys and accountants from the SEC's Divisions of Corporation Finance and Investment Management review the documents for compliance with the applicable legal and accounting requirements. The staff reviews all registration statements (which include prospectuses) for initial public offerings and all Exchange Act registration statements that are filed by first time filers to register a class of securities for listing. These registration statements are given a full review by the staff, although such reviews do not include an inspection of the issuer itself.

349. The staff may select subsequent filings for review if it has a specific concern about the issuer's industry group or about a specific financial statement disclosure that it has observed, among other things. A filing that is selected for review in that case may be subject to a more limited review that focuses on the issue of concern to the SEC staff. In any case, every reporting issuer is subject to a review21 at least once every 3 years.

350. The general process for the Divisions of Corporation Finance and Investment Management review of disclosure and application of US GAAP involves reading the documents that have been filed and issuing comment letters to issuers, including requesting explanations and justifications of accounting treatments therein that appear questionable or incomplete.

351. When issues arise regarding the application of GAAP, the SEC Office of the Chief Accountant may also review filing documents, along with any explanations and justifications of accounting treatments and disclosures therein.

352. The Office of the Chief Accountant and the Divisions of Corporation Finance and Investment Management do not routinely review source documents or work papers, although reviews of such documents may take place if the SEC Enforcement Division commences an investigation. The Enforcement Division may also take testimony from issuers and auditors and others. The Commission, through its Enforcement Division, can subpoena documents and testimony from issuers, auditors, third parties, and generally undertakes a comprehensive and thorough investigation into allegations of financial fraud when this is warranted.

353. In addition, a company may be selected at any time by the SEC staff for a special review when the SEC is reviewing a targeted topic area, an industry, or a specific type of disclosure -- for example, restructuring charges, environmental liabilities. Such special reviews are sometimes initiated if the SEC staff is concerned about a certain type of problem in one or more issuer companies in the same industry.

354. Other organizations such as the Public Company Accounting Oversight Board (PCAOB) play a role in promoting correct application of US GAAP in inspections of public company audits because instances of improper application of US GAAP may come to light in inspections. When such issues arise, the PCAOB staff would bring such matters to the attention to the SEC staff as well as discuss the issues with the auditors and issuer companies involved.

Actions

Principle 16

[21] All reviews are not necessarily full reviews - some may be limited to financial statements or targeted at one or more accounting or disclosure items. The nature of these reviews tends to be primarily financial in nature.

Where a material misstatement in the financial information is detected enforcers should take appropriate actions to achieve an appropriate disclosure and where relevant, public correction of misstatement (in line with the requirements of the reporting framework). Non-material departures from the reporting framework will not normally trigger public correction even though they normally deserve an action as well.

Materiality should be assessed according to the relevant reporting framework.

355. All of the measures noted may be applicable as the circumstances warrant. Consideration would be given to all the facts and circumstances of each case in determining the appropriate action. The SEC Division of Corporation Finance requests issuers to restate results or make corrective disclosures when needed. Cases may also be referred to the SEC Enforcement Division for further investigation . The SEC has legal authority to suspend trading and deregister a security. In the case of delisting, the action would be carried out by the relevant exchange.

356. Materiality, frequency of misstatements or other elements would be part of the overall consideration of facts and circumstances rather than used as governing factors in some predetermined way.

357. The basic definition of materiality used in staff reviews is whether the misstatement or omission is one that would affect a reasonable investor's decisions regarding the purchase or sale of securities.

Principle 17

Actions taken by the enforcers should be distinguished from sanctions imposed by the national legislation. Actions are measures generally aimed at improving market integrity and confidence.

Principle 18

Actions should be effective, timely enacted and proportional to the impact of the detected infringement.

Principle 19

A consistent policy of actions should be developed, whereby similar actions are adopted where similar infringements are detected.

358. Once it has completed its review, the staff communicates with issuers regarding incorrect, questionable or incomplete data or application of GAAP. In cases where a misapplication of GAAP and material misstatement occurs, the financial statements are in error and correction is requested by restatement. In cases where disclosure improvements of a less material nature are determined to be needed, correction may be done prospectively. The Divisions of Corporation Finance and Investment Management may also refer cases to the SEC Enforcement Division.

359. The SEC Enforcement Division conducts investigations into possible violations of the federal securities laws, and prosecutes the Commission's civil suits in the federal courts as well as in its administrative proceedings. The Enforcement Division conducts both formal and informal inquiries and may initiate an investigation at any time a violation is suspected.

360. In addition to the investigative and prosecutorial activities conducted by the Enforcement Division on a civil basis, the US Department of Justice may initiate criminal actions for violations of the federal securities laws. The Department of Justice enforces Section 906 of the Sarbanes-Oxley Act of 2002, whereby the CEO and the CFO of an issuing entity must now certify that financial statements comply with Sections 13(a) or 15(d) of the Securities Exchange Act of 1934, and that the information "fairly presents" the financial condition and results of business operations under threat of criminal penalties22.

361. For Enforcement Division Actions, in the 2003 Annual Report on the SEC website, the total number of enforcement cases of all types was 679, of which 199 were financial statement and reporting cases. In 2004, the number of financial statement and reporting cases was 179.

Coordination and enforcement

Principle 20

In order to promote harmonization of enforcement practices and to ensure a consistent approach of the enforcers to the application of the IFRS's, coordination on ex-ante and ex-post decisions taken by the authorities and /or delegated entities will take place.

Material controversial accounting issues will be conveyed to the bodies responsible for standard setting or interpretation.

No general application guidance on IFRS's will be issued by the enforcers.

362. Within the SEC staff, reviews and consultations take place in a supervisory hierarchy within the Divisions of Corporation Finance and Investment Management. Consultations also occur with accounting specialists in the Office of the Chief Accountant and with the Deputy and Chief Accountant as needed. SEC staff letters to and from registrants with respect to particular filings are maintained in files. The SEC Enforcement Division also has an internal review process and supervisory hierarchy for enforcement actions.

363. The Office of the Chief Accountant and the Divisions of Corporation Finance and Investment Management also issue informal interpretive guidance and other information such as Staff Accounting Bulletins, interpretive releases, frequently asked questions and answers, no action letters, and other guidance that is posted on the SEC website in the Information for Accountants and Divisions of Corporation Finance and Investment Management sections.

364. The SEC staff also participates in informal discussions with other financial regulators in the US and in other countries on accounting matters arising from their reviews of listed companies and supervised entities, as part of a number of efforts to promote consistency of interpretations among regulators.

365. The Corporate Financial Division uses no-action letters to issue guidance in a more formal manner.

Reporting

Principle 21

[22] "Knowing" false certification is punishable by a fine of up to $1 million and imprisonment of up to 10 years. "Willful" false certification is punishable by a fine of up to $5 million and imprisonment of up to 20 years.

Enforcers should periodically report to the public on their activities providing at least information on the enforcement policies adopted and decisions taken in individual cases including accounting and disclosure matters.

366. The SEC issues an Annual Report each year that describes activities of all its Divisions and Offices. Information is included on the number and type of issuer reviews and enforcement cases, as well as on other activities associated with financial reporting.

367. In regard to the routine ongoing reviews and inquiries made of issuers to promote and improve disclosure to investors, and investigations of possible violations, the SEC does not normally make any report on an "issuer-identified" basis while such work is in progress. If a company judges that information regarding SEC inquiries in progress would be material to investors, the company is obligated to disclose this information to the public.

368. The Commission has announced that filing review correspondence from the Division of Corporation Finance for filings made after August 1, 2004, and for which the review has been completed will be posted on the SEC's website.

CESR

ANNEX 1

RELEVANT LEVEL 1- TEXTS (PROSPECTUS AND TRANSPARENCY LEGISLATION)

A. Prospectus Directive and Regulation

Directive 2003/71/EC of the European Parliament and of the Council of 4 November 2003 on the prospectus to be published when securities are offered to the public or admitted to trading and amending Directive 2001/34/EC.

Article 7.1 - Minimum information

Detailed implementing measures regarding the specific information which must be included in a prospectus, avoiding duplication of information when a prospectus is composed of separate documents, shall be adopted by the Commission in accordance with the procedure referred to in Article 24(2). The first set of implementing measures shall be adopted by 1 July 2004.

Article 20 - Issuers incorporated in third countries

1. *The competent authority of the home Member State of issuers having their registered office in a third country may approve a prospectus for an offer to the public or for admission to trading on a regulated market, drawn up in accordance with the legislation of a third country, provided that:*

   (a) *the prospectus has been drawn up in accordance with international standards set by international securities commission organisations, including the IOSCO disclosure standards;*

   (b) *the information requirements, including information of a financial nature, are equivalent to the requirements under this Directive.*

3. *In order to ensure uniform application of this Directive, the Commission may adopt implementing measures in accordance with the procedure referred to in Article 24(2), stating that a third country ensures the equivalence of prospectuses drawn up in that country with this Directive, by reason of its national law or of practices or procedures based on international standards set by international organisations, including the IOSCO disclosure standards.*

Commission Regulation (EC) No 809/2004 of 29 April 2004 implementing Directive 2003/71/EC of the European Parliament and of the Council as regards information contained in prospectuses as well as the format, incorporation by reference and publication of such prospectuses and dissemination of advertisements

Article 35 - Historical financial information

1. *The obligation for Community issuers to restate in a prospectus historical financial information according to Regulation (EC) No 1606/2002, set out in Annex I item 20.1, Annex IV item 13.1, Annex VII items 8.2, Annex X items 20.1 and Annex XI item 11.1 shall not apply to any period earlier than 1 January 2004 or, where an issuer has securities admitted to trading on a regulated market on 1 July 2005, until the issuer has published its first consolidated annual accounts with accordance with Regulation (EC) No 1606/2002.*

2. *Where a Community issuer is subject to transitional national provisions adopted pursuant Article 9 of Regulation (EC) No 1606/2002, the obligation to restate in a prospectus historical financial information does not apply to any period earlier than 1 January 2006 or, where an issuer has securities admitted to trading on a regulated market on 1 July 2005, until the issuer has published its first consolidated annual accounts with accordance with Regulation (EC) No 1606/2002.*

3. *Until 1 January 2007 the obligation to restate in a prospectus historical financial information according to Regulation (EC) No 1606/2002, set out in Annex I item 20.1, Annex IV item 13.1, Annex VII items 8.2, Annex X items 20.1 and Annex XI item 11.1 shall not apply to issuers from third countries:*

    (1) who have their securities admitted to trading on a regulated market on 1 January 2007; and

    (2) who have presented and prepared historical financial information according to the national accounting standards of a third country.

    In this case, historical financial information shall be accompanied with more detailed and/or additional information if the financial statements included in the prospectus do not give a true and fair view of the issuer's assets and liabilities, financial position and profit and loss.

4. *Third country issuers having prepared historical financial information according to internationally accepted standards as referred to in Article 9 of Regulation (EC) No 1606/2002 may use that information in any prospectus filed before 1 January 2007, without being subject to restatement obligations.*

5. *From 1 January 2007 third country issuers, as referred to in paragraphs 3 and 4, shall present the historical financial information referred to in paragraph 3 point (1) following the establishment of equivalence pursuant to a mechanism to be set up by the Commission. This mechanism shall be set up through the Committee procedure provided for in Article 24 of Directive 2003/71/EC.*

6. *The provisions of this Article shall also apply to Annex VI, item*

Extracts of the most relevant annexes referred to in article 35.1.

Item 20 of the Annex I to the EC Regulation (minimum disclosure requirements for the share Registration Document – schedule)

FINANCIAL INFORMATION CONCERNING THE ISSUER'S ASSETS AND LIABILITIES, FINANCIAL POSITION AND PROFITS AND LOSSES

20.1. Historical Financial Information

Audited historical financial information covering the latest 3 financial years (or such shorter period that the issuer has been in operation), and the audit report in respect if each year. Such financial information must be prepared according to Regulation (EC) No 1606/2002, or if not applicable to a Member State national accounting standards for issuers from the Community.

For third country issuers, such financial information must be prepared according to the international accounting standards adopted pursuant to the procedure of Article 3 of Regulation (EC) No 1606/2002 or to a third country's national accounting standards equivalent to these standards. If such financial information is not equivalent to these standards, it must be presented in the form of restated financial statements.

The last two years audited historical financial information must be presented and prepared in a form consistent with that which will be adopted in the issuer's next published annual financial statements having regard to accounting standards and policies and legislation applicable to such annual financial statements.

Item 13 of the Annex IV to the EC Regulation (Minimum Disclosure Requirements for the Debt and Derivative Securities Registration Document - schedule)

FINANCIAL INFORMATION CONCERNING THE ISSUER'S ASSETS AND LIABILITIES, FINANCIAL POSITION AND PROFITS AND LOSSES

13.1. Historical Financial Information

Audited historical financial information covering the latest 2 financial years (or such shorter period that the issuer has been in operation), and the audit report in respect of each year. Such financial information must be prepared according to Regulation (EC) No 1606/2002, or if not applicable to a Member States national accounting standards for issuers from the Community.

For third country issuers, such financial information must be prepared according to the international accounting standards adopted pursuant to the procedure of Article 3 of Regulation (EC) No 1606/2002 or to a third country's national accounting standards equivalent to these standards. If such financial information is not equivalent to these standards, it must be presented in the form of restated financial statements.

The most recent year's historical financial information must be presented and prepared in a form consistent with that which will be adopted in the issuer's next published annual financial statements having regard to accounting standards and policies and legislation applicable to such annual financial statements.

B. Transparency Directive[23]

The relevant texts are the article 23 (Third Countries) and 30, § 3 of draft Transparency Directive.

Article 23

1. *Where the registered office of an issuer is in a third country, the competent authority of the home Member State may exempt that issuer from requirements under Articles 4 to 7 and Articles 12(6), 14, 15 and 16 to 18, provided that the law of the third country in question lays down equivalent requirements or such an issuer complies with requirements of the law of a third country that the competent authority of the home Member State considers as equivalent. However, the information covered by the requirements laid down in the third country shall be filed in accordance with Article 19 and disclosed in accordance with Articles 20 and 21.*

2. By way of derogation from paragraph 1, an issuer whose registered office is in a third country shall be exempted from preparing its financial statement in accordance with Article 4 or Article 5 prior to the financial year starting on or after 1 January 2007, provided such issuer prepares its financial statements in accordance with internationally accepted standards referred to in Article 9 of Regulation (EC) No 1606/ 2002.

3. The competent authority of the home Member State shall ensure that information disclosed in a third country which may be of importance for the public in the Community is disclosed in accordance with Articles 20 and 21, even if such information is not regulated information within the meaning of Article 2(1)(k).

4. In order to ensure the uniform application of paragraph 1, the Commission shall, in accordance with the procedure referred to in Article 27(2), adopt implementing measures
(i) setting up a mechanism ensuring the establishment of equivalence of information required under this Directive, including financial statements and information, including financial statements, required under the law, regulations or administrative provisions of a third country;
(ii) stating that, by reason of its domestic law, regulations, administrative provisions, or of the practices or procedures based on the international standards set by international organisations, the third country where the issuer is registered ensures the equivalence of the information requirements provided for in this Directive.

[23] Directive 2004/109/EC of the European Parliament and of the Council of 15 December 2004 on the harmonisation of transparency requirements in relation to information about issuers whose securities are admitted to trading on a regulated market and amending Directive 2001/34/EC.

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The Commission shall, in accordance with the procedure referred to in Article 27(2), take the necessary decisions on the equivalence of accounting standards which are used by third country issuers under the conditions set out in Article 30(3) at the latest five years following the date referred to in Article 31. If the Commission decides that the accounting standards of a third country are not equivalent, it may allow the issuers concerned to continue using such accounting standards during an appropriate transitional period.

5. In order to ensure uniform application of paragraph 2, the Commission may, in accordance with the procedure referred to in Article 27(2), adopt implementing measures defining the type of information disclosed in a third country that is of importance to the public in the Community.

6. Undertakings whose registered office is in a third country which would have required an authorization in accordance with Article 5(1) of Directive 85/611/EEC or, with regard to portfolio management under point 4 of section A of Annex I to Directive 2004/39/EC if it had its registered office or, only in the case of an investment firm, its head office within the Community, shall also be exempted from aggregating holdings with the holdings of its parent undertaking under the requirements laid down in Article 12(4) and (5) provided that they comply with equivalent conditions of independence as management companies or investment firms.

7. In order to take account of technical developments in financial markets and to ensure the uniform application of paragraph 6, the Commission shall, in accordance with the procedure referred to in Article 27(2), adopt implementing measures stating that, by reason of its domestic law, regulations or administrative provisions, a third country ensures the equivalence of the independence requirements provided for under this Directive and its implementing measures.

Article 30, §3

Where an issuer is incorporated in a third country, the home Member State may exempt such issuer only in respect of those debt securities which have already been admitted to trading on a regulated market in the Community prior to 1 January 2005 from drawing up its financial statements in accordance with Article 4(3) and its management report in accordance with Article 4(5) as long as

(a) the competent authority of the home Member State acknowledges that annual financial statements prepared by issuers from such a third country give a true and fair view of the issuer's assets and liabilities, financial position and results;

(b) the third country where the issuer is incorporated has not made mandatory the application of international accounting standards referred to in Article 2 of Regulation (EC) No 1606/2002; and

(c) the Commission has not taken any decision in accordance with Article 23(4)(ii) as to whether there is an equivalence between the abovementioned accounting standards and

- *the accounting standards laid down in the law, regulations or administrative provisions of the third country where the issuer is incorporated,*
- *or the accounting standards of a third country such an issuer has elected to comply with.*

Article 33

The Commission shall by 30 June 2009 report on the operation of this Directive to the European Parliament and to the Council including the appropriateness of ending the exemption for existing debt securities after the 10-year period as provided for by Article 30(4) and its potential impact on the European financial markets.

ANNEX 2

FORMAL MANDATE TO CESR FOR TECHNICAL ADVICE ON IMPLEMENTING MEASURES ON THE EQUIVALENCE BETWEEN CERTAIN THIRD COUNTRY GAAP AND IAS/IFRS

The present mandate takes into consideration the agreement on implementing the Lamfalussy recommendations reached with the European Parliament on 5 February 2002. In this agreement, the Commission committed itself to a number of important points, including increasing transparency. For this reason, this request for technical advice will be made available on DG Internal Market's web site once it has been sent to CESR. The European Parliament has also been duly informed.
This mandate focuses on a technical issue which is common to both the adoption of Level 2 Regulation (EC) 809/2004 implementing Directive 2003/71/EC (the Prospectus Directive which entered into force on 31 December 2003) and the Transparency Directive (approved by the European Parliament on 30 March 2004 and by the Council on 11 May 2004; formal adoption pending): it relates to the recognition of financial statements prepared in accordance with third country GAAP as being equivalent to those prepared in accordance with IAS/IFRS, as endorsed under the IAS Regulation.
The legal base for future implementing measures are (a) Article 7 of Directive 2003/71/EC (Level 1), in conjunction with Article 35 (5) of Commission Regulation (EC) No 809/2004 implementing this provision in respect of disclosure of information prior to the admission of securities to a regulated market/prior to a public offer of securities, as well as (b) Article 19 (3a) of the Transparency Directive.

1.1. Legal context

In its conclusions in March 2000, the Lisbon European Council emphasised that in order to accelerate completion of the internal market for financial services, steps should be taken to set a tight timetable so that the Financial Services Action Plan is implemented by 2005. For this purpose, both the Prospectus Directive and the Transparency Directive follow the four-level approach (essential principles, implementing measures, co-operation and enforcement), as endorsed by the Stockholm European Council in March 2001 and the European Parliament in February 2002. The Commission is assisted by CESR, in its capacity as an independent advisory group, in its preparation of draft implementing measures.

On the Prospectus Directive, the Level 1 measure (Directive 2003/71/EC) entered into force on 31 December 2003 (date of its publication in the Official Journal). It will be applicable as from 1 July 2005 (as well as the related Level 2 measure).

On the Transparency Directive, the Level 1 Directive has been fully agreed by the European Parliament on 30 March 2004. The ECOFIN Council has approved the text voted by the EP on 11 May 2004. Its formal adoption is not expected before autumn 2004. (The Commission also granted a mandate to CESR for preparing its technical advice on other level 2 measures, including on the equivalence of drawing up management reports.)

The new EU legislation agreed under the FSAP requires the Commission to set up a mechanism for assessing equivalence under the comitology framework and to take the necessary decisions as to whether a given third country GAAP (Generally Accepted Accounting Principles) is equivalent to IAS/IFRS (International Accounting Standards, or International Financial Reporting Standards), as endorsed under the IAS-Regulation. Under Article 35 of the Prospectus Regulation, the Commission should decide prior to 1 January 2007 in accordance with the comitology framework. In the absence of such a decision, third country issuers who wish to have their securities admitted to trading on a regulated market will have to restate their

financial statements under IAS according to Regulation 1606/2002[24] because the transitional arrangements will expire on the date above.

In its meeting of 19 April 2004, the European Securities Committee (ESC) invited the Commission to consider adopting a single decision covering both the Prospectus and the Transparency Directive and granting to CESR a single and specific mandate in order to receive a technical advice in advance of such a decision.

1.2. Mechanism for assessing the equivalence

The Commission is not only required to take decisions on the equivalence but also to set up the appropriate mechanism for assessing such equivalence of third country GAAP (Article 35 (5) of the Level 2 Prospectus Regulation; Article 19 (3) of the future Transparency Directive). To this end, the Commission intends to apply, in full agreement with the European Securities Committee, the following mechanism:

the European Securities Committee will assist the Commission as the regulatory committee under the existing comitology framework (Article 24 of the Prospectus Directive, Article 23 of the future Transparency Directive);

in accordance with the arrangements recommended by the Lamfalussy Report and endorsed by the Stockholm European Council in March 2001 and by the European Parliament in February 2002, CESR should provide a technical advice for the assessment of the equivalence between IAS (IAS/IFRS), as adopted at EU-level, and third country GAAP.

1.3. Deadline for CESR's technical advice: JUNE 2005

This mandate takes into consideration that CESR needs enough time to prepare its technical advice. Furthermore, under the Lamfalussy arrangement, the European Parliament will benefit from three months to consider the draft implementing measures. The June 2005 deadline is based on the following timetable:

Deadline	Action
June 2005	CESR technical advice
July 2005	Publication of a first working document by Commission services on possible Level 2 legislation + public call for comments
July 2005	1 July: Level 1 and 2 rules on prospectuses become applicable in the EU
September	Formal Commission proposal for level 2 legislation sent to ESC and published on the Internet
December 2005	Vote in the European Securities Committee on level 2 proposals
December 2005	Formal adoption of Level 2 measure by the Commission
November 2006 (?)	Transposition period for Transparency Directive (Level 1) expired
January 2007	Transitional arrangements under Article 35 (4) of the Prospectus Regulation (Level 2) expire on 1 January

In order to facilitate the implementation process, the Commission may, whenever justified, consider proposing the adoption of directly applicable decisions or regulations for the issue covered by the present mandate. The Stockholm European Council, the European Parliament itself and the Lamfalussy report all urged the use of regulations whenever possible. The Commission will have to consider this issue at a later stage, depending on the content of the advice that CESR is going to provide to the Commission services.

2. THE PRINCIPLES THAT CESR SHOULD TAKE ACCOUNT OF

[24] See the Level 2 – Prospectus Regulation, in particular Annex I item 20.1., Annex IV item 13.1; Annex VII items 8.2., Annex X items 20.1. and Annex XI, item 11.1.; as well as Article 19 (1) of the future Transparency Directive

2.1. The working approach agreed between DG Internal Market and the European Securities Committee

On the working approach, CESR is invited to take account of following principles:

The principles set out in the Lamfalussy Report and mentioned in the Stockholm Resolution of 23 March 2001;

CESR should provide comprehensive advice on the subject matters described below covered by the delegated powers included in the relevant comitology provision of the level 1 Directive, in the corresponding recitals as well as in the relevant Commission request included in the mandate;

CESR should address to the Commission any questions they might have concerning the clarification on the text of the two Directives or other parts of Community legislation, which they should consider of relevance to the preparation of its technical advice;

The technical advice given by CESR to the Commission will not take the form of a legal text. However, CESR should provide the Commission with an "articulated" text which means a clear and structured text, accompanied by sufficient and detailed explanations for the advice given, and which is presented in an easily understandable language respecting current legal terminology used in the field of securities markets and company law at European level;

CESR should provide advice which takes account of the different opinions expressed by the market participants (practitioners, consumers and end-users) during the various consultations. CESR will provide a feed-back statement on the consultation justifying its choices vis-à-vis the main arguments raised during the consultation;

2.2. Consultation of the public

The Stockholm European Council endorsed the Lamfalussy recommendations on consultation and transparency. In particular, it invited the Commission to make use of early, broad and systematic consultation with the institutions and all interested parties in the securities area, especially by strengthening its dialogue with consumers and market practitioners. It also stated that CESR should "*consult extensively, in an open and transparent manner, as set out in the final report of the Committee of Wise Men and should have the confidence of market participants*".

Article 5 of the Commission Decision establishing the CESR provides that "*before transmitting its opinion to the Commission, the Committee [CESR] shall consult extensively and at the early stage with market participants, consumers and end-users in an open and transparent manner*".

In this context, DG Internal Market draws CESR's attention to the European Parliament's Resolution on the implementation of financial services legislation of 5 February 2002 and the Commission's formal Declaration in response.

Moreover, CESR could take into account the particular nature of this mandate when carrying out its public consultations.

DG Internal Market will ensure that the Stockholm European Council recommendations on consultation have been fully met. In particular, it will satisfy itself that CESR has consulted all interested parties on its technical advice in accordance with the CESR Public Statement on Consultation Practices. This mandate will also be posted on DG MARKT website.

Once the Commission has received the CESR's advice, it will draw up draft working documents to put forward to the ESC and the European Parliament. It simultaneously publishes those texts

on its Internet site. If the Commission amends its draft to reflect discussions in the ESC, those amended drafts will also be made public on the website.

Interested parties will have the opportunity to comment on published draft working documents. The Commission has set up a dedicated e-mail address (Markt-ESC@cec.eu.int), allowing all interested parties to send their contributions to the Chairman of the ESC.

Interested parties will have sufficient time to participate in this exercise because the ESC will not be asked for a vote until at least three months have elapsed from the publication of initial draft implementing rules. This will also allow the European Parliament to follow the process and, if it so wishes, to make its views known.

2.3. Enabling investors to take informed investment decisions

In giving its advice, CESR should take full account of the following key objectives:

When assessing as to whether financial statements prepared under third country GAAP provide a true and fair view of the issuer's financial position and performance, the priority should lie on assuring the protection of investors;

A global and holistic assessment of the quality of the financial information provided by the accounting system in question should be carried out from a technical point of view and independently from any international convergence project aiming at a single set of accounting standards, such as the project currently conducted by the International Accounting Standard Board and the US-Financial Accounting Standard Board.

The global and holistic assessment should be based on the entirety of the third country GAAP in force as of 1 January 2005. The assessment should focus only on the significant differences between IAS/IFRS as endorsed at EU level and the third country GAAP in question.

The assessment should not relate as to whether the third country GAAP in question might be conducive to the European public good. This is a criterion for endorsing IAS/IFRS at European level pursuant to Article 3 (2) of the IAS-Regulation, but not for assessing equivalence.

The assessment should also be carried out independently of whether the third country concerned already recognises IAS/IFRS as equivalent to their domestic GAAP.

3. CESR is invited to provide technical advice by June 2005

3.1. Scope of the assessment

CESR is invited to assess the equivalence of the following GAAP by June 2005:

a) US-GAAP

b) Japanese GAAP, and

c) Canadian GAAP.

The assessment should encompass standards applicable to annual and interim financial reporting as well as the objective and conditions for preparing consolidated financial statements, as they should be applied by issuers as from June 2005.

3.2. Objective of the assessment

CESR is invited

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a)	to undertake a global assessment as to whether the financial statements prepared under the third country GAAP mentioned above provide equivalently sound information to investors when those investors make investment decisions on regulated markets across Member States. Investors should be able to take economic decisions on the basis of understandable, relevant, reliable, and comparable information about the issuer's assets and liabilities, financial position and profit or loss;
b)	to advice on an early warning mechanism in case of significant changes to the third country GAAP occurred after 1 January 2005; and
c)	to describe the mechanisms (outside the areas of audit and of corporate governance) provided for at least in the US, Canada and Japan ensuring that the third country GAAP mentioned above are respected.

3.3. Remedies

In case where equivalence cannot be confirmed in respect of one the third country GAAP mentioned above, CESR is invited to consider what kind of remedies should be applied by the competent authority of the home Member State:

a)	Do the third country issuers concerned have to restate their financial statements in all cases?
b)	Are there cases in which more limited remedies should be provided for? If so, what should be the reconciliation items or what should be explained further by notes or other explanatory material?

ANNEX 3

(EXCTRACTS OF CONCEPT PAPER)

Ref: CESR/04-509C

CONCEPT PAPER ON

EQUIVALENCE OF CERTAIN THIRD COUNTRY GAAP

AND ON

DESCRIPTION OF CERTAIN THIRD COUNTRIES MECHANISMS OF ENFORCEMENT OF FINANCIAL INFORMATION

February 2005

Ref: CESR 04-509C

Executive Summary

The European Commission (E.C.) has asked CESR for advice on equivalence of three third country GAAP's with IAS/IFRS as benchmark (i.e. Canadian, Japanese and US GAAP). The E.C. also requested CESR to describe the mechanisms existing at least in Canada, Japan and US, for the enforcement of financial information.

The concept paper therefore sets out the basis upon which CESR will approach the analysis of equivalence. In particular, CESR indicates that the approach to the Mandate will predicate on the basis that the investor's decision should be unaffected by the use of different accounting standards when assessing whether or not to invest in any given product. In receiving financial information based on third country GAAP, investors should be enabled to make similar decisions as when they had received financial information based on IAS/IFRS.

In CESR's view, this assumption is the basis for the global assessment. The objective of the review of the general principles is to compare third country GAAP's and IAS/IFRS with regard to the underlying principles of financial reporting. Additionally, CESR proposes to conduct a technical assessment of significant differences in accounting standards of third country GAAP's compared to IAS/IFRS.

The consequences of the conclusions reached of both assessments of the third country GAAP may vary from the introduction of a requirement for third country issuers to undertake a complete restatement to the acceptation of third country GAAP's when both accounting standards are equivalent.

Finally, CESR's advice to the Commission will also include advice on the implementation of early warning mechanisms to ensure that future changes in third country GAAP can be taken into account. The advice will also include a description of the enforcement mechanisms in the considered third countries.

Ref: CESR 04-509C

CONCEPT PAPER ON EQUIVALENCE OF CERTAIN THIRD COUNTRY GAAP & ENFORCEMENT ASPECTS

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1. General background

A. Introduction

The implementation of two new EU legislative measures will soon require the European Commission to establish whether a given third country GAAP is equivalent to IAS/IFRS. These measures include Prospectus Directive (including the implementing measures of this Directive) and the forthcoming Transparency Directive.

As a result of the new EU-wide rules on prospectus, third country issuers (non-EU issuers) who have their securities admitted to trading on an EU regulated market or who wish to make a public offer of their securities in Europe, will be required as from 1st January 2007, to publish a prospectus including financial statements prepared on the basis of EU endorsed IAS/IFRS or on the basis of third country's national accounting standards (third country GAAP) if these standards are equivalent to the endorsed IAS/IFRS. In the meantime, appropriate transitional arrangements will apply under Article 35 of Commission Regulation (EC) 809/2004 on Prospectus.

Similarly, under the future Transparency Directive, third country issuers whose securities are admitted to trading on a EU-regulated market will also have to provide annual and half-yearly financial statements (as from January 2007) which should either be prepared in accordance with IAS/IFRS or third country GAAP equivalent to the endorsed IAS/IFRS. Appropriate transitional arrangements will also apply under Article 26 (3) of that Directive.

The two EU legislative measures require the European Commission to take the necessary decisions as to whether a given third country GAAP is equivalent to IAS/IFRS.

B. Mandate to CESR for Technical Advice on Equivalence

(Not included: see annexe 2 of the draft technical advice)

C. Key elements of the EC mandate to CESR

(Not included: see annexe 2 of the draft technical advice)

D. CESR public consultation

(Not included: see Introduction, point D of the draft technical advice)

2. CESR Concept paper

2.1. Equivalence between certain third country GAAP and IAS/IFRS: Global assessment

A. Objective of equivalence

1. **CESR believes one of the most important issues in undertaking this mandate is to determine what is meant by equivalence. CESR has discussed this issue at length and is firmly of the view that equivalent should not be defined as meaning 'identical'. Rather CESR believes that, in the framework of the mandate given by the European Commission, third country GAAP can be declared as equivalent to IAS/IFRS when financial statements prepared under such third country GAAP enable investors to take similar decision in terms of whether to invest or divest, as if they were provided with financial statements prepared on the basis of IAS/IFRS.**

2. **CESR can envisage that some differences between third country's GAAP and IAS/IFRS would not give rise to differing investment decisions. For example, some differences in accounting treatment may not be significant in terms of equivalence because they arise from differing legal elements, for instance accounting for tax purposes.**

3. A third country GAAP can not only be described in terms of its primary objectives and its conceptual framework, but also in terms of its direct effects on investor decision-making. For the equivalence assessment it is critical to assess to what extent economic decision making by investors is influenced by the use of a third country GAAP compared to the use of IAS/IFRS. Considering that IAS/IFRS will be required for listed companies in the EU, this implies for example that the typical range of decisions by an investor regarding listed stocks (buy, sell, hold), should not be affected by the use of the third country GAAP compared with using IAS/IFRS. Hence, the potential effects should be assessed of using a third country GAAP on the range of economic decisions made by investors active in regulated markets. CESR looks to market participants for providing input on this aspect as they are primarily affected by this issue.

4. In CESR's view, the point is to know what the impact of GAAP differences on investor's decision is. If, after analysis of general principles and significant differences between a given third country GAAP and IAS/IFRS, it appears that financial information provided by third country issuer leads to a different investor's interpretation of the issuer's financial position and results, then it can be assumed that investors' decisions regarding investment/divestment in securities of this issuer could hardly be "similar". This is of course a general and abstract exercise that CESR will conduct very carefully, considering all evidence available from all market participants.

5. In this approach, CESR takes into account the cost that would represent for investors the need to have reliable, comparable and understandable financial information (which is basically quantitative) when such information is prepared under different reporting rules. The objective of possible remedies and restatement is precisely to alleviate the burden of cost that this situation will represent for investors who, going forward will progressively consider IAS/IFRS as normal reporting framework in Europe (i.e. their common language for understanding financial statements).

6. It is clearly not possible to consider all possible reactions of all investors. First, a practical analysis will not be possible without having a complete view of significant GAAP differences (this will come after the second stage of the equivalence assessment). Secondly, investors' decisions integrate many other considerations that cannot be encompassed in an equivalence exercise. Even when provided with exactly the same information, different investors might still take completely different decisions. This is why CESR choose to conduct a technical, focused on accounting aspects, assessment of equivalence. This is the only credible way for providing a relevant advice to the European Commission.

7. The European Commission's mandate requires CESR to assess third country GAAP against four characteristics. Investors should be able to take economic decisions on the basis of understandable, relevant, reliable and comparable information about the issuer's assets and liabilities, financial position and profit or loss. Those characteristics are intrinsic elements of IFRS's principles as included in the conceptual framework and IAS-1 and will be addressed in the first step of the assessment, the review of general principles.

8. CESR believes that understandability and comparability have an external meaning as well with respect to assessing equivalence. According to CESR, a GAAP equivalent to IAS/IFRS should have similar **understandable** and **comparable** outcomes. Therefore, CESR included those external factors in the second step of its assessment, the technical assessment. Investors basing their decision on third country GAAP financial statements should be enabled to **understand** such financial statements. They may also need to **compare** the performance and financial position of different issuers/enterprises apart from the fact that they use different GAAP. Nevertheless, it is not necessary to expect investors to compare in detail all the individual items in the financial statements, but only the ones which are significant.

9. This concept paper deals with the methodology how to assess equivalence of GAAP's. GAAP is an acronym of Generally Accepted Accounting Principles, which include conceptual frameworks, accounting standards and other guidance in a certain jurisdiction. According to CESR, the global assessment should have three elements:

   a) **Review of general principles**

      In this context, CESR will consider the following aspects of the assessment:

      - The primary objectives of the GAAP under consideration, its conceptual framework and its relevant characteristics.

      - Evidence that market participants responding to the present consultation will provide to CESR on the reliance placed on third country GAAP financial statements in making investor decisions (compared with decisions making based on IAS/IFRS financial statements).

   b) **Technical assessment of the significant differences in accounting standards.** In this regard the assessment should not aim at identifying every difference between third country GAAP and IAS/IFRS. Rather, CESR believes that the cost of undertaking an exercise at this level of detail would outweigh the benefits to investors.

   c) **Appropriate remedies to meet investors' needs.**

10. CESR believes that a basic assumption for assessing the equivalence is to consider that investors on European markets will have a reasonable knowledge of IAS/IFRS. IAS/IFRS will be used by European listed companies as from 2005. These international accounting standards, in particular their basic principles, will become the "accounting language" that European investors will use and recognise when analysing financial statements for investment purposes. Recognising, however, that it can be argued that Canadian, Japanese and US GAAP are already used to varying extents in EU markets. Actually, CESR also assumes that rational investors in securities of third country issuers will have a reasonable knowledge of reporting environment of considered third countries, as reporting framework in EU and in third Countries are not as such required to be identical under Prospectus and Transparency Directives.

11. CESR does not to make a distinction between investors for the purpose of equivalency assessment (e.g. between professional and retail investors). It should however be signalled that only 'direct investors' in securities of third country issuers admitted to trading in EU are considered and not investors who indirectly invest in third country issuers through investment vehicles nor investors investing in securities offered through private placement . CESR assume that such investors have a reasonable knowledge of reporting environment in third countries and

primarily rely on financial reporting released by third country issuers under Prospectus and Transparency Directives for taking their investment decision.

12. According to CESR, the following issues do not fall within the scope of the mandate. Firstly, the mandate implies an assessment of the standards, but not of the standard setting mechanisms. Secondly, as European legislation applies to regulated markets and no other differentiation has been made, CESR's advice will not differentiate between types of security offered by third country issuers and/or admitted to trading on EU Regulated markets, such as bond issuers and equity issuers. CESR will not either attempt to identify and assess on certain reporting requirements that may exist for specific market segments. CESR is invited to provide technical advice on whether third country GAAP are equivalent to IAS/IFRS, therefore the test should definitely be at GAAP level.

13. Part of the mandate deals with the description of enforcement mechanisms in Canada, Japan and US. As such, assessment of the quality of enforcement systems in third countries is not part of this mandate and has to be seen separately from GAAP equivalence.

14. It should however be noted that there are in practice cases where a third country GAAP is applied by an issuer not regulated by that third country (e.g. a non-US issuer applying US GAAP). This might raise broader enforcement issues that have not been covered by the mandate given to CESR. This concept paper does not deal with these important enforcement aspects and is therefore limited to the assessment of GAAP equivalence in the most common situations, i.e. third country GAAP as applied and enforced in that third country.

15. Equivalence is not a pre-requisite for a public offering on European regulated markets. It would only affect the way issuers have to present their financial information (periodic disclosures and prospectuses). To this aim, the mandate explicitly requests advice on remedies for non-equivalence (see Section D).

16. In accordance with the mandate of the European Commission, CESR will focus its advice on assessing the equivalence between Canadian, Japanese and US GAAP and IAS/IFRS. CESR will advise on those GAAP's for June 2005. However, this concept paper is aimed at designing a methodology for all GAAP's that will possibly be assessed in the future.

B. Review of general principles

17. In order to conduct the general principles review, CESR will take into account the four characteristics mentioned in the European Commission's mandate (relevance, understandability, reliability and comparability) and the fact that third country GAAP cover similar financial reporting topics and have comparable objectives.

B.1. The four characteristics

18. Given the context described above and in particular the fact that the reference for European issuers will become the IAS/IFRS standards, a link with this set of standards should be made for defining the four criteria. In this regard, the IAS Framework (as published in the annex of the Communication that the European Commission released in November 2003 on the interaction between the IAS regulation and the Accounting Directives[1]) provides a definition of these terms and CESR therefore sets out below where a reference to these definitions seems particularly appropriate.

19. It is worth noting that the four characteristics have to be considered in combination, no one prevailing over others (e.g. financial information based on cost accounting principles may tend to provide more reliability, but not systematically more relevance in terms of information).

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[1] European Commission's comments concerning certain Articles of the Regulation (EC) No 1606/2002 of the European Parliament and of the Council of 19 July 2002 on the application of international accounting standards and the Fourth Council Directive 78/660/EEC of 25 July 1978 and the Seventh Council Directive 83/349/EEC of 13 June 1983 on accounting.
Quotations of IAS Framework below are taken out of the annex to the EC's communication.

20. CESR has outlined below IASB's definitions of these terms and intends to assess third country GAAP's equivalence to them. This means that CESR will check whether the third countries GAAP contain or are based on these principles.

Understandability

21. IAS framework, paragraph 25 describes the understandability as follows: "*An essential quality of the information provided in financial statements is that it is readily understandable by users. For this purpose, users are assumed to have a reasonable knowledge of business and economic activities and accounting and a willingness to study the information with reasonable diligence. However, information about complex matters that should be included in the financial statements because of its relevance to the economic decision-making needs of users should not be excluded merely on the grounds that it may be too difficult for certain users to understand.*"

22. When investors receive information that is basically quantitative, they will need additional explanations on the underlying rules and principles for preparing and presenting financial statements under third country GAAP when these principles and rules are different. Narrative explanations are important but may not be sufficient for complying with the other criteria.

23. It should also be noted at this stage that similarity in terminology may not necessarily lead to equivalence if the terms have a different meaning or imply different accounting rules under third country GAAP.

Relevance

24. The paragraph 26 of the IAS Framework indicates that information is relevant "*when it influences the economic decisions of users by helping them evaluate past, present or future events or confirming, or correcting, their past evaluations.*"

25. This criterion will have an important impact on the level of detail of the assessment of GAAP differences that CESR will be conducting and on the characteristics and extent of possible remedies which may be considered appropriate. Only relevant GAAP differences have to be considered and only relevant remedies have to be envisaged.

26. It should be noted that in the context of the mandate given to CESR by the Commission, relevance will only be considered with reference to investors in European financial markets.

Reliability

27. The paragraph 31 and 32 of the IAS framework defines the meaning of the reliability, as follows:

    Para 31: "*Information has the quality of reliability when it is free from material error and bias and can be depended upon by users to represent faithfully that which it either purports to represent or could reasonably be expected to represent.*"

    Para 32: "*Information may be relevant but so unreliable in nature or representation that its recognition may be potentially misleading.*"

28. In terms of equivalence, a lack of reliability could appear where third country GAAP allow or require the use of valuation methods, type of data or assumptions that are less reliable than the ones adopted by IAS/IFRS.

Comparability

29. The paragraphs 39 and 40 of the IAS framework provide important clarifications on the meaning of comparability:

Para 39: "*Users must be able to compare the financial statements of an enterprise through time in order to identify trends in its financial position and performance. Users must also be able to compare the financial statements of different enterprises in order to evaluate their relative financial position, performance and changes in financial position. Hence, the measurement and display of the financial effect of like transactions and other events must be carried out in a consistent way throughout an enterprise and over time for that enterprise and in a consistent way for different enterprises.*"

Para 40: "*An important implication of the qualitative characteristic of comparability is that users be informed of the accounting policies employed in the preparation of the financial statements, any changes in those policies and the effects of such changes. Users need to be able to identify differences between the accounting policies for like transactions and other events used by the same enterprise from period to period and by different enterprises. Compliance with International Accounting Standards, including the disclosure of the accounting policies used by the enterprise, helps to achieve comparability.*"

B.2. The topics covered by IAS/IFRS

30. Third country GAAP should contain standards and principles covering the same topics as the IAS/IFRS. The list of topics will be defined by CESR on the basis of the standards endorsed for use at EU level as from 1st January 2005, in the framework of the EC regulation No 1606/2002 of the European Parliament and of the Council of 19 July 2002 on the application of international accounting standards, and on the basis of subsequent endorsement regulations.

31. Third country GAAP could appear as not equivalent if they do not cover all topics regulated by IAS/IFRS. However, it remains to be seen whether this possible lack is relevant at the level of issuers making a public offer in Europe or having securities admitted to trading on a European regulated market and raises a significant concern to the investors.

32. Where third country GAAP provide standards and/or principles on topics that are not covered by IAS/IFRS (e.g. for specialised industries), such third country GAAP must at least comply with IAS/IFRS basic principles contained in the IAS Framework and IAS 1 and should not be in contradiction with any other IAS/IFRS endorsed for use in the EU.

B.3. The objectives of IAS/IFRS

33. The equivalence between third country GAAP and IAS/IFRS can not be asserted if financial statements prepared on the basis of third country GAAP do not at least pursue the same objectives as financial statements prepared under IAS/IFRS.

34. The paragraph 12 of the IAS Framework defines what the objective of IAS/IFRS financial statements is:

    Para 12: *"The objective of financial statements is to provide information about the financial position, performance and changes in financial position of an enterprise that is useful to a wide range of users in making economic decisions."*

35. In the scope of equivalence, the focus is on investors in EU financial markets.

36. Equivalence can hardly exist if third country GAAP (in general and standard by standard) pursues other objectives (e.g. tax purposes) and if this has a significant impact on the relevance, understandability and reliability of the information provided by financial statements prepared on the basis of such GAAP for investors in financial markets. Therefore, CESR will look at the objectives of the third country GAAP when assessing the review of general principles. As for accounting principles, concepts and rules, the onus will be on the final outcome of objectives, and not on pure terminology differences (see also par. 49).

C. Technical assessment

37. As indicated in the mandate, the assessment must be based on the entirety of the IAS/IFRS and third country GAAP in force as from 1 January 2005 and focus on the significant differences between IAS/IFRS and third country GAAP.

38. IAS/IFRS and third country GAAP have been developed in a different legal environment. Therefore, it is necessary to define what has to be considered as the entirety of GAAP.

C.1. IAS/IFRS

39. As far as IAS/IFRS are concerned, the assessment can only cover the standards and interpretations applicable to annual and interim financial statements, officially endorsed by the European Union and published (or about to be published with sufficient certainty[2]) in the Official Journal[3]. Therefore, the assessment will not explicitly cover IAS Framework and the Implementation Guidance and Basis for Conclusions usually published by the IASB along with standards and interpretations. However as such additional material needs to be read and considered for a proper understanding and application of the standards or interpretations, they should be included in the materials used for the assessment process[4].

C.2. Third country GAAP

40. With respect to the third country GAAP, CESR will ask the third country national standards setters and official regulatory agencies to define the applicable accounting standards and interpretations to be considered as applicable and enforceable as of 1st January 2005 for the preparation and presentation of financial reporting by companies presenting the same profile as companies listed on a regulated market in Europe. Information on the Standard Setting Process will also be asked (for a better understanding of the regulatory framework).

41. It is possible that third country issuers are not listed in their home country and, for that reason, use a set of accounting standards that is less demanding than the set applicable to listed companies in that country (e.g. in the US, segment reporting is not required for non-listed companies). An assumption under equivalence is that each and every third country issuer makes use of the most demanding set of third country accounting standards applicable to any listed company when it claims to obtain the benefits of the equivalence. To this aim, the technical advice will identify standards that can be considered as equivalent.

42. Furthermore, third countries can justify that their standards are equivalent to IAS/IFRS by making reference to additional guidance or regulations that are not as such part of third country GAAP provided that these are mandatory.

43. CESR may also consider third country standards as equivalent if the disclosure is given somewhere else than in the financial statements according to enforceable non-accounting requirements.

44. The third country agencies will also be asked about the set of applicable and enforceable standards and interpretations expected to be applicable as at 1st January 2005, even if the request for information is sent by CESR before that date

45. CESR will only consider third country GAAP applicable as at 1st January 2005 for financial years starting after this date. This will therefore not encompass:

    - future standards (e.g. standards whose application is dated after 1st January 2005, or draft standards).

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[2] It encompasses all endorsement proposals transmitted to Parliament until 31 December 2004. CESR believes reasonable to assume that the endorsing regulation(s) of IFRS 2 and IFRIC 2 to5 will be published (for application as of 1st January 2005). These standards will therefore be included in the assessment.

[3] For the moment, CESR assumes that all standards published by IASB and in force as of 1 January 2005 will be endorsed by the EU. CESR will work on the basis of the English version.

[4] In this regard, see also the Communication that the EC published in November 2003 on the interaction between the IAS regulation and the Accounting Directives

- previous versions of GAAP that cease to be applicable as at 1st January 2005 (even if they still have an impact on financial statements published after that date because of past operations still accounted for under past standards when allowed as such by GAAP). See also exceptions provided by IFRS 1, First Time Adoption of IFRS, allowing non-retroactive application of some accounting provisions.

C.3 Significance

46. The mandate requires CESR to focus the assessment only on the significant differences between IAS/IFRS and third country GAAP.

47. CESR will potentially have to consider all kind of provisions of IAS/IFRS and the third country GAAP, i.e. primarily recognition, measurement and presentation, but also scope and disclosure requirements.

48. Similarly, CESR will look at differences in terms of accounting principles, concepts, rules, but will not provide an advice on pure terminology differences if the accounting principles behind the different wording are equivalent.

49. It is a delicate exercise to define ex abstracto the potential effect of a GAAP difference. Certain GAAP differences may potentially have a very important impact on investors' ability to understand and compare third country GAAP which are material given the characteristics of a specific issuer or industry. Indeed, the significance of a large number of GAAP differences will vary with respect to individual companies depending on such factors as the nature of the company's operations, the sector in which it operates and, more importantly, on the financial position and results of the company.

50. On this basis, CESR's approach will be to limit its analysis to the differences commonly found in practice or known to be significant as such by the financial and audit community in Europe and in third countries. A convergence program in the third country may provide helpful input. In CESR's view, this approach is consistent with the objectives and requirements of the EC mandate.

51. CESR recognises that accounting practices are converging and this is a helpful development which will be taken into account when establishing which areas of practice remain significantly different.

52. It is important to stress that the opinion delivered by CESR on the equivalence may have to be accompanied by an appropriate set of caveats highlighting the limitations of the assessment.

D. Consequences of non-equivalence

53. The mandate from the European Commission invites CESR to consider what kind of remedies should be applied in cases of non-equivalence, and in particular whether third country issuers should be required to restate their financial statements or whether there may be more limited remedies (e.g. reconciliation items, notes or other explanatory material).

54. In assessing how to design remedies, CESR took into account the fact that the Prospectus Regulation does not provide for any remedy other than restatement for non-equivalence (see Annex 1, Item 1 of the Annex to the EC regulation, minimum disclosure requirements for the share Registration Document – schedule[5]). The Transparency Directive does not provide an indication on possible remedies in case of non-equivalence; nevertheless, CESR believes that the approach should be consistent under the two legislative measures.

[5] 20.1 "*For third country issuers, such financial information must be prepared according to the international accounting standards adopted pursuant to the procedure of Article 3 of Regulation (EC) No 1606/2002 or to a third country's national accounting standards equivalent to these standards. If such financial information is not equivalent to these standards, it must be presented in the form of restated financial statements*".

55. CESR expects that there may be three potential outcomes from the assessment process. At one end of the scale is the finding of equivalence of the third country GAAP with no adjustments. Whilst at the other end of the scale is a finding of non-equivalence (under which restatement is the only solution).

56. However, between these extremes CESR believes there is a range of instances where third country GAAP could be considered as equivalent subject to remedies. CESR's view is that the objective of the remedies should be to enable investors to make similar investment decisions.

57. CESR believes that there should be a hierarchy of potential remedies that are designed to achieve the objective of allowing investors to make the same judgement. The remedies differ according to the nature of the difference between the accounting models. In each of the models outlined below, the assumption is that companies will continue to publish their full financial statements in accordance with third country GAAP, but that these should be supplemented with additional information. CESR would also expect that the remedies would be subject to audit and that the auditor's opinion should cover the original third country financial statements and the additional remedies. Where information required by IAS/IFRS is subject to audit or review in EU, equivalent information provided by third country issuers should be provided with the same level of assurance

58. Presentation of remedies: remedies must always be presented in a clear, complete and consistent way, using plain language. Remedies can be integrated into third country financial statement or be presented as a separate statement, subject to the assurance as described in paragraph 58. In the later case, remedies must always be published along with third country GAAP financial statements for reporting purposes on EU financial markets.

D.1. Remedies

59. Remedies deal with resolving differences with IAS/IFRS provisions as outlined in paragraph 44. Possible remedies are, in hierarchy, as follows:

1) Additional disclosures

60. Where the differences from IAS/IFRS arise from different disclosure requirements, it should be possible to resolve the problem by requiring the information to be disclosed with the same prominence as would be required under IAS/IFRS. CESR suspects that this approach might not be sufficient in cases where the difference is in respect of recognition and measurement.

2) Statements of reconciliation

61. Where there are differences of measurement or recognition which do not affect many lines in the income statement or balance sheet, CESR believes that a sufficient remedy might be to require reconciliation for these specific lines of income statement or balance sheet from the local GAAP to equivalent IAS/IFRS requirement. However, this would need to be given equal prominence with that of the original statements – e.g. via an additional statement at the foot of the income statement. There would also need to be additional disclosures to explain the reconciling items and provide a context for their inclusion.

3) Supplementary statements

62. Where the differences in measurement or recognition are complicated or numerous, CESR believes that a reconciliation would be too complicated to enable users to understand the full implications. In such cases, CESR believes that it would be appropriate to provide investors with supplementary statements ((in the form of condensed income statement, balance sheet and possibly cash flow statement) to augment the existing local GAAP financial statements (supported by the range of additional disclosures described above). Such additional statements would enable investors and other users to see the adjustments in context. This could focus only on the issues that are material to

investors' understanding, or could be a full reconciliation to bring the results into line with those that would have been recorded under IAS/IFRS. The extent and content of these supplementary statements will depend on the particular situation of the reporting company and this will address the situations where there are complicated and numerous differences in measurement or recognition. The final technical advice to the Commission will clarify when this remedy is needed.

63. CESR believes that this approach would be needed for all significant differences in presentation, as it would not be possible to remedy a major difference in presentation through disclosure or reconciliation.

D.2. Restatement

64. The Commission's mandate also mentions the possibility to require restatement. However, CESR does not interpret this outcome as a remedy – rather it is the only available option for the Commission in circumstances where it concludes that that third country GAAP is not equivalent to IAS/IFRS. This approach might apply where the differences with the third country GAAP are so widespread, fundamental and material that there can be circumstances where no other remedy will enable them to be deemed to be equivalent.

65. Where a restatement is necessary, CESR is of the view that the restatement will provide useful information to investors only if it is presented as a full set of financial statements (including all notes) under IAS/IFRS which replaces rather than supplements the third country GAAP financial statements that are provided for the home country investors. As noted above, the effect of a few differences from IAS/IFRS can be remedied by supplementary accounts or reconciliations, but a restatement will not comply with either third country GAAP or IAS/IFRS unless it covers all elements of the financial statements.

D.3. Responsibility for application of remedies

66. For the instances where third country GAAP could be considered as equivalent subject to remedies, CESR also intends to describe the necessary remedies corresponding, e.g. to the significant GAAP differences identified as described above. A list of remedies is expected to clarify the reporting requirements for third country issuers and auditors.

67. Such a list of remedies would however be general and abstract, as it will be drawn up at GAAP level and not at each different reporting entity level. All the potential significant GAAP differences will not necessarily have the same impact on all third country issuers. In CESR's views, application of a remedy will depend on the materiality (for a given issuer) of the (significant) GAAP difference identified in the equivalence assessment.

68. The remedies that CESR has identified will be appropriate in different circumstances depending on the particular business profile and accounting policies of the reporting company. An accounting treatment that would commonly need reconciliation may not be a material issue for a company that does not undertake the business to which the treatment applies. Therefore, CESR believes that the first judgement for the application of the remedy should be made by the company and assessed by the auditors as to its appropriateness in the particular case of the issuer. However, when reporting entities conclude that remedies are not applicable, because they are non existent or not material, this should be stated explicitly (for each of the remedies).

69. As a general rule, issuers have to provide disclosures in addition to those set out by financial reporting requirements, when this is necessary for enabling users to take informed investment decisions[26]. On this basis, in those circumstances as described in paragraph 57 of this Concept Paper, issuers are obligated to provide additional information for GAAP differences other than the ones identified in the technical assessment (e.g. for specific industries or unusual transactions).

[26] See in this regard par graphs 13 and 15 (c) of IAS 1, *Presentation of Financial Statements*.

70. A dialogue can be established on these aspects between issuers/auditors and competent authorities under the Prospectus Regulation and the Transparency Directive. . Enforcement of remedies by competent authorities will be an integral part of overall enforcement practice as applied to prospectuses and periodic financial reporting.

E. Early warning mechanisms

71. The requested assessment of GAAP's is explicitly limited and based on the situation existing at a specific point (i.e. fixed targets). Due to the further changes in IAS/IFRS and other GAAP's, the European Commission asked advice on early warning mechanisms.

72. An early warning mechanism could take the form of a mandate given to an existing or newly created body, appropriately funded and accountable for this task.

73. CESR proposes this approach because the objective and final outcome of an early warning mechanism is a regular monitoring and possible review of equivalency decisions on considered GAAP. Any final equivalency decisions on third country GAAP will be taken following a due political process at EU level and, at the end, will be embedded in a formal European legal text (see EC mandate, point 1.3 for more details in this respect). The decision process leading to any revision of equivalency legislation must be organised in a way that provides the same legal certainties for all market participants.

74. It is not CESR's task to formulate proposals on this decision making process and therefore, the following elements are limited to technical aspects that might be considered by the European Commission when making proposal as to any possible early warning mechanisms.

75. In the events that remedies are applicable a regular reassessment of equivalence by this body would be relevant. At this stage an annual reassessment every June 30th could be considered as sufficient for these purposes. However, first reassessment should take place at least for January 2007 (end of transitional period).

76. Nevertheless, it is possible to foresee that the periodicity of the assessment of changes in GAAP might be reduced both during the first years of application of IAS/IFRS in Europe; or where remedies are not considered to be sufficient and a restatement is deemed necessary.

77. This periodicity of review is proposed as a reasonable medium solution between a too short one (which would not be technically sustainable by the mechanism) and a too long one (which would lead to uncertainties for market participants and could maintain in place restatement requirements that are not any more justified). A one year periodicity corresponds to most usual financial reporting timeframes and to the usual periodicity of publication of academic and professional updates researches on GAAP differences.

78. The following elements can be included in an early warning mechanism:

    - does the change affect IAS/IFRS or third country GAAP?

    - does the change affect an issue which is remedied by the CESR assessment?

    - does the change increase or decrease the gap between IAS/IFRS and third country GAAP?

79. The designated body should be assumed to be aware of changes in IAS/IFRS. Given the initial assessment as of January. 1st 2005, this body can assess whether this change affects issues that were remedied. The designated body will need to be aware of changes in third country GAAP. The most efficient way to get this knowledge is probably that the relevant standard setters and regulators alert the designated body to explain the changes.

CESR

2.2. Description of enforcement mechanisms in Canada, Japan and US

2.2.1 Principles to be followed

80. The mandate requires CESR "*to describe the mechanisms (outside the areas of audit and of corporate governance) provided for at least in the US, Canada and Japan ensuring that the third country GAAP mentioned are respected".*

81. The task of CESR is not to make an assessment of the effectiveness and efficiency of such mechanisms. As already indicated in the introduction, quality of enforcement systems in third countries is not a condition for GAAP equivalence, even if it may have an influence on the reliance of those third countries' financial statements (which must be assessed independently).

82. However, in order to respond meaningfully to the mandate, CESR needs to clarify what should be understood by "mechanisms … ensuring that the third country GAAP mentioned are respected". Such clarification is the purpose of the present concept paper on this part of the mandate.

83. The words "ensuring" and "respected" as used by the European Commission in the mandate, and the objective of the mandate, lead CESR to consider that the required description should not cover all possible third country mechanisms and institutions which, for one or another reason, carry out their supervisory competencies and powers in relation with financial statements. National tax authorities should, for example, not be included because their objectives are not to ensure that the national GAAP are respected with a view of ensuring a proper information of financial markets.

84. The objective of the European Commission's mandate on GAAP equivalence is for CESR to assess whether financial statements prepared under third country GAAP provide equivalently sound information to investors taking investment decisions on regulated markets and, so, ensure investors protection through proper financial reporting. The part of the mandate that requires CESR to describe the enforcement mechanisms comes within the framework of that generic objective.

85. Standard No 1 on Financial Information – Enforcement of Standards on Financial Information that CESR published in April 2003 sets out the basic principles for a robust and consistent enforcement of the financial reporting framework. In particular, the Principle 1 of this Standard defined as follows the objective of enforcement mechanisms:

    "The purpose of enforcement of standards on financial information provided by_the issuers mentioned by principle 9 is to protect investors and promote market confidence by contributing to the transparency of financial information relevant to the investors' decision making process."

86. The other principles of the Standard No 1 describe the key characteristics that enforcement mechanisms of financial information should have in Europe for fulfilling the purpose set out by the Principle 1.

87. On this basis, CESR believes that the principles of Standard No 1 will constitute the most appropriate reference for determining which mechanisms in the third countries' are relevant in the framework of the mandate. Consequently, the principles of the Standard No 1, i.e. the characteristics of the enforcement mechanisms in Europe, will serve as benchmark for describing the possible relevant third country mechanisms.

88. This approach does not mean that CESR will assess the appropriateness of third country enforcement mechanisms on the basis of the Standard No 1. It only means that the description of the third country mechanisms will follow a systematic methodology using the characteristics of enforcement mechanisms defined by the Standard No 1 as "analysis grid". The objective is to find out whether and how the main issues which can be considered relevant for enforcement such as purpose, independence, powers, resources, selection methods, actions etc. are incorporated in the third country's enforcement mechanism.

89. For example, the Standard No 1 indicates that enforcement system must have the necessary minimum powers as defined in more detail by the Prospectus and Transparency Directives. On this basis, the description of third country mechanisms could indicate whether such mechanisms provide the third country identified bodies with at least similar powers.

2.2.2. The procedure to be followed

90. For performing its technical description, CESR will call on each of the relevant third country regulatory agencies to provide information so that CESR can obtain an appropriate and meaningful understanding of the third country relevant enforcement mechanisms.

91. In this respect, CESR will send directly, to the regulatory agencies of the considered three countries, a detailed questionnaire in order to gather the necessary information.

92. CESR will also consider any other existing source of information or evidences that market participants will provide as a result of the consultation process on the present concept paper.

2.2.3. Further issues identified

93. The mandate given to CESR focuses on the equivalence with IAS/IFRS of three third countries GAAP and on the description of enforcement mechanisms of at least the same three countries (Canada, Japan and US). This is expected to cover the most prominent current situations of third country issuers in Europe. For that reason and in combination with the tight timetable set for the finalisation of the mandate, CESR will concentrate on these three countries.

94. The variety of third country issuers in Europe is such that other situations can already be identified and may develop in the future. Indeed, for the time being not all third country issuers in Europe that use these GAAP are incorporated in Canada, Japan and US (nor are subject to the described enforcement mechanisms). Alternatively, third country issuers can make use of other GAAP than the three assessed in the scope of the mandate. CESR believes that these situations also need to be addressed at a later stage in terms of enforcement, in the interest of investors' protection and for creating a necessary level playing field between all possible third country issuers in Europe.

95. Beyond giving a technical advice to the European Commission under the mandate on equivalence, it will remain a generic issue for CESR to co-ordinate the approach of its members to the enforcement of financial statements of third country issuers. This could be part of the future activities of CESR's operational group on financial reporting (CESR-Fin), and more particularly of the CESR-Fin Sub-Committee on Enforcement (SCE).

ANNEX 4

LIST OF INTERNATIONAL STANDARDS (IAS/IFRS) AND INTERPRETATIONS (SIC/IFRIC) USED IN THE ASSESSMENT

IFRS 1	First time adoption of International Financial Reporting
IFRS 2	Share Based Payments
IFRS 3	Business Combinations
IFRS 4	Insurance Contracts
IFRS 5	Non-Current assets held for sale and discontinued operations
IAS 1	Presentation of financial statements
IAS 2	Inventories
IAS 7	Cash Flow Statements
IAS 8	Accounting policies, changing in accounting estimates
IAS 10	Events after the balance sheet date
IAS 11	Construction contracts
IAS 12	Income taxes
IAS 14	Segment reporting
IAS 16	Property, plant and equipment
IAS 18	Revenue
IAS 19	Employee benefits
IAS 20	Accounting of governance grants and disclosure of government assistance
IAS 21	The effects of changes in foreign exchange rates
IAS 22	Business combinations
IAS 23	Borrowing costs
IAS 24	Related party disclosures
IAS 27	Consolidated and separate financial statements
IAS 28	Investment in associates
IAS 29	Financial reporting in hyperinflationary economies
IAS 30	Disclosures in the financial statements of banks and similar financial institutions
IAS 31	Interests in joint ventures
IAS 32	Financial instruments: disclosure and presentation
IAS 33	Earnings per share
IAS 34	Interim financial reporting
IAS 36	Impairment of assets
IAS 37	Provisions, contingent liabilities and contingent assets
IAS 38	Intangible assets
IAS 39	Financial instruments: recognition and measurement
IAS 40	Investment property
IAS 41	Agriculture
SIC 7	Introduction of the euro
SIC 10	Government assistance
SIC 12	Consolidation- Special purpose entities
SIC 13	Jointly controlled entities- Non-Monetary contributions by Venturers
SIC 15	Operating leases- incentives
SIC 21	Income taxes- recovery of revalued non-depreciable assets
SIC 25	Income taxes- Changes in the tax status of an enterprise or its shareholders
SIC 27	Evaluating the substance of transactions in the legal form of a lease
SIC 29	Disclosure- Service concession arrangements
SIC 31	Revenue- Barter transactions involving advertising services
SIC 32	Intangible assets- Website costs
IFRIC 1	Changes in existing Decommissioning, Restoration and Similar Liabilities

ANNEX 5

FINANCIAL REPORTING STANDARDS ENFORCEABLE IN CANADA, JAPAN AND USA

(Description based on responses received to CESR questionnaires)

CANADA

Business entities applying Canadian generally accepted accounting principles (GAAP) must follow the financial reporting standards in the CICA Handbook – Accounting, as described in Section 1100 thereof, “Generally Accepted Accounting Principles”.

The Handbook contains the accounting standards promulgated by the Canadian Accounting Standards Board (AcSB). The contents of the Handbook, together with other material developed by the AcSB, constitute the primary sources of Canadian GAAP. Section 1100 also describes other sources of GAAP and how they are to be applied. Handbook Section 1100 specifies that the primary sources of GAAP, in descending order of authority, are:

1. Handbook Sections 1300-4460, including Appendices and Board Notices;
2. Accounting Guidelines, including Appendices and Board Notices;
3. Abstracts of Issues Discussed by the Emerging Issues Committee (EIC Abstracts), including Appendices;
4. Background Information and Basis for Conclusions documents accompanying pronouncements described in 1 and 2, including Appendices;
5. Illustrative material of those pronouncements described in 1 – 4; and
6. Implementation Guides authorized by the AcSB.

JAPAN

The Japanese financial reporting standards legally enforceable to public companies, as of January 2005 consist of the following:

1. Securities and Exchange Law (the “SEL”), and its related regulations
2. Accounting Standards (issued by the Business Accounting Council (the “BAC”), an independent body within the Financial Services Agency organised for accounting and auditing issues; and had been an accounting setter until the Accounting Standards Board of Japan (the “ASBJ”) was established in July 2001.)
3. Accounting standards, Guidance on Accounting Standards, and Reports of Practical Issues Task Force (issued by the ASBJ, an independent private accounting setter).
4. Practical Guidelines on Accounting Standards (issued by the Japanese Institute of Certified Public Accountant (the “JICPA”), a statutory organisation of auditing practitioners, and had prepared guidelines for Accounting Standards announced by the BAC, until the ASBJ was established in July 2001.)

USA

The US financial reporting standards legally enforceable to public companies, as of January 2005 consist of the following:

1. Financial Accounting Standards Board Statements of Financial Accounting Standards and Financial Accounting Standards Board Interpretations

2. Accounting principles promulgated by a body designated by the AICPA Council to establish such principles, pursuant to Rule 203 of the AICPA Code of Professional Conduct.1 As such, category (a) consists of Financial Accounting Standards Board (FASB) Statements of Financial Accounting Standards and Interpretations, Accounting Principles Board Opinions, and AICPA Accounting Research Bulletins.
3. Pronouncements of bodies, composed of expert accountants, who deliberate accounting issues in public forums for the purpose of establishing accounting principles and have been exposed for public comment and cleared2 by a body referred to in category (1). As such, category (2) consists of FASB Technical Bulletins and, if cleared by the Board, AICPA Industry Audit and Accounting Guides and AICPA Statements of Position.
4. Pronouncements of bodies, organized by a body referred to in category (1), which publicly deliberate accounting issues that are cleared by a body referred to in category (1), but have not been exposed for public comment. As such, category (3) consists of AICPA Accounting Standards Executive Committee (AcSEC) Practice Bulletins that have been cleared by the Board and consensus positions of the FASB's Emerging Issues Task Force.
5. Practices or pronouncements that are widely recognized as generally acceptable because they represent prevalent practice in a particular industry or the knowledgeable application to specific circumstances of pronouncements that are generally acceptable.