THE COMMITTEE OF EUROPEAN SECURITIES REGULATORS

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

FEEDBACK STATEMENT

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

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

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

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

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

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

CESR observes that the draft recommendation on transition to IFRS has received sufficient support from those who responded to the consultation to go on with the final publication of a recommendation, considering the amendments brought to the initial text proposal and the clarifications given via this feedback statement[1].

1. Nature of the CESR guidance

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

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

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

Although each national regulator could decide to go beyond and require full or partial compliance with this guidance, CESR believes that a recommendation is sufficient at this stage in order to meet two objectives. The first objective is to keep the distinction between standards provided by EU regulations and directives in the area of financial reporting (notably through endorsement of IASB's standards) and additional guidance

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

provided by CESR Members. The second objective is that the recommendation remains at the level of principles whose primary aim is to foster listed companies to adopt proper communication policies during the transition process with sufficient flexibility and not to create detailed reporting rules, in terms of timing and content of such reporting.

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

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

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

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

2. The 4 milestones

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

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

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

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

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

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

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

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

3. Publication of the 2003 financial statements

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

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

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

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

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

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

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

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

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

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

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

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

4. Publication of the 2004 financial statements

4. a. Reliability of quantitative information

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

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

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

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

- Analysis

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

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

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

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

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

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

4. b. Reference to the Implementation Guidance of IFRS1

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

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

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

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

5. 2005 interim reporting

5.a. Applicable standards

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

The draft Transparency Directive contains different provisions regarding the publication of half-yearly financial reports and quarterly financial information by companies whose shares or debt securities (only for half-yearly reports) are traded on a regulated market. This draft Directive is currently subject to discussions at the level of European Institutions. The CESR's recommendation does not attempt to pre-empt the possible outcome of these discussions.

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

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

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

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

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

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

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

5.b. Comparative figures

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

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

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

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

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

6. Audit and presentation of the information

6. a. Audit and location of the information

In different places of the draft recommendation, it was suggested to include the recommended disclosures in the annual report or in the notes to the financial statements (see previous §§ 10, 14[2]).

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

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

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

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

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

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

6. b. The "bridge approach"

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

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

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

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

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