



Ref: CESR/04-509

**CONCEPT PAPER ON  
EQUIVALENCE OF CERTAIN THIRD  
COUNTRY GAAP  
AND ON  
DESCRIPTION OF CERTAIN THIRD  
COUNTRIES MECHANISMS OF  
ENFORCEMENT OF FINANCIAL  
INFORMATION**

**CONSULTATION PAPER**

**October 2004**



Ref: CESR 04-509

## **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 acceptance 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.

<p style="text-align: center;"><b>DRAFT CONCEPT PAPER ON EQUIVALENCE OF CERTAIN THIRD COUNTRY GAAP &amp; ENFORCEMENT ASPECTS</b></p>
--

**PLAN**

**1. General background**

- A. Introduction
- B. Mandate to CESR for Technical Advice on Equivalence
- C. Key elements of the EC mandate to CESR
- D. CESR public consultation

**2. CESR Concept paper**

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

- A. Objective of equivalence
- B. Review of general principles
  - B.1.The four characteristics
  - B.2.The topics
  - B.3.The objectives
- C. Technical assessment
  - C.1.IAS/IFRS
  - C.2.Third-country GAAP
  - C.3.Significance
- D. Consequences of non-equivalence
  - D.1.Remedies
  - D.2.Restatement
  - D.3.Responsibility for application of remedies
- E. Early warning mechanisms

**2. 2. Description of enforcement mechanisms in Canada, Japan and US**

- 2.2.1. Principles to be followed
- 2.2.2. The procedure to be followed
- 2.2.3. Further issues identified



*The public consultation of the present paper will close on the 22<sup>nd</sup> December 2004. Responses to consultation should be sent via CESR's website ([www.cesr-eu.org](http://www.cesr-eu.org)) in the section "Consultations".*

*In order to give interested parties an opportunity to express their opinions on the consultation paper, CESR will hold an open hearing on 23 November 2004 from 2pm till 5pm at the CESR premises, 11-13 avenue de Friedland, Paris. [An](#) agenda for the hearing is available in the CESR website.*

## **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 1<sup>st</sup> 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 (presumably as from autumn 2006) 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**

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 therefore covers implementing measures that are common to both the Level 2 Regulation (EC) 809/2004 on Prospectus (implementing the Level 1 Directive 2003/71/EC on Prospectus) and the Transparency Directive as approved by the European Parliament on 30 March 2004 and by the Council on 11 May 2004 (formal adoption of the Transparency Directive is scheduled for autumn 2004).

The mandate requires CESR to:

1. assess the equivalence between Canadian GAAP, Japanese GAAP and US GAAP and IAS/IFRS;
2. describe the mechanisms provided for at least in the US, Canada and Japan ensuring that the third country GAAP mentioned above are respected.

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

As a first step in preparing its advice, CESR indicated on receiving the mandate from the European Commission that it would release a concept paper, i.e. the present document. The objective of the concept paper will be to clarify the meaning of equivalence and the methods and criteria to be used for the technical assessment of the equivalence and the method to be followed for the description of enforcement mechanisms. This concept paper will be the object of a public consultation.

The second step for CESR will be to conduct the global assessment of the equivalence under the EC mandate, in line with the mandate and the principles set out in the concept paper.

Basically, CESR looks to the interested third countries standard setters and regulatory agencies in order to get an appropriate and meaningful understanding of the third country GAAP and their possible equivalence with IAS/IFRS. CESR also looks to market participants, especially to users of financial information, preparers and auditors for any input indication on the equivalence issues



developed in this paper, in particular on what, in their opinion, the significant differences between GAAP and IAS/IFRS are, and what is their needs in terms of remedies in case of non-equivalence.

Within CESR, the operational group CESR-Fin chaired by John Tiner, Chief Executive Officer of the UK FSA will, through its two sub-committees on endorsement (SISE) and enforcement (SCE) be in charge of the present mandate of equivalence. The SCE is chaired by Mr Lars Østergaard, Director at the Finanstilsynet in Denmark (Danish Financial Supervisory Authority - DFSA) and the SISE is chaired by Mr Paul Koster, Commissioner of the Netherlands Authority of Financial Markets (AFM).

In order to meet the deadlines set by the European Commission, an indicative timetable for the work CESR will be undertaking in response to the mandate is attached.

### **C. Key elements of the EC mandate to CESR**

The mandate given by the European Commission to CESR was published by the Commission and CESR on 29 June 2004. A complete version of the mandate is on 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. CESR public consultation**

Following receipt of the mandate from the European Commission, CESR began its work on 29 June 2004 by launching a call for evidence for interested parties to submit comments by 29 July 2004. As a result of this consultation, CESR received 11 responses from a wide range of interested parties. These responses have been published on CESR's website ([www.cesr-eu.org](http://www.cesr-eu.org)) and have formed a very helpful source and have assisted greatly in the preparation of this concept paper.

The public consultation on the present paper will close on the 22<sup>nd</sup> December 2004. Responses to consultation should be sent via CESR's website ([www.cesr-eu.org](http://www.cesr-eu.org)) in the section "Consultations".

In order to give interested parties an opportunity to express their opinion on the consultation paper, CESR will hold an open hearing on 23 November 2004 from 2 pm till 5 pm at the CESR premises (11-13 avenue de Friedland, Paris).

Commentators are invited to respond to the specific questions raised in this document, but also to provide any other indication and information that might be relevant for CESR to consider in finalising the advice to the Commission.



In particular, CESR would also invite users of financial statements, preparers and auditors to provide technical indications on the different aspects of this mandate, notably on what is necessary for a proper functioning of the markets in relation with financial information provided by third country issuers.

Following consultation a final concept paper will be published along with the responses received to this consultation. CESR will then move on to finalising its draft technical advice on equivalence and the description of enforcement mechanisms (see the attached general indicative workplan and timetable for this mandate).



## 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 at least 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. 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.
5. 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.

Q: Do you agree with the proposed definition of equivalence and reference to investors' needs?

6. 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.**

Q: Do you agree with this approach?

Q: What characteristics should a difference between IAS/IFRS and third countries GAAP have to be perceived as significant for an investor?

Q: Do you consider other general aspects should be taken into account for the assessment of equivalence?

7. 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 as these standards 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.

Q: Do respondents believe that EU investors can be assumed to have a good knowledge of third country GAAP or that IAS/IFRS should be assumed to be the only benchmark?

Q: Should this issue have an impact on the assessment of equivalence, and if so, how?

Q. Do you think that CESR should distinct professional and individual investors in assessing equivalence?

8. 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 segments of the regulated markets, such as bond issuers and equity issuers.
9. Part of the mandate deals with the description of enforcement mechanisms in Canada, Japan and US. As such, the quality of enforcement systems in third countries is not a condition for GAAP equivalence.
10. 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.

11. Equivalence is not a condition 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).
12. 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**

13. 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**

14. 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<sup>1</sup>) provides a definition of these terms and CESR therefore sets out below where a reference to these definitions seems particularly appropriate.
15. 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).
16. CESR has outlined below IASB's definitions of these terms and intends to assess third country GAAP's equivalence to them.

#### **Understandability**

17. 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."*
18. 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.

---

<sup>1</sup> 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.

19. 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**

20. 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.*”
21. 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.
22. 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**

23. 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.*”

24. 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**

25. 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**

26. 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.

27. 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.
28. 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**

29. 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.
30. 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."*

31. In the scope of equivalence, the focus is on investors in EU financial markets.
32. 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.

Q: Do you believe that the three elements mentioned above are relevant and sufficient for conducting a review of general principles?

Q: Do you have other views on how to take investors' needs into account in a global assessment?

Q. Do you believe that the review of general principles as described above is appropriate and sufficiently complete?

Q. Q. Do you have comments on the articulation between the technical assessment and the review of the general principles, which are both parts of the global assessment?

## **C. Technical assessment**

33. 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.
34. 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**



35. 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<sup>2</sup>) in the Official Journal<sup>3</sup>. 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<sup>4</sup>.
36. CESR may have to make assumptions on standards and interpretations that will potentially be in force as of 1 January 2005. Save for this time gap between now and late 2004, draft standards or interpretations will not be considered because final adoption of new standards or amendments to existing standards is not always guaranteed, in particular when they bring about intense political and economic debate. In practical terms, CESR-Fin would consider all Standards and Interpretations that form the “stable platform” published by IASB as of March 31st 2004 plus the standards and interpretations published until September 30, 2004.

## **C.2. Third country GAAP**

37. 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).
38. 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.
39. 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.
40. 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.
41. 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
42. 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).

---

<sup>2</sup> It encompasses all endorsement proposals transmitted to Parliament until 31 December 2004.

<sup>3</sup> 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.

<sup>4</sup> 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).

### **C.3 Significance**

43. The mandate requires CESR to focus the assessment only on the significant differences between IAS/IFRS and third country GAAP.
44. 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.
45. 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.
46. 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.
47. 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.
48. 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.
49. 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.

Q: Do you agree with the proposed approach for identifying significant differences between third country GAAP and IAS/IFRS?

Q: Do you see other specific elements to be considered for defining what the significant differences are?

### **D. Consequences of non-equivalence**

50. 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).
51. 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<sup>5</sup>). The Transparency Directive does not provide an indication on possible

---

<sup>5</sup>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

remedies in case of non-equivalence; nevertheless, CESR believes that the approach should be consistent under the two legislative measures.

52. 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).
53. However, between these extremes CESR believes there is a range of instances of non-equivalence that could be solved by remedies. CESR's view is that the objective of the remedies should be to enable investors to make similar investment decisions.
54. 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.

Q: Do you agree that there may be three potential outcomes from the assessment process, as described above?

Q. Do you agree that the auditor's opinion should cover the original third country GAAP financial statements and the additional remedies? Which level of comfort should be provided for the additional remedies (equal to full audit?)?

### **D.1. Remedies**

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

#### **1) Additional disclosures**

56. 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**

57. 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 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**

58. 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 require supplementary statements (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

---

*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".*





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.

59. 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.

Q: Do you believe that these three different kinds of remedies are appropriate or whether one or more of them would be enough in all circumstances?

Q: Are the three remedies sufficiently clear? If not, please provide us with specific alternatives?

### **D.2. Restatement**

60. 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.
61. 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**

62. As indicated above, the assessment of equivalence will be limited to significant differences between third country GAAP and IAS/IFRS. However, 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 depends on the materiality (for a given issuer) of the (significant) GAAP difference identified in the equivalence assessment.
63. The remedies that CESR has identified will be appropriate in different circumstances depending on the particular business profile and accounting policies of the company. An accounting treatment that would commonly need a reconciliation may not be a material issue for a company that does not undertake the business to which the treatment applies. CESR believes that the first judgement for the application of the remedy should be made by the company and endorsed by the auditors, having taken into account the guidance provided by the relevant competent authority as defined by the Prospectus Regulation and the Transparency Directive and the specific circumstances of the company.
64. Issuers are responsible for applying an appropriate remedy in cases including GAAP differences that would not have been listed in the technical advice of CESR.

Q: Do you agree with this approach?

## **E. Early warning mechanisms**

65. 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 as of January 1<sup>st</sup> 2005.

66. An early warning mechanism could take the form of a mandate given to an existing or newly created body, appropriately funded for this task.
67. 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).
68. 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.
69. 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?
70. 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.

Q: Do you agree with this approach?
-------------------------------------

## 2.2. Description of enforcement mechanisms in Canada, Japan and US

### 2.2.1 Principles to be followed

71. 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”*.
72. 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).
73. 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.
74. 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.
75. 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.
76. 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.”**
77. 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.
78. 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.
79. 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.

80. 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**

81. 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.
82. 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.
83. 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**

84. 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.
85. 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.
86. 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 1. Prospectus and Transparency Directive

### 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 of 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**

The relevant texts are the article 19 (Third Countries) and 26, § 3 of draft Transparency Directive.<sup>7</sup>

### **Article 19**

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 11(4), 11b, 11c and 12 to 14, 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 15 and disclosed in accordance with Articles 16 and 17.*

- 1a. *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. *In order to ensure the uniform application of paragraph 1, the Commission shall, in accordance with the procedure referred to in Article 23 (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 international standards set out by international organisations, the third country where the issuer is registered ensures the equivalence of the information requirements provided for in this Directive.*

*The Commission shall, in accordance with the procedure referred to in Article 23 (2), take the necessary decisions on the equivalence of accounting standards which are used by third*

---

<sup>7</sup> The text inserted is an extract of the Transparency Directive as published by the European Commission on its website (unofficial text).

*country issuers under the conditions set out in Article 26 (3) at the latest five years following the date referred to in Article 27. 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.*

*3a. In order to ensure uniform application of paragraph 2, the Commission may, in accordance with the procedure referred to in Article 23(2), adopt implementing measures defining the type of information disclosed in a third country that is of importance to the public in the community.*

#### **Article 26, §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 European Union 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 the Regulation No 1606/2002; and
- c) the Commission has not taken any decision in accordance with Article 19 (3) ii) as to whether there is an equivalence between the accounting standards referred to in Article 2 of Regulation No 1606/2002, 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 29**

The Commission shall by the 30 June 2009 at the latest 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 26(3a) 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<sup>8</sup> 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:

<b>Deadline</b>	<b>Action</b>
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

<sup>8</sup> 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

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**

### **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](mailto: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

- 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? |



Indicative CESR Work Plan for the mandate on equivalence between certain third country GAAP and IAS/IFRS

