

European Securities Regulatory Proposal Affects U.S. Companies Listed in the EU

In April 2005, the Committee of European Securities Regulators (CESR) issued a consultation paper, Draft Technical Advice on Equivalence of Certain Third Country GAAP and on Description of Certain Third Countries Mechanisms of Enforcement of Financial Information [], which concludes that U.S. GAAP, Canadian GAAP, and Japanese GAAP (collectively Third Country GAAP) are equivalent to International Financial Reporting Standards (IFRS) as adopted by the European Commission (EC). Therefore, if the proposal is adopted by the EC, non-European Union (EU) companies (e.g., a U.S. company with securities listed on a European exchange) would not be required to prepare their financial statements in accordance with IFRS as adopted by the EC, which otherwise would have been required in filings with European exchanges beginning on or after January 1, 2007.

As discussed further below, CESR proposes that these companies provide supplemental disclosure of significant differences between Third Country GAAP and IFRS as adopted by the EC. In addition, CESR proposes that the supplemental disclosures be audited and suggests, but does not propose, that the auditor issue a separate report on these supplemental disclosures, in addition to their report on the Third Country GAAP financial statements. CESR believes that auditor involvement is necessary in determining (i) whether the non-EU company has identified all differences between Third Country GAAP and IFRS as adopted by the EC, and (ii) whether identified differences are significant.

Comment letters on the consultation paper are due by May 27, 2005. In addition, interested parties may present their views in a public hearing to be held on May 18, 2005.

Further Discussion:

Background

Pursuant to EU regulations, non-EU companies must prepare their financial statements in accordance with IFRS as adopted by the EC in filings with a European exchange beginning on or after January 1, 2007, unless the third country GAAP is determined to be equivalent to IFRS as adopted by the EC. In June 2004, the EC issued a mandate to CESR to advise whether U.S., Canadian and Japanese GAAP are equivalent to IFRS as adopted by the EC. For purposes of the mandate, CESR determined that Third Country GAAP would be considered equivalent to IFRS as adopted by the EC if the Third Country GAAP enabled investors to make similar investment decisions.

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GAAP Equivalence

CESR conducted its technical assessment of GAAP equivalence based on the standards effective for fiscal years beginning on or after January 1, 2005 and provided a summary of the differences between the respective Third Country GAAP and IFRS. The technical assessment only focused on the more significant differences between Third Country GAAP and IFRS as adopted by the EC, and CESR emphasized that the summary was neither exhaustive nor determinative. That is, CESR has proposed that non-EU companies (i) provide supplemental disclosure of all significant GAAP differences including any not included in the summary, and (ii) carefully consider whether the recommended disclosure is appropriate based on their specific facts and circumstances.

Supplemental Disclosures

CESR proposes that non-EU companies provide supplemental disclosure of significant differences between Third Country GAAP and IFRS as adopted by the EC either as a footnote to the respective Third Country GAAP financial statements or, preferably, as a separate presentation. However, non-EU companies would not be required to provide a statement of reconciliation, which CESR originally considered. CESR has proposed supplemental disclosures in the following two categories:

Additional Disclosures

Disclosure A: Additional narrative and/or quantitative disclosures that supplement existing Third Country GAAP disclosures (e.g., IFRS may require disclosure of the fair value of an asset that is not required by Third Country GAAP);

Disclosure B: Additional disclosure about assumptions, valuation methods, economic data, and hypothesis used under Third Country GAAP; and

Disclosure C: Disclosure quantifying the gross and after tax impacts of the GAAP difference on net income (loss) and shareholders' equity.

Supplementary Statements

Pro forma condensed income statement and balance sheet information (and possibly cash flow information) prepared to show the effects of accounting for specified, but not necessarily all, items on the basis of IFRS as adopted by the EC. (Supplementary Statements generally would be required when the GAAP differences are complicated or numerous.)

For Disclosures A and B, consistent with its conclusion regarding GAAP equivalence, CESR indicated that the differences between Third Country GAAP and IFRS as adopted by the EC generally would relate to the specific GAAP disclosure requirements, rather than to measurement and recognition principles. CESR also indicated that for Disclosure C and Supplementary Statements, non-EU companies may follow the principles of IFRS 1,

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First-time Adoption of International Financial Reporting Standards, which provides the recognition and measurement requirements, as well as the presentation and disclosure requirements, when a company changes its basis of accounting from Previous GAAP (i.e., the basis of accounting that a first-time adopter uses immediately before adopting IFRS) to IFRS. IFRS 1 requires a company to apply retroactively, for all periods presented, the IFRS standards and interpretations in place at the end of the financial year in which the company adopts IFRS for the first time. However, IFRS 1 provides certain elective (e.g., business combinations, pensions) and certain mandatory (e.g., hedge accounting) exceptions to this general requirement of retrospective application. Therefore, non-EU companies may follow any of the elective or mandatory exceptions in IFRS 1 with corresponding disclosure about the exception.

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