

Mr. F Demarigny
Secretary General
The Committee of
European Securities Regulators
11-13 avenue de Friedland

F – 75008 Paris

13 September, 2005

Re. : Consultation paper – CESR’s technical advice to the European Commission on a possible amendment to Regulation (EC) 809/2004 regarding the historical financial information which must be included in a prospectus

Dear Sir,

We would like to thank you for the opportunity to provide you with our comments on the Consultation Paper “CESR’s technical advice to the European commission on a possible amendment to Regulation (EC) 809/ 2004 regarding the historical financial information which must be included in a prospectus”.

This comment letter addresses issues of a general nature before responding to the specific questions posed by CESR.

General Comments

The current version of the EU Prospectus Regulation provides essentially a sufficient basis for the preparation of prospectuses in accordance with the rules and regulations. In particular, the details in the framework for preparing and presenting historical financial information, including pro-forma financial information are adequate to ensure that sufficient information will be provided to investors. This assumes greater significance, as a prospectus under article 5 of the Directive 2003/71/EC, regardless of the minimum requirements of the EU Prospectus Regulation, must contain all information necessary in a given case, to enable an investor to make a well-founded

assessment of the net assets, financial position and results of operations of the issuer.

In order to keep up with the developments both within the capital markets and in company law in a flexible manner, in formulating new laws and regulations it is necessary to bear in mind the fact that the higher the degree of detail the higher the danger that inappropriate overregulation will result. Those responsible for formulating the laws and regulations are, in any case, not realistically in a position to capture every conceivable circumstance and development, in setting each new regulation.

Having stated this, we would like to respond to the specific questions posed by CESR as follows:

40. Q: *Do you believe that the cases described below should be considered as a comprehensive list? If not, please provide examples of any other cases you would consider convenient to address and of the additional requirements you would consider appropriate to require in those examples.*

It will be extremely difficult to develop a list of every conceivable grooming transaction, and in particular to incorporate future developments into such a list. Nevertheless we welcome the list that has been presented intending to include the most significant of the constellations that occur in practice, and to develop general valid principles for the presentation of complex financial histories in prospectuses.

If it is considered necessary to amend the EU Prospectus Regulation, we recommend the Regulation be amended, in the abstract, applying these principles as a basis. We do not consider it appropriate, however, for requirements relating to specific cases to be included in the Regulation, as this would limit the flexibility required in preparing prospectuses in order to consider all situations which can take place in reality. Nevertheless flexibility as meant in this context should be limited by the above described principle based approach. In any case we recommend to avoid that the content of a prospectus has to be negotiated between the issuer and the regulator in every single case due to the absence of clear rules in the law.

45. Q: *Do you agree with the proposed approach? Please give your reasons.*

We consider it generally appropriate to provide an investor with sufficient financial information for the last three years, and equally when the issuer is a newly incorporated holding company.

However, CESR should take the following into account:

- Each regulation should be formulated in the abstract, so that prospectuses can be designed in such a way as is appropriate in the individual circumstances. For instance, inclusion of additional financial information on an acquired business segment in the prospectus should not be mandatory. If a newly incorporated holding company already existed at the last balance sheet date and the transaction occurred prior to that date, in accordance with IFRS, the principle of reverse acquisition may apply under certain conditions. According to this principle a newly incorporated holding company would be allowed to present a financial history spanning more than one year, thus obliterating the necessity for additional financial information on an acquired business in the prospectus.
- We would like to point out that the Directive resp. the Prospective Regulation should not create new accounting requirements.
- We agree with CESR, that an extension of the information requirements in a prospectus should be restricted to those business areas that constitute the main business of the newly incorporated holding company. In determining criteria to establish what the main business constitutes, it will however be necessary to take the current structure of the newly incorporated holding company as the point of reference, i.e., once all the transactions have been executed.

We are also pleased that CESR has retained its position, that pro-forma financial information is only acceptable for the period defined in Annex II of the EU Prospectus Regulation, and so is not proposing changes to the Regulation in this respect.

51.Q: *Which of the three options proposed do you prefer? Please give your reasons.*

52.Q: *If option 2 or option 3 is preferred, how would you request the issuer to conform the information given to the issuers' accounting standards?*

- Restatement*
- Reconciliation*
- Narrative description of the differences?*

Please give your reasons and provide input on the costs that each of the options would imply for issuers.

We would like to refer to the following principles before discussing the individual options in detail:

Restatement (Conversion from the relevant national accounting standards to the issuer's accounting standards): Conforming the accounting of an acquired business, under its national accounting standards, to the issuer's accounting standards will necessitate restatement of the last historical financial statements. This is the most suitable way of making financial statements comparable.

Reconciliation: A minimum number of items or lines from the balance sheet and income statement should be set (e.g., profit for the year before or after tax and equity) for which a reconciliation is to be presented. In addition it will be necessary to determine a uniform basis for how such reconciliation should be presented and which additional explanations it would be required for inclusion in a prospectus.

Narrative description of the differences: Currently, there is no "framework" for narrative descriptions depicting material differences between accounting standards. Finding a uniform presentation in Europe would therefore pose considerable difficulties. This applies even more so, as due to the, in part, significant differences between national accounting standards and IFRS the nature of any narrative presentation can only be limited and in any case, will be purely indicative. In our opinion, such presentation would only be appropriate where it is used to inform investors of the main features of the differences in accounting systems. In contrast, a narrative description will not be sufficient to facilitate the comparison of financial statements.

We would like to make the following comments on the options:

Option 1 allows the investor sufficient insight into the relevant acquired business segment and also appears practicable. We agree with the approach as it is in line with a) the systematic treatment prescribed by the EU Prospectus Regulation in requiring the restatement of financial statements prepared in accordance with non-equivalent accounting standards of other countries, and b) the equivalence of member states accounting standards. In this respect this is similar to the EU convergence project for IFRS US Canadian and Japanese accounting standards.

Options 2 and 3 have in common the connection between the NewCo's accounting and that of the acquired entity, and as such, both require "conformity".

As far as option 3 relates to financial statements that have been prepared according to accounting standards which are other than EU or EU equivalent accounting standards, a full restatement in accordance with option 1 should be recommended.

As far as financial statements that have been prepared according to EU or EU equivalent accounting standards are concerned such restatement would also appear desirable on the basis of the comparability this would achieve. In addition, reconciliation of specific financial statement items and a narrative description of the major differences, when considered necessary, may also be conceivable. Both would entail

implementation of detailed guidance, which would have to be similar to that envisaged by CESR in the context of its recommendations on equivalence of Canadian, Japanese and US GAAP.

The required timeframe for such “conformity” will need to be clarified. According to the current version of the EU Prospectus Regulation, only the previous two years figures presented on the basis of those accounting standards that are to be applied in the future have to be included in the prospectus relation to a share issue. This could be taken as a maximum timeframe in respect of the financial information of subsidiaries.

We would like to recommend either of the following two possibilities:

- Option 2, modified, by requiring restatement of all financial statements to conform to the issuer’s accounting standards, to ensure the optimal comparability of financial reporting.
- Option 1 is very practicable, and, for those financial statements prepared in accordance with equivalent accounting standards, in conjunction with the current requirement to include pro-forma financial information, ensures a basis for providing sufficient information to the addressees of prospectuses.

In our opinion, the options providing for either reconciliation or narrative description of major differences have less to recommend them, since there is no appropriate framework to facilitate this, their implementation appears to be time consuming and they do not ensure comparability, and certainly not full comparability, of the financial statements.

The respective standard setters, either national or international (IAASB) would have to prepare a framework for the reconciliation or narrative description of major differences.

The extent of costs resulting from options 1 and 2 will largely depend on the individual circumstances, so it is not really feasible to make a general statement on this aspect. Restatement, in particular, is likely to involve significant resources in terms of cost and time. But it has to be kept in mind that reconciliations are also likely to be both time-, and cost-intensive.

Usually the respective subsidiaries, for which such a restatement or reconciliation required, preparing the historical financial statements of the last three (in our opinion at the maximum two years) financial years did not take into account that requirement. In regard of this fact we would like to point out, that preparing financial statements based on new seriously deviating accounting standards retrospectively will be very time- and cost-expensive. This fact has to be weighted even stronger, since usually

conversion projects refer to current financial periods and the preparer knows in advance the requirement of preparing financial statements based on new accounting standards.

57. Q: *Which of the three options proposed do you prefer? Please give your reasons.*

In our opinion, both options 1 and 2 are appropriate, provided the relevant accounting standards are adhered to. We consider option 3 less suitable, as, generally, financial statements can only be understood in conjunction with all the required accompanying notes.

61. Q: *Do you agree with this approach? Please give your reasons.*

We agree with the position that a prospectus should only contain historical financial statements or consolidated financial statements prepared in accordance with the applicable accounting standards if these have been audited. We see no difference to the regulation currently in force in this respect.

63. Q: *Do you agree that there should be auditor's involvement concerning this additional information given in the case of reconciliation or narrative description? Please give your reasons.*

64. Q: *What kind of assurance should the auditor provide in relation to the restatement, reconciliation or narrative description:*

- a a full scope audit*
- b a review scope*
- c a report, as in item 7a) of the pro forma annex, stating that in their opinion the financial information has been properly compiled on the basis stated?*

On its merits, we view auditor involvement as desirable, but would like to point out that the auditor's opinion is affected by two factors. Firstly, it is affected by the comparison of the specific requirements, which have to be applied to the subject matter so that it is in accordance with the relevant framework applicable. Secondly, by the nature of the assurance engagement, which according to the international standards promulgated by the IAASB will be either an audit, providing reasonable assurance (conclusion in the positive form), or a review, providing limited assurance (conclusion in the negative form). Therefore, any involvement of the auditor would require a clear

determination of the accounting framework and the audit or review to be performed. Both the accounting framework to be audited resp. reviewed by the auditor and the audit resp. review procedures would have to be established by the authoritative national or international standard setters.

It will be necessary to differentiate the following elements in considering the possible form of opinion expressed by the auditor on the various forms of “conformity”:

1. In restating the financial statements from national accounting standards to IFRS or other accounting standards, either IFRS or the other accounting standards provide a basis for determining what the resultant financial statements should contain. The auditor can then either audit or review the restated financial statements and issue an opinion, as appropriate.
2. If, however, there is no detailed accounting framework, in respect of the reconciliation it can not be audited resp. reviewed as there is no basis for the audit resp. the review. In these circumstances no audit or review opinion can be expressed. If a suitable framework were to be established, it would be possible to express either an audit or a review opinion which could either cover preparation in accordance with the framework (“...prepared in accordance with...”) or a basis of preparation set out by the issuer itself (“...properly compiled on the basis stated...”).
3. This applies equally in respect of narrative descriptions of the differences.

68. Q: *Do you agree with this approach? Please give your reasons and provide input on the costs that each year of drawing up of historical financial information would imply for issuers.*

In responding to the question, we have interpreted the example cited as follows:

A NewCo acquires (regardless of whether legally independent) a component or components of a corporate group. These components were under common control in the transaction year. The issuer has no historical financial statements (reflecting the new structure).

According to the current version of the EU Prospectus Regulation this situation would be dealt with by including pro-forma financial information in a prospectus. In addition, an issuer could already have given thought to preparing so-called carve-out financial statements (combined financial statements) on an IFRS basis. This would be permissible, if the components concerned were under common control and belonged to a reporting entity.

Preparation of carve-out financial statements (combined financial statements) could also possibly be used to solve CESR's example case. A prerequisite for the preparation of such financial information is, however, that the component concerned has continuously had an independent set of books for its accounting. In individual cases the preparation of carve-out financial statements may be appropriate, however, in our opinion, this should not be made a general requirement.

We are not convinced by the deliberations in respect of the inclusion of internal or management accounts in a prospectus. Such accounts are often not prepared in accordance with the same standards applicable to external accounting and would therefore not be suitable as information for investors.

This will apply even where the basis for the information is publicized, since investors cannot normally assess the precise content of internal or management accounts. Therefore, it is particularly important that there will be a requirement that the financial information to be included in a prospectus is prepared in accordance with national or international accounting standards. Any relaxation of this principle would be severely detrimental to the quality and comparability of this financial information.

70. Q: Which of the above options proposed do you prefer? Please give your reasons and provide input on the costs that each of the options would imply for issuers.

If financial information were prepared in accordance with national or international accounting standards it could be subject to audit or review.

To avoid misunderstandings as to the subject matter of an assurance engagement and the scope of an auditor's responsibilities, the auditor would be unable to express an opinion, in this context, where no such framework exists.

We would like to make the following observations in respect of the differentiation CESR has made between "full scope audit" and "review scope" on the one hand and the opinion in respect of "proper compilation" on the other: The terms "full scope audit" and "review scope" describe the scope of examination procedures undertaken and, as such, this is a question of principle relating to assurance engagements. The term "proper compilation" describes the nature and quality of the engagement subject matter, and, as such, is an issue relating to accounting standards. This means that an opinion as to "proper compilation" can be formed just as well on the basis of an audit as of a review. The difference will lie in the quality of the assertion (reasonable assurance as opposed to limited assurance).

An opinion as to "proper compliance" is always coupled directly to the requirements of the accounting standards. In contrast, the assessment of the "true and fair view" that the subject matter of the assurance engagement may intend to provide will de-

pend on whether the applicable accounting system is designed to show such a “true and fair view”.

77. Q: Which of the alternatives proposed do you prefer? Please give your reasons.

78. Q: Would you propose any other option to deal with these situations? Please give your reasons and provide input on the costs that each of the options would imply for issuers.

In our opinion, option 1 constitutes the most appropriate means of providing investors with a sufficient view of the net assets, financial position and results of operations of the last (three) years. Each issuer is also able to provide any additional information in the prospectus to the extent that it considers necessary. Individual issuers ought therefore be able to consider whether, and where appropriate the degree of detail with which changes in the entity’s structure should be presented in the “operating and financial review” section of the prospectus.

We strongly support the fact that no suggestion has been made in option 2 to amend Annex II in such a way that pro-forma financial information would be acceptable over a longer period of time, as is already stated in the EU Prospectus Regulation. In our opinion it is questionable whether there is a need for information exceeding that foreseen in option 1. We therefore favor option 1, and we currently do not envisage any further need for regulation in this area.

81. Q: Do you agree with this approach? Please give your answers.

In our view, when an acquisition or disposal of an entity component is forthcoming, but has not yet occurred, it will be necessary to differentiate that:

- Presentation of pro-forma financial information in a prospectus in accordance with the current version of the EU Prospectus Regulation would be both necessary and appropriate, as long as the transaction is sufficiently likely to occur, and in the case of an acquisition, as long as the issuer has sufficient access to the financial information of the target component.
- If, however, the transaction is not sufficiently likely to occur, and in the case of an acquisition, the issuer does not have sufficient access to the financial information of the target component, preparation of pro-forma financial information should not be countenanced. In such cases it would appear appropriate to describe the target component/targeted structure in the prospectus, and when an acquisition is planned, inclusion of publicly available financial information of the target entity in the prospectus.

83. Q: *Do you agree with this approach? Please give your reasons.*

We agree with this approach. The solution put forward by CESR is practicable for ensuring that a prospectus will normally include historical financial statements for at least three calendar years. In case that one or more of the financial statements cover a shorter period than one calendar year four or even more financial statements should be included in the prospectus in order to cover at least three calendar years.

We hope that our comments will be helpful to CESR in formulating this technical advice. If you have any further questions about our views on these matters, we would be pleased to be of further assistance.

Yours sincerely,

Martin Pföhler

Chairman of the IDW Working Party

"Prospective Directive"

Member of Consultative Working Groups to advise
CESR Expert Group on Prospectus