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Transition Without Tears: A Five-Point Plan for IFRS Disclosure

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Preparing for the imminent arrival of International Financial Reporting Standards (IFRS) is proving challenging for many European companies for which IFRS takes effect in 2005. Not least among these challenges are that reporting requirements are substantial and time to prepare is running short. Transition to the new standards will bring further demands as market participants familiarize themselves with the revised financial reporting. Specifically, companies will need to pay particular attention to how they communicate their financial restatements. If market participants are not provided with clear information, the capital markets could face potential disruption if investors and analysts adopt overly conservative positions until greater clarity is obtained.

In this report, Standard & Poor's Ratings Services outlines its evaluation of certain effects of reporting under IFRS and explains five crucial disclosure points we believe will help achieve a smooth transition. We illustrate these disclosure practices with examples from companies that have already made significant progress toward IFRS reporting, and provide an update on steps we are taking to address the question of how the new standards could affect credit quality among rated entities in the region. For ease of reference, we frequently refer in this report to dates relevant to a company adopting IFRS for its year ending Dec. 31, 2005 and restating its 2004 figures. For companies whose financial year ends at another time during the year, the relevant dates are the first year ending after Dec. 31, 2005, and restatement of the financial year before this.

The majority of European companies rated by Standard & Poor's plan to adopt IFRS in 2005, as do companies in other countries such as Australia. We welcome this convergence to IFRS, and the long-term convergence of accounting standards worldwide, as it will help improve the consistency and transparency of financial information. Furthermore, we believe that the disclosure practices described in this report will increase clarity, thereby easing the transition process for companies that must explain these changes to interested parties such as analysts, investors, regulators, lenders, and other users of their financial statements. Transparency is likely to prove to be subjective, but these practices should help market participants rapidly identify what is important in the transition and what is not.

Ongoing Consultation Yields Positive Feedback

Following Standard & Poor's announcement of its intention to consult with rated European entities on the effects of IFRS (see article titled "S&P Enters Dialogue with European Companies on Impact of New Int'l Accounting Standards," published on RatingsDirect, Standard & Poor's Web-based credit analysis system, on March 29, 2004), we have undertaken preliminary discussions with credits across all industry sectors. In addition, our Industrials and Financial Institutions Ratings practices have undertaken a more formal approach, surveying companies to assess the progress made toward IFRS and any likely implications for their creditworthiness. (Our approach to assessing the latter is outlined in Box 1.) Most of the questionnaires sent out by our Industrials practice have been returned and now serve as tools for ongoing surveillance. Responses to questionnaires sent out by the Financial Institutions practice are due shortly.

Box 1
Will Credit Ratings be Affected by IFRS?

In evaluating the transition to International Financial Reporting Standards (IFRS), Standard & Poor's focuses on distinguishing aspects of transition that have the potential to influence an entity's credit rating.

Ratings could be affected if new information presented under IFRS changes our assessment of the existing business or financial risk profile of an entity, or if these risk profiles actually do change as a direct or indirect consequence of IFRS. New information could result from improved transparency of a claim on--or access to--cash or from a changed assessment of cash flow generation, for example. Real changes in cash transactions and related risk could result from:

(i) changes in an entity's own business behavior (hedging policy or securitization practices, for example); or

(ii) changes resulting from the treatment of the company by other parties such as a tax, legal, or regulatory consequence, or a change in borrowing arrangements to address concerns under current financial covenant requirements.

Consistent with Standard & Poor's established criteria, analysts will continue to adjust amounts reported by companies for significant topics where quantified adjustments provide more meaningful measures for the assessment of creditworthiness and where such adjustments are practical. Following the transition to IFRS, adjustments will be made from the new IFRS basis of accounting. Even in the absence of significant new information or real change in transactions, however, it is unlikely that full reversion to Standard & Poor's previous adjusted amounts will result because it may not be practical or desirable to adjust for the full range or company adjustments in adopting IFRS. A qualitative assessment is made where information to make a significant quantified adjustment is unavailable.

We continue to encourage a timely dialog on transition issues in order to:

(i) improve our understanding of the impact of IFRS on reported information and business behavior; and

(ii) help us limit the impact of changes on credit ratings where appropriate.

We have seen no evidence to date that widespread or significant rating actions will be required. Nevertheless, the transition will be closely monitored throughout the process and changes may well become necessary in certain instances. Entities whose existing ratings are constrained or pressured by their financial risk profile will likely be most sensitive to new information or real changes in risk. It is possible, however, that the business risk profile of a company could be affected if, as a result of new disclosures, management is considered to have withheld meaningful information from the market, significant issues of noncompliance with accounting requirements are revealed, or the confidence of trading partners is damaged.

Many of the most critical accounting policies for the financial institutions sector will potentially come into effect later than key policies for the industrial and services sectors. This is because the application of IAS 32 and IAS 39 on financial instruments is optional for 2004 transition restatements. The European Commission's endorsement of IAS 39 has only recently been finalized. The Commission introduced a limited number of changes that disallow optional fair valuing of financial liabilities and relax certain hedge accounting restrictions. Final changes for 2005 are expected by year-end, as the International Accounting Standards Board (IASB) plans to finalize its more limited version of the fair-value option and submit it for consideration by the European Commission. Nevertheless, Standard & Poor's continues to discuss IFRS implications with rated entities in the financial institutions sector because the finishing touches on transition must now be determined for 2005.

In the insurance sector, potentially significant changes have been deferred to Phase 2 of the IASB's insurance project, which is not expected for several years. Consequently, changes required for the arrival of IFRS in 2005 are expected to be less significant at this stage and are being assessed through direct dialog with rated entities.

Effective Company Communication: Crucial to a Smooth Transition

From our early discussions with rated companies in Europe, most have recognized that there are broad communication issues raised by IFRS transition. Some are planning special investor presentations to explain the transition, and a few have now held such introductory sessions, highlighting various aspects of expected changes in varying degrees of detail. Many, however, appear undecided on their approach to the more detailed points that may prove crucial in determining how the new financial statements will be received by analysts and investors. A major concern for Standard & Poor's and other market participants is that the transition could potentially pose a disruption to capital markets in the short term because of user misinterpretation of the different information provided under IFRS.

The risk for companies making the transition to IFRS is that market participants could potentially be forced to act first and clarify or confirm their interpretation later if the transition cannot be readily understood. Should investors and other users of financial information be left to fill in the blanks on unexplained or unclear transitional effects, there is a risk to the company that these parties may make an incorrect assessment or take overly conservative positions until greater levels of comfort can be reached. In the interim, the market prices of debt and equity instruments could benefit or suffer. In the extreme, access to new capital at an economical cost could be hindered or even suspended until additional clarity is provided. To date, Standard & Poor's sees no evidence that this will be prove a significant concern, although the uncertainty and potential risk exists.

A likely result of applying certain requirements of IFRS is increased volatility of earnings and balance-sheet amounts, and many companies are considering how best to address this. Replacing economic hedges with more costly alternative instruments in order to achieve hedge accounting, or reducing the amount of risk covered by hedges, may in some cases help manage accounting volatility and may be under consideration by a number of companies. It is possible that in certain cases these actions would bring a more economical response to addressing risks including any adverse market reaction to volatility. Equally, these actions could result in greater risk exposure and/or costs.

A more effective solution may lie in clear and transparent disclosure of the transition and ongoing implications of new accounting policies. In this respect, communication with investors, lenders, regulators, and other constituencies can be considered an essential part of a risk management program around IFRS implementation. Even those companies with new and potentially negative information to report to the market as a result of the increased transparency achieved under IFRS could benefit from explaining their transition clearly so as to not be penalized by market overreaction to that new information. Furthermore, the risk of overreaction will likely be lessened if companies keep the market informed from an early stage.

Best Practice Processes Aid Market Intelligence

Although many market commentators highlight communication as a significant concern, little has been said of how to achieve clarity in this area. From our ongoing consultation with rated European entities, we have identified five practices that provide a high level of transparency in communicating the IFRS transition to market participants. These practices go beyond both what is specified by the IASB in its standard "IFRS 1, First-Time Adoption of International Financial Reporting Standards" (IFRS 1) and the disclosure recommendations of The Committee of European Securities Regulators (CESR). In our opinion, these practices would assist in providing clear communication of the IFRS-related information revisions in a user-friendly and easily understandable manner to minimize confusion. Moreover, they will allow market participants to focus appropriately on matters that are more relevant to their own economic judgments, and more quickly discern what is important in the transition documentation. Some of the points described in this report are logical interpretations of what could be provided by companies to meet the level of disclosure intended by the IASB. They could, therefore, even be interpreted as "required", at least in some circumstances. Standard & Poor's encourages companies to provide such detailed disclosure in all cases where relevant.

Standard & Poor's expects companies, in reporting details of their transition to IFRS, to need to offer supplementary information above the minimum disclosures required under the IASB's transition standard (further details of which can be found in the Appendix at the end of this report). It is possible that there will be circumstances in which IFRS transition proves to have very limited effects on reported financial statement information. For the vast majority of companies, however, a greater level of complexity is expected, and differing needs of various users of their financial statements can prove difficult to establish. In this respect, application of the disclosure practices outlined in Box 2 and further discussed in Section 1-Section 5 should address a broad range of needs.

Box 2
At-a-Glance: Five Crucial Disclosure Practices That Ease IFRS

1. Reconciliation of Restated Balance Sheets and Income Statements
Reconciliations of the balance sheet and income statement for various dates and periods are required by IFRS 1 to explain differences between prior GAAP and restated IFRS amounts. However, the format of these reconciliations is not specified. A comprehensive reconciliation would show all significant adjustments made to the previously reported information, in a tabular presentation, both line-by-line for the financial statements and by topic or nature of adjustment, with clear disclosure of the need and basis for each adjustment. This presentation would distinguish between adjustments that are reclassifications of amounts from one line to another, and adjustments resulting from changes in accounting policy. It would also make clear
(i) the impact of a single adjustment that affects several lines, and
(ii) a single line affected by several adjustments.

2. Transition Date Balance Sheet
The transition date balance sheet is the initial balance sheet prepared under the IFRS framework. For many companies, this balance sheet will be stated on Jan. 1 2004. Although the IASB does require disclosure of the adjustments made to reconcile the previously reported balance sheet with the restated IFRS amounts at this date, it does not require the corresponding IFRS balance sheet to be disclosed. Disclosure of this balance sheet adds data for an additional year-end that is essential for trend analysis and the calculation of financial measures and ratios commonly used by Standard & Poor's and other financial analysts. With potentially little effort, companies that disclose this balance sheet add another year to the track record that management will seek to establish under IFRS following the break in series resulting from transition.

3. Reconciliation of Restated Cash Flow Statements
This is the cash flow statement counterpart to point 1 above. IFRS does not require reconciliation of the restated cash flow statement, only an explanation of material adjustments. A comprehensive reconciliation, however, would significantly increase an analyst's ability to interpret changes to the cash flow statement. These would include changes resulting from any revisions to the scope and method of consolidating investments and other interests held, the definition of cash and cash equivalents, and the classification of cash flows as operating, investing, and financing under IFRS.

4. Accounting Policies and Their Effect on Reported Amounts and Future Trends
The financial position reported in the balance sheet at transition and subsequent profitability will be influenced by the accounting method applied to move to IFRS accounting, the transition options chosen, policy choices made, the assumptions and estimates used in applying those policies, and the degree of fair value methods employed. It will also be affected by any changes to business practices such as hedging, stock option plans, and securitization programs. Disclosure of these accounting policy influences is considered crucial to the interpretation of transition statements and future financial results, not least to minimize surprises and misunderstandings.

5. Maintenance of Relevant Disclosures
The conversion to IFRS will likely raise the standard of disclosure significantly for those companies that currently lag the norm in financial data transparency, while those that already exhibit highly transparent financial information are expected to continue this level of disclosure. Although rationalization of overly detailed, lengthy, or repetitive disclosure may be appropriate, IFRS should not be used as an opportunity to drop meaningful disclosure.

These disclosure practices reflect our practical views resulting from evaluating the disclosures made by companies already well on the way to fulfilling their IFRS requirements. Each section includes a detailed discussion of the disclosure practice, the technical accounting requirements involved, and related analytical concerns. Illustrations adapted from recent transitions to IFRS by U.K.-based pharmaceuticals company AstraZeneca PLC (AA+/Stable/A-1+) and Finnish forest products company UPM-Kymmene Corp. (BBB/Stable/A-2), which initially announced their IFRS restatements on Oct. 25, 2004, and March 24, 2004, respectively, are also included.

We note that full restated financial statements, including fully detailed notes, will eventually become available in the publication of annual financial statements for the first year IFRS is applied. That said, such IFRS statements could become available more than one year after companies initially announce their transition.

We believe that transition disclosures are best presented as a complete package, covering:

- A full set of restated financial statements (balance sheets, income statements, cash flow statements, and statements of changes in shareholders' equity);
- Notes explaining the restatement, including reconciliations from previously reported amounts to restated amounts under IFRS; and
- Notes on the accounting policies to be applied under IFRS and applied at transition.

Additional footnote detail may then follow in the annual financial statements for the first year IFRS is applied. In the interim, however, to provide a thorough understanding of the transition, it will be necessary to identify all the relevant factors in the transition disclosure package.

In some cases, transition disclosure is likely to be made at a stage when the outcome of various IFRS requirements is not yet defined due to pending approvals by the IASB and/or the European Commission, for example. Given that IFRS amendments that become applicable for 2005 will affect the policies applied in companies' 2005 annual reports, disclosure of the assumptions made will also help users anticipate and interpret changes if they do occur. AstraZeneca, for example, has indicated that its restatement to IFRS assumes approval of the IASB's proposal to allow immediate recognition of actuarial gains and losses on defined-benefit pension and other plans within shareholders' equity. It also assumes application of the EU version of IAS 39, which excludes the option to fair value financial liabilities such as a company's own debt obligations. In addition, the company sets out alternative approaches if the method of accounting adopted for defined-benefit plans does not become available or if the fair-value option does become available. In applying these assumptions and providing the related disclosure details, AstraZeneca was able to disclose its IFRS transition early.

The IFRS transition disclosure packages provided by AstraZeneca and particularly by UPM-Kymmene were provided well in advance of the European requirement for 2005 adoption. Each has also provided a package of fairly detailed disclosure, enabling us to use their information to illustrate the disclosure practices discussed in this report. Neither provides an all-inclusive illustration of these practices, however.

Section 1: Reconciliation of Restated Balance Sheets and Income Statements

Financial statement reconciliation requirements.

As IFRS requires one year of comparative information, companies that adopt IFRS in 2005 will be required to restate their 2004 financial statements. In the Appendix to this report, Box 3 summarizes the requirement for reconciliations of various balance sheet and income statement information. The term "reconciliation" refers to the disclosure of quantified differences between amounts originally reported under prior accounting standards to corresponding amounts reported under IFRS. Such reconciliations are required to be sufficiently detailed to provide an understanding of material adjustments to the balance sheet and income statement, although the precise format of these reconciliations is not specified in IFRS 1.

IFRS is expected to change the presentational format of the balance sheet and income statement. Further changes will arise from the application of new accounting policies such as the move to bring derivative assets and liabilities onto the balance sheet and adjust them to fair value. Both format and policy changes will need to be clear to analysts, investors, and other users of the financial statements.

Format of IFRS financial statements.

There are no standard formats for an IFRS balance sheet or income statement that companies must adopt. Nevertheless, certain general guidelines do apply for these statements, and there are minimum requirements for items that must be included on the face of the balance sheet or income statement rather than in the notes. IFRS also requires that items be presented separately when their presentation is "relevant to the understanding" of the financial position or performance. Two general points on the format of the IFRS balance sheet and income statement are relevant for financial analysis:

- Balance sheet. Assets and liabilities are presented in a current/noncurrent (long-term) format, unless a format that presents them in descending order of liquidity provides more relevant information.

- Income statement. Expenses can be displayed either by function (such as cost of sales, general, and administrative), or nature (such as depreciation, salaries and benefits, and materials), depending on which is more relevant. If they are classified by function on the income statement, disclosure by nature must be included in the notes to the financial statements. Items cannot be labeled as exceptional or extraordinary under IFRS, but separate disclosure is required to explain financial performance during the period, listed on the face of the income statement or in the accompanying notes.

Comprehensive reconciliation.

A comprehensive reconciliation as described here refers to a tabular presentation showing the adjustments made to the previously reported balance sheet and income statement, both line by line and by topic or nature of adjustment. If not already available, such reconciliations would generally be easy for a company to create. Absent such clear disclosure, users may struggle to reconcile previously reported amounts to their restated IFRS equivalents by line or topic, depending on their specific needs.

Although a narrative description of the nature of any significant adjustments would be expected as part of meeting the disclosure requirements of IFRS 1, this may not prove sufficient in all instances. A single line on the financial statements may be affected by several adjustments, for example. Equally, a single adjustment may affect several lines on the statements. Complex relationships such as these would require the narrative to be exceptionally detailed, and so are more readily identified in tabular form. A more focused approach is to disclose meaningful commentary accompanied by the comprehensive reconciliation which confirms the adjustments by topic and by line, distinguishing between reclassification of amounts from one line to another and between separate policy changes.

Table 1 illustrates a comprehensive reconciliation for AstraZeneca. We consider this table to be particularly useful as it quantifies adjustments made both by line item and for each significant adjustment (related detailed disclosures have not been included in our report). The specific level of detail will vary by company, but line items that reflect those used in the annual financial statements will be most useful. Similarly, adjustments should be shown separately and include each significant adjustment topic, so that any residual amounts described as "other" would not mask offsetting or otherwise significant amounts.

Table 1 AstraZeneca PLC Transition to IFRS--Income Statement Reconciliation for 2003									
(Mil. $)	*Previously reported under UK GAAP*	*IFRS 2 Share-Based Payments*	*IAS 19 Employee Benefits*	*IFRS 3 Business Combinations*	*IAS 32/39 Financial Instruments*	*IAS 12 Income Tax*	*Other*	*Total effect of transition to IFRS*	*Restated under IFRS*
Sales	18,849								18,849
Cost of sales	(4,469)	(2)	(2)		11		(1)	6	(4,463)
Distribution costs	(162)								(162)
Research and development	(3,451)	(42)	(5)				486	439	(3,012)
Selling, general, and administrative expenses	(6,856)	(110)	(7)	59	4		(483)	(537)	(7,393)
Other operating income	200				(12)			(12)	188
Operating profit	4,111	(154)	(14)	59	3		2	(104)	4,007
Net finance costs	89		(7)		(24)		(2)	(33)	56
Income from associates	2								2
Profit before tax	4,202	(154)	(21)	59	(21)			(137)	4,065
Taxation	(1,143)	18	6		5	82	3	114	(1,029)
Profit for the period	3,059	(136)	(15)	59	(16)	82	3	(23)	3,036
Attributable to minority interests	23		(1)					(1)	22
Attributable to equity holders of the company	3,036	(136)	(14)	59	(16)	82	3	(22)	3,014
Source: AstraZeneca PLC.									

The column headed "Other" in table 1 includes AstraZeneca's reclassification of certain amounts previously included in R&D as selling, general, and administrative expenses. This reclassification accounts for all but a negligible portion of the amounts shown as "Other".

Table 2 shows a similarly comprehensive reconciliation of AstraZeneca's balance sheet at Dec. 31, 2003. It demonstrates the clarity of the tabular format, in that the provisions line, for example, is affected by many adjustments and the employee benefit adjustment affects many lines, all of which are clearly shown. The column headed "Other" was not explained in the company's information release, but primarily relates to the reversal of the accrual for dividends, because they were not declared at the balance sheet date.

Table 2 AstraZeneca PLC Transition to IFRS--Balance Sheet Reconciliation at Dec. 31, 2003									
(Mil. $)	*Previously reported under UK GAAP*	*IFRS 2 Share-Based Payments*	*IAS 19 Employee benefits*	*IFRS 3 Business combinations*	*IAS 32/39 Financial instruments*	*IAS 12 Income Tax*	*Other*	*Total effect of transition to IFRS*	*Restated under IFRS*
Noncurrent assets									
Property, plant, and equipment	7,536						11	11	7,547
Goodwill and intangible assets	2,884			59			84	143	3,027
Other investments	220				(7)		(80)	(87)	133
Deferred tax assets		19	472		2	1,021		1,514	1,514
Total	10,640	19	472	59	(5)	1,021	15	1,581	12,221
Current assets									
Inventories	3,022								3,022
Trade and other receivables	5,960		(643)			(897)		(1,540)	4,420
Short-term investments, cash, and cash equivalents	3,951				200			200	4,151
Total	12,933		(643)		200	(897)		(1,340)	11,593
Total assets	23,573	19	(171)	59	195	124	15	241	23,814
Current liabilities									
Short-term borrowings, overdrafts, and current instalments of loans	152								152
Other creditors	7,543		(143)				(994)	(1,137)	6,406
Total	7,695		(143)				(994)	(1,137)	6,558
Noncurrent liabilities									
Loans	303								303
Retirement benefit obligations			1,528					1,528	1,528
Provisions	2,266		(314)	2	61	132	6	(113)	2,153
Other liabilities	52						11	11	63
Total	2,621		1,214	2	61	132	17	1,426	4,047
Total liabilities	10,316		1,071	2	61	132	(977)	289	10,605
Net assets	13,257	19	(1,242)	57	134	(8)	992	(48)	13,209
Capital and reserves attributable to equity holders									
Share capital	423								423
Share premium account	449								449
Other reserves	1,857								1,857
Retained earnings	10,449	19	(1,242)	57	134	(18)	992	(58)	10,391
Total	13,178	19	(1,242)	57	134	(18)	992	(58)	13,120
Minority interest	79					10		10	89
Total equity and reserves	13,257	19	(1,242)	57	134	(8)	992	(48)	13,209
Source: Standard & Poor's and AstraZeneca PLC.									

Line-by-line reconciliation.

Another potential reconciliation format is that referred to here as "line-by-line", which is illustrated in the guidance notes accompanying IFRS 1. Table 3 shows an example of what this would look like for AstraZeneca. This format provides less clarity, because it does not show the contribution of separate adjustments to the line-by-line adjustment amounts, or that certain adjustments such as employee benefits affect several line items.

Table 3 AstraZeneca PLC Transition to IFRS--Balance Sheet Reconciliation at Dec. 31, 2003			
(Mil. $)	*Previously reported under UK GAAP*	*Total effect of transition to IFRS*	*Restated under IFRS*
Noncurrent assets			
Property, plant, and equipment	7,536	11	7,547
Goodwill and intangible assets	2,884	143	3,027
Other investments	220	(87)	133
Deferred tax assets		1,514	1,514
Total	10,640	1,581	12,221
Current assets			
Inventories	3,022		3,022
Trade and other receivables	5,960	(1,540)	4,420
Short-term investments, cash, and cash equivalents	3,951	200	4,151
Total	12,933	(1,340)	11,593
Total assets	23,573	241	23,814
Current liabilities			
Short-term borrowings, overdrafts, and current instalments of loans	152		152
Other creditors	7,543	(1,137)	6,406
Total	7,695	(1,137)	6,558
Noncurrent liabilities			
Loans	303		303
Retirement benefit obligations		1,528	1,528
Provisions	2,266	(113)	2,153
Other liabilities	52	11	63
Total	2,621	1,426	4,047
Total liabilities	10,316	289	10,605
Net assets	13,257	(48)	13,209
Capital and reserves attributable to equity holders			
Share capital	423		423
Share premium account	449		449
Other reserves	1,857		1,857
Retained earnings	10,449	(58)	10,391
Total	13,178	(58)	13,120
Minority interest	79	10	89
Total equity and reserves	13,257	(48)	13,209
Source: AstraZeneca PLC.			

Reconciliation by topic.

If the balance sheet reconciliation were to show only the changes to shareholders' equity by topic, an adjustment that makes only a slight difference to the net equity figure, but a considerable change to assets and liabilities would not appear to be significant. The comprehensive reconciliation format including line item changes makes such offsetting changes clear. This effect will be particularly significant in respect of any changes made to consolidate special-purpose vehicles (SPVs) or recognize derivative positions on the balance sheet, for example. Consolidation of SPVs with assets that are close in value to their liabilities would increase both consolidated assets and liabilities, but would have little effect on shareholders' equity. Derivative gains and losses, on the other hand, are unlikely to qualify for offsetting against one another and would not be offset against any corresponding hedged risk if the company hedged risk associated with another line item.

Nevertheless, as line items are likely to be described differently under IFRS, and as the opening IFRS balance sheet is not a required disclosure (see Section 2), some companies may elect to provide the reconciliation in the by-topic format used in U.S. filings of foreign private issuers (Form 20-F). To illustrate, table 4 summarizes information from AstraZeneca's more detailed disclosure, reformatted to show amounts only by topic headings.

Table 4 AstraZeneca PLC Transition to IFRS--Reconciliation by Topic 2003		
(Mil. $)	*Earnings*	*Shareholders' equity*
Previously reported under UK GAAP	3,036	13,257
IFRS 2 Share-Based payments	(136)	19
IAS 19 Employee Benefits	(14)	(1,242)
IFRS 3 Business Combinations	59	57
IAS 32/39 Financial Instruments	(16)	134
IAS 12 Income Tax	82	(8)
Other	3	992
Total effect of transition to IFRS	(22)	(48)
Restated under IFRS	3,014	13,209
Source: AstraZeneca PLC.		

This format does nothing to explain the extent to which individual line items are affected by each adjustment topic. The income tax adjustment shown as an $8 million decrease in shareholders' equity, for example, affects several line items, as can be seen in table 2. The narrative provided by the company explains that the most significant changes include: a reclassification of $851 million from current to noncurrent assets; an increase in deferred tax assets of $123 million related to unrealized profits on intragroup sales; and increased deferred tax liabilities of $131 million for rolled-over capital gains that, under UK GAAP, were not expected to crystallize. These more significant movements are embedded in the negligible change of $8 million shown in the reconciliation format in table 4. Note also that this adjustment reflects the deferred tax consequences of applying IFRS to the UK GAAP accounting balances. In the full reconciliation shown in table 2, the tax effects of applying the other adjustments made to reconcile to IFRS-restated amounts can be seen in the respective column for each adjustment, although, in contrast, this information cannot be gleaned from the format shown in table 4.

IAS 32 and IAS 39--a second transition for financial instruments.

The application of IAS 32 and IAS 39 to financial instruments, and in some circumstances IFRS 4 on insurance, is optional for 2004 transition restatements, but must be applied in financial years beginning on or after Jan. 1, 2005. Opting out of these standards for 2004 will therefore create a second transition for companies to address. As with the initial transition to IFRS, the adjustments needed for the balance sheet to conform to IAS 32 and IAS 39 at Jan. 1, 2005, will be made to individual asset and liability amounts and charged or credited directly to shareholders' equity.

Adopting IAS 32 and IAS 39 could make a significant difference to a company's balance sheet and income statement. A company might, for instance:

- Reclassify certain instruments from equity to liabilities;
- Split convertible bonds into debt and equity components;
- Mark a portion of its investments portfolio to market or to amortized cost;
- Recognize various derivative positions at market;
- Apply certain fair-value adjustments to the carrying amounts of financial and nonfinancial items where risk has been hedged; and
- Change recognition of additional asset and liability amounts under securitization programs.

The nature of each of these adjustments differs, as may the line items affected on the financial statements. As these standards cover a large number of topics and financial statement line items, this second transition may prove complex and warrant equally detailed disclosure of comprehensive reconciliations of the restated balance sheet and income statement amounts.

AstraZeneca chose to apply IAS 32 and IAS 39 in its restatement of 2004 financial statements. Although it has shown the entire effect in a single column (see table 2), the amounts are not material, partly as a result of the changes it has made to its hedging policy. Furthermore, although its disclosure generally refers only to financial assets and liabilities, these appear to relate mainly to derivatives. For many companies, it is expected that the magnitude and complexity of change will be significantly greater than this and separate presentation of significant changes will make the result more understandable.

Section 2: Transition Date Balance Sheet

The second transparent transition disclosure practice is to present the IFRS balance sheet at the date of transition. It will be necessary for companies to prepare a balance sheet under IFRS at the date of transition (Jan. 1, 2004, for companies adopting IFRS for calendar 2005). Auditors will also need to be comfortable with this balance sheet for the purpose of auditing the first year results under IFRS (2004 for companies adopting IFRS in 2005). The IASB has required disclosure of the adjustments needed to reconcile previously reported shareholders' equity with the restated amount under IFRS at the transition date. It has not, however, required that the corresponding IFRS balance sheet be disclosed.

As already indicated, the format of reconciliation is not specified by IFRS. That said, this second disclosure point is settled if a company provides a line-by-line reconciliation of the balance sheet (or the more informative comprehensive reconciliation described in Section 1) at the transition date, because the opening balance sheet will be shown in this reconciliation, assuming sufficiently detailed line items. A format using topic headings would not, however, automatically result in disclosure of the transition balance sheet. Both AstraZeneca and UPM-Kymmene effectively provided transition date balance sheets by presenting the corresponding reconciliation.

Additional year-end data set extends much-needed track record.

From an analytical perspective, disclosure of the transition date balance sheet adds comparable data for an additional year-end, providing another period for trend analysis, ratios, and other measures. This allows for the development of various financial measures that depend on balance sheet values or averages for the period, such as return on assets and turnover ratios. It would also give management an earlier start on establishing the track record under IFRS--a useful element to present to interested parties, given the break in financial reporting caused by transition. (See Section 4, "Accounting Policies and their Effect on Reported Amounts and Future Trends," for additional discussion on the break in series resulting from transition).

Section 3: Reconciliation of Restated Cash Flow Statements

IFRS reported cash flows.

Although the IASB considers that an evaluation of the entity's ability to generate cash and cash equivalents is essential for users such as analysts and investors to make meaningful economic decisions, at times it gives short shrift to the reporting of cash flow information. Specifically in the context of a first-time adoption of IFRS, it requires only that an explanation of material adjustments be disclosed rather than the reconciliation required for the restated balance sheet and income statement. In Standard & Poor's view, a reconciliation would provide clearer differentiation of material adjustments to the cash flow statement that would be useful in all but the most straightforward of situations.

Revised accounting practices obviously do not change the cash transactions that will have occurred within a restated period. Nevertheless, there are a number of requirements under IFRS that will influence the information reported on the cash flow statement and could therefore influence views on cash protection and the capacity to generate cash flows through operations.

IFRS changes to reported cash flows.

IFRS will significantly increase transparency for companies that previously did not present a cash flow statement. For others, changes in reported cash flows may arise in three areas:

1. Consolidation.

Any changes in the scope of consolidation or method of including investee or other entities will result in a change in which entities' cash flows (or portions of cash flows) are included in the group's consolidated cash flow statement. The cash flows of consolidated or proportionally consolidated entities will be included in the consolidated statement as cash flows of the group (100% and the proportional amount, respectively). This contrasts with the portrayal under the equity method, or where an investment is accounted for at fair value or at amortized cost, when only dividend cash flows and additional investments are shown, as sources and uses of investing cash flows.

2. Cash and equivalents.

The cash flow statement shows the changes in the balance of cash and cash equivalents during the period. Cash equivalents are defined as short-term, highly liquid investments that are readily convertible to known amounts of cash and which are subject to an insignificant risk of changes in value. The amount of cash and cash equivalents shown in the cash flow statement is reduced by bank overdrafts that are repayable on demand if they form an integral part of a company's cash management.

Any changes in the scope of what is included in the total amount that is effectively reconciled in the cash flow statement will affect both that total amount and the reported changes in that amount. This is because transfers among components of cash and cash equivalents are not shown as operating, investing, or financing cash flows as movements do not result in a change in total cash and cash equivalents. For example, if an overdraft was excluded from cash and cash equivalents (or similar cash balances previously reconciled in the cash flow statement), but is included in cash and cash equivalents under IFRS, changes in the borrowing amount will no longer be shown as financing cash flows. Changes in the specific investments included in, or excluded from, cash and cash equivalents will similarly result in different investing cash flows being reported. U.K. companies will show changes in cash and equivalents under IFRS, but have typically shown changes in net funds (debt, net of cash and short-term investments) under UK GAAP, resulting in a significant change in the presentation of the cash flow statement.

3. Classification of cash flows.

The changes in total cash and cash equivalents are classified as operating, investing, or financing. That said, there is explicit flexibility in classifying changes such as interest and dividends, both paid and received. Taxes, on the other hand, are classified as operating unless they can be specifically identified with financing or investing activities.

Certain systems of accounting such as UK GAAP have many more classifications of cash flows than under IFRS. As a result, some items will need to be reclassified as operating, investing, or financing, and may not be as transparent as they are at present. Interest and taxes paid, for instance, are shown separately in the cash flow statement in accounting systems such as those in the U.K., but will need to be included within one of the three IFRS classifications.

In addition, in cases where IFRS does not allow deferral or capitalization of certain costs (project bid costs or start-up costs, for example), the corresponding cash flows should be included in operating cash flows, whereas they might previously have been classified as investing, not operating costs. Finally, disclosure may be made of noncash transactions such as the investment in assets under a finance lease.

Comprehensive reconciliation of the cash flow statement.

A comprehensive reconciliation will provide clearer differentiation of material adjustments to the cash flow statement. Changes resulting from a different scope of consolidation, differing definitions of the cash and equivalents amount being reconciled, and specific reclassifications of cash flows from one category to another should each be highlighted separately in such a reconciliation. In our view, a comprehensive reconciliation provides greater clarity in all but the most simplistic of situations.

AstraZeneca provided restated cash flow statements in its initial disclosure package, but it did not explain the changes necessary to convert its previous statement showing movements in net funds to its IFRS statement showing changes in cash and cash equivalents.

Under Finnish Accounting Principles (FAS), UPM-Kymmene already displayed cash flows classified as operating, investing, and financing, as under IFRS. No IFRS cash flow statements were included in the initial disclosure, but, in a condensed version, they were later included in the publication of quarterly results. Under FAS, certain overdrafts were included in cash and equivalents, but to the extent they did not meet the criteria for including them within cash and equivalents under IFRS, they were reclassified as current interest-bearing liabilities. This increases the balance of cash and equivalents shown in the cash flow statement.

Table 5 compares UMP-Kymmene's FAS cash flow statement to its IFRS equivalent for the year ended Dec. 31, 2003. Cash and equivalents increase under IFRS by 17% and 13% at the beginning and end of 2003, respectively. The changes have not been shown in a reconciliation. On Nov. 23, 2004, the company published a full set of audited financial statements and notes under IFRS that includes a fully detailed cash flow statement, but no further reconciliation or explanation for change.

A comprehensive reconciliation would break out the amount we have shown as "Total transition effect" in table 5 into meaningful categories that separately explain (as applicable) the effect of changes in consolidation, changes in the amount reconciled (cash and equivalents under IFRS), and changes in classification of cash flows into operating, investing, and financing under IFRS.

Table 5 UPM-Kymmene Corp. Transition to IFRS--Comparison of Cash Flow Statement for Year Ending Dec. 31, 2003

(Mil. €)

FAS description	FAS	Total transition effect	IFRS	IFRS description
Net profit	368	(49)	319	Net profit
Income taxes	193	(193)		
Financial income and expense	225	(225)		
Minority interest	(2)	2		
Operating profit	784	(784)		
Depreciation and other adjustments	723	(723)		
		1,081	1,081	Adjustments total
Change in working capital	122	(5)	117	Changes in working capital
Financial income and expenses and income taxes paid	(365)	205	(160)	Income taxes paid
		(99)	(99)	Finance costs, net
Cash from operating activities	1,264	(6)	1,258	Net cash from operating activities
Acquisitions and share purchases	(16)		(16)	Acquisitions and share purchases
Other investments and purchases of tangible and intangible assets	(564)	(33)	(597)	Purchases of intangible and tangible assets
Asset sales and change in noncurrent receivables	228	12	240	Asset sales and other investing cash flow
Cash used in investing activities	(352)	(21)	(373)	Net cash used in investing activities
Dividends paid	(390)		(390)	Dividends paid
Change in loans and other financial items	(528)	3	(525)	Change in loans and other financial items
Cash used in financing activities	(918)	3	(915)	Net cash used in financing activities
Change in cash and cash equivalents	(6)	(24)	(30)	Change in cash and cash equivalents
Effect of exchange rate changes	(31)	(1)	(32)	Foreign exchange effect on cash
Cash and cash equivalents at beginning of period	425	74	499	Cash and cash equivalents at beginning of period
Cash and cash equivalents at end of period	388	49	437	Cash and cash equivalents at end of period

Source: UMP-Kymmene Corp. FAS--Finnish Accounting Principles.

Section 4: Accounting Policies and their Effect on Reported Amounts and Future Trends

Disclosure of any significant influences on trends that are built into the IFRS accounting methods at and beyond transition will significantly assist analysis and reduce the potential for surprises and misunderstandings. Accounting for the transition itself, transition policy options, policy choices available within IFRS, assumptions and estimates made in applying those policies, the greater use of fair-value or similar methods, and the effect of changes in transactions entered into as a result of different treatment by other parties or changes in the company's own business behavior may each contribute to the financial position reported at transition, subsequent profitability, and even cash flows in the case of transactions influenced by accounting policy. They will also have implications for modeling and forecasting.

The switch to IFRS can be expected to exacerbate normal levels of enquiry in relation to accounting practices. Companies with less room on key financial performance and other measures in their current ratings category can expect to come under particular scrutiny. This is due to such companies' increased sensitivity to changes in factors related to IFRS implementation that could affect their business and/or financial risk profile.

Accounting for transition and transition policy options.

The break in accounting methods from those employed previously to IFRS creates a net difference in reported shareholders' equity at the date of transition, reflecting changes in assets and liabilities on the restated balance sheet. The net difference is charged directly to shareholders' equity. Although this is a tidy accounting solution, it means that over time the transition accounting will affect the trend of reported information, with some items never being charged to profitability and others being counted twice. The value of property, plant, and equipment previously depreciated on an accelerated basis and restored to a slower method under IFRS, for example, will be redepreciated following the transition to IFRS. As a result, some of the same costs will have been depreciated twice. Conversely, pension deficits brought on balance sheet at the time of transition will never be charged to earnings. The consequences of these transitional trends will need to be understood in order to draw appropriate analytical conclusions.

IFRS 1 generally requires the accounting policies applicable at the reporting date (year ending Dec. 31, 2005 for most) to be applied on a retrospective basis as if they had always applied consistently over time. The IASB, however, has assumed that for certain items (such as pensions, business combinations, and property plant and equipment), the cost of producing the information on this basis would exceed the benefits to end-users of the financial statements. IFRS therefore allows the choice of opting out of full retrospective treatment for these specified exceptions. The cost-to-benefit justification need not be proven or true.

Choices made in the transition to IFRS will be relevant as they affect the financial and capital position reported at transition. They may also lead to a phased approach in the full application of IFRS policies, and may result in differences that will make reported information incomparable among companies new to IFRS and between new IFRS-stated companies and those that have already made the switch.

As an example, for assets such as property, plant, and equipment, fair value can be used at transition in place of cost. In this case, fair value amounts are referred to as "deemed cost" at transition. Over time, an increasing proportion of the balance sheet amount for these assets will be measured at cost, as newly purchased assets are valued at cost and assets that were included at fair value at transition are depreciated and eventually retired. A second example is found in pension accounting, where the opening balance sheet may fully reflect the deficit or surplus. Over time, however, companies that apply the corridor approach, which defers and amortizes actuarial gains and losses, could develop significant off-balance-sheet actuarial gains or losses.

There is also one key area in which retrospective treatment is prohibited. The IASB does not allow retrospective designation of hedging relationships. As a result, certain derivatives previously considered to provide economic hedge protection may not qualify under IFRS for hedge accounting. If hedge accounting is not available, mark-to-market changes will be included in earnings and may not be offset by corresponding gains or losses on the hedged risk, creating earnings volatility. Such volatility underlines the need for transparent disclosure.

In addition, the IASB has offered a transitional option in relation to IAS 32 and IAS 39 on financial instruments. Companies that adopt IFRS before Jan. 1, 2006 (calendar 2005 or earlier), are allowed to continue to apply previous accounting requirements for financial instruments in the comparative statements (2004 for a company adopting in 2005) rather than restating for the requirements of IAS 32 and 39. Firms choosing this option must disclose the accounting policies applied under the previous accounting requirement, together with the nature of the main adjustments that would make the information comply with IAS 32 and 39. These adjustments need not be quantified, however. Because companies opting for this approach will ultimately show two transitions to full IFRS--the first relating to all requirements except financial instruments (at Jan. 1, 2004), the second relating to financial instruments (at Jan 1, 2005)--there will be two pivot points around which clear transition disclosure of accounting policy implications will be necessary.

Policy choices have significant influence on balance sheet strength.

Generally, when there are choices to be made on accounting policies, a stronger balance sheet (that is, greater net assets as a result of higher values of assets or lower values of liabilities) translates to weaker future earnings. Equally, a weaker balance sheet translates to stronger future earnings. This is true also of the effect of assumptions and estimates that, over time, are adjusted to reflect actual results. The use of more conservative assumptions to determine the levels of provisioning warranty obligations would weaken the balance sheet, for example, but the excess provisioning results in higher subsequent earnings as it can be used to avoid future charges to earnings for warranty costs or even reversed as an increase to earnings.

In the transition to IFRS, the choices companies make regarding which accounting policies to adopt, and which assumptions and estimates to use, will have a significant bearing on the strength of the company's underlying financial position reported in the IFRS opening balance sheet. Moreover, those choices will ultimately influence the company's subsequent earnings.

Greater use of fair-value techniques increases volatility.

It is already clear that IFRS will lead to increased volatility of earnings and equity because more balance sheet items will be accounted for at fair value or using market-based assumptions. As a consequence, transparent disclosure of the key components in the financial statements by line item, the amounts involved, and an indication of how they will be determined in the future will be crucial to: (i) understanding the sources and meaning of this volatility; and (ii) performing meaningful financial analysis. Clear articulation of accounting policy and the sensitivity of reported amounts to changes that drive accounting value changes are therefore paramount.

Behavioral changes.

IFRS may also influence changes in companies' business behavior and result in real economic effects such as changes in hedge practices or the use of securitization. Changes may also result from the treatment of other parties, resulting in, for example, different tax or regulatory consequences, or consequences stemming from the need to change financial debt covenants that may no longer be met once IFRS is adopted. The effects of these real economic changes will need to be explained by companies if their influence on reported profitability, financial position, and cash flows is to be fully understood by end-users of financial statements.

Transition accounting in practice.

There will be many cases of accounting policy issues influencing reported amounts. Two examples are given below, the first looking at financial instrument accounting, and the second at the expensing of stock option costs.

Both AstraZeneca and UPM-Kymmene have chosen to apply IAS 32 and IAS 39 when restating their financial statements. AstraZeneca revised its hedging policy before 2004, its restated period. As a result, its hedges comply with the IFRS hedge accounting requirements for the full restated period.

In UPM-Kymmene's adoption of IFRS, the company has applied IAS 32 and IAS 39 in their restatement of 2002 and 2003. The company disclosed that, in its restatement, derivatives used for hedging did not meet hedge accounting requirements before February 2003. The reason for this, along with details of subsequent changes, is not disclosed. UPM-Kymmene does indicate, however, that fair-value adjustments on hedges before this date are included in earnings under financial items, and that sales have been adjusted to remove derivative amounts. The related amounts are not explicitly disclosed, but 2003 operating profits appear to fall by about 15% as a result of this accounting change. From February 2003, hedges have been documented and accounted for as cash flow hedges, whereby, to the extent the hedges qualify as being effective, changes in the fair value of the derivatives will be deferred in equity and recorded in sales when the related sales are recognized.

AstraZeneca also disclosed that it has fully restrospectively applied IFRS 2, Share-Based Payment. This is permitted (but not required) in cases where a company has previously disclosed the fair-value amount of costs of its share-based incentive program. For those companies that adopt IFRS 2 for grants made after Nov. 7, 2002, the expense will initially relate to a smaller portion of outstanding awards, which increases over time as new grants are awarded after this date. AstraZeneca's charge for share-based compensation in 2005 is expected to be about the same as in 2004, partly because there is no cost increase purely resulting from its accounting policy choice.

Section 5: Maintenance of Relevant Disclosures

The transition to IFRS is likely to result in significant new disclosures for those companies that currently lag in terms of transparency. Generally, a decrease in meaningful disclosure signals potential risk: a company might be stretched to deliver expected results, for example, and will not want to highlight sensitive matters with disclosure that is not required by accounting rules or regulations. Although this is something that Standard & Poor's will be monitoring closely, it is recognized that a rationalization of overly detailed, lengthy, or repetitive disclosure might well be appropriate.

Conversion to IFRS provides something of a fresh start, but companies that already have a high level of transparency will be expected to continue to provide similar levels of information. The transition to IFRS does however present an ideal opportunity for companies to tidy up their disclosures, eliminate repetition, and clarify points. This may in some cases involve shortening disclosure to focus on the most relevant points.

Potential loss of information.

Overall, IFRS should result in considerably more information being disclosed in published financial statements. That said, it is possible that in some areas and for some companies, less information will be required. Companies reporting under UK GAAP, for instance, are required to disclose the breakdown of pension plan assets in broad categories. This information is not required under IFRS at present. A similar position exists regarding operating leases, for example, an area where Standard & Poor's makes significant analytical adjustments. IFRS only requires disclosure of minimum lease payments due no later than one year, the total due for years two to five, and the total due later than five years. Some accounting systems require more detailed information than this--the amounts due in each of years one to five, and a total for years thereafter.

Analysts in Standard & Poor's Financial Services practice highlight concerns about the level of information on the separate insurance and banking activities of certain financial institutions. Some institutions now provide financial statements that clearly and separately show the amounts relevant to banking and insurance activities. IFRS, however, is likely to result in greater consolidation of insurance or banking activities, particularly where the difference in activities has been key to nonconsolidation under prior accounting standards. Although in certain cases the financial statements may still present separate line items for these separate activities, the IFRS consolidated financial statements could reflect amounts from these separate activities in a single line item. The information lost on these separate activities is unlikely to be compensated for by the level of required segment disclosure. Nevertheless, Standard & Poor's will have no less a need for this information and will still require access to this data. As a result, separate financial statements or expanded segment disclosure may be requested if it is not already provided in a company's financial statements. The same issue arises for many conglomerates and companies with activities as diverse as manufacturing and captive finance.

The importance of maintaining meaningful disclosure data.

IFRS conversion provides an opportunity for management teams to rethink the level and quality of disclosures in general, not only those required by IFRS. As the previous comments indicate, it should not be taken for granted that IFRS requirements cover all the information necessary.

Retaining meaningful disclosure (even if it could be argued that it is not required by IFRS) will significantly assist analysis. What is meaningful will vary by industry sector, and by company where specific issues arise. In this respect, Standard & Poor's criteria and methodology documentation is a good place to start as it contains information that analysts are likely to continue to require.

To the extent that companies plan to reduce current disclosures in line with IFRS, Standard & Poor's will reserve the right to request relevant information confidentially. If such information were not provided, we would need to address the resulting information risk. One area where such concerns may arise is the assessment of operating lease obligations. Future minimum operating lease obligations for the restated year (2004 for many companies) are not required to be disclosed under IFRS. If, however, operating leases remain important to a company after adopting IFRS, such future payment information may be requested by Standard & Poor's.

APPENDIX

Required Transition Disclosures and Reconciliations

Box 3 summarizes various disclosures required by the IASB in the first IFRS financial statements if they have not been provided earlier. The dates shown refer to a Jan. 1, 2005, adoption by a company, assuming it presents comparative financial statements for just one year (2004). This will be the situation for the majority of EU companies adopting IFRS in 2005. The general requirement is that companies explain how transition to IFRS has affected their reported financial position, financial performance, and cash flows. These explanations are supposed to be provided in sufficient detail to enable end-users to understand the material adjustments made. Reconciliations are required regarding the balance sheet and income statement at various dates, although this does not apply to the cash flow statement. The content of narrative disclosures is not specified, but is to be inferred from the need to explain the transition.

Box 3
Transition Disclosure and Reconciliations Required in First-Time IFRS Statements

First Annual IFRS Financial Statements
1. Reconciliations of equity.
- Date of transition (Jan. 1, 2004).
- End of the latest period presented in the most recent annual financial statements under the prior GAAP (Dec. 31, 2004).

2. Reconciliation of profit or loss.
- Most recent annual period under prior GAAP (2004).

3. Material adjustments to the prior GAAP cash flow statement (if one existed).
4. Any errors in prior GAAP statements that are discovered.

Interim IFRS Financial Statements for Periods Within the First 12 Months
1. Reconciliation of equity.
- End of the prior comparative interim period(s).

2. Reconciliation of profit or loss.
- Prior comparative interim period(s).

3. Disclosure of material adjustments to the cash flow statement.

Source: IASB

Reconciliations refer to disclosure of quantified differences between amounts originally reported under the prior accounting standards to the corresponding amounts as restated under IFRS. Under IFRS 1, reconciliations must give sufficient detail to enable users to understand material adjustments to the balance sheet and income statement. No specific format is required, although an example is provided in the guidance notes that accompany IFRS 1. This example identifies only the total or net adjustment made to each line item on the balance sheet and income statement. (See table 3 for an example of what this might look like for AstraZeneca.)

Interim accounts.

IFRS has no requirement to produce interim accounts. If a company does publish interim accounts within the first 12 months to which IFRS is applied, the related disclosure requirements listed in Box 3 are required.

Transition Disclosure Recommendations of CESR

CESR weighed in on aspects of the transition to IFRS with an approach to disclosure that began with annual reports for 2003. CESR's recommendations to its members, Europe's securities regulators, were that those regulators encourage companies to make the disclosures summarized in Box 4. These recommendations are not binding on its members, so the specific actions of each country's regulator are relevant. To date, most companies have provided only limited disclosure.

Box 4
Recommended Approach to Disclosures for CESR Members

2003 Annual Reports

- Description of plans for the transition and degree of achievement.
- Narrative description of the key differences known with sufficient certainty.

2004 Annual Reports

- Disclosure of relevant quantified information as soon as the company can quantify the effects on 2004 amounts in a sufficiently reliable manner.
- Such disclosure should be made in a way that is not misleading (that is, it should cover all possible effects).

2005 Interim Reports

- Apply either IAS 34, or if this is not possible, at least the IFRS recognition and measurement principles that will be applicable at year-end.
- Comparative information under IFRS: Use the same accounting rules as in 2005 (including IAS 32 and IAS 39 on financial instruments).

2005 Annual Reports

- If two comparative years are presented, the earliest (2003) need not be restated under IFRS (2004 is the overlap period, with both prior and IFRS results being published as a "bridge").

Source: CESR.

The CESR recommendations strike a balance between providing timely information as soon as it is known with sufficient certainty. There are two areas, however, where CESR steps beyond the accounting required by the IASB:

- Encouragement to apply IAS 34, Interim Financial Reporting, or IFRS principles in interim reports for 2005, rather than continuing with the current basis of accounting and restating later.

- Encouragement to apply IAS 32 and IAS 39 in the comparative statements for 2004, whereas the IASB has indicated that IAS 32 and 39 are optional for 2004 for first-time IFRS transitions occurring in 2005.

The first point may be overtaken by country law, stock exchange, or other more demanding requirements. For U.K.-listed companies, 2005 quarter- and half-year interim accounts will be required to be prepared under IFRS, for example. The second point on applying IAS 39 in 2004 restatements is looking increasingly doubtful for companies with extensive or complex financial instruments. This is due to delays in the IASB's completion of the version of IAS 39 that will apply for 2005 and endorsement by the European Commission, which only occurred late in November 2004.

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