

The Committee of European Securities Regulators  
Avenue de Friedland  
75008 Paris  
France

27 December 2004

Dear Paul Koster

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

We are pleased to provide you with our comments on the CESR Concept paper. This response has not been subject to EFRAG's due process, but reflects the views expressed by EFRAG's Technical Experts at the EFRAG meeting 9 December 2004.

We appreciate the great effort put into developing the paper and we generally support the approach taken by CESR on how to measure the equivalence of certain third country GAAP and on describing certain third countries' mechanisms of enforcement of accounting standards. Hereby we provide you with our comments on the CESR concept paper and answers to the questions raised. We hope that our input may be useful for your further process of assessing equivalence.

Basically we support the proposed key objectives and the definition of equivalence and believe it complies with the mandate given to CESR by the European Commission.

However, we believe that the meaning of 'significant differences' in accounting standards could be clarified by improving the definition in the concept paper.

We believe it is important to find and evaluate all existing differences between IAS/IFRS and third country GAAP, to be able to conclude whether these can result in 'significant differences'. Differences may have very different impacts on different entities within one industry and may also have different impacts on entities in different industries. We understand the practical difficulties, but we are concerned that equivalence may be assessed at a too high level and therefore differences that might lead to significant differences may not be assessed at all. We therefore recommend a more thorough analysis of the differences.

When evaluating equivalence we recommend CESR to consider not only the requirements of the IFRS's as such but also in other mandatory EU requirements for financial reporting, for example the requirements concerning the director's report.

We believe that the only GAAP to be considered as the basis for comparison should be IFRS GAAP with additional EU requirements as mentioned above.

We recommend CESR also to evaluate the overall financial reporting environment and "climate" in the third countries.

We are in general supportive of the three different kinds of remedies (additional disclosure, statements of reconciliation and supplementary statements). We are not in favour of a "simple" reconciliation involving only a reconciliation of the bottom line of the income statement and equity. Full reconciliation in terms of showing the consequences of the differences identified and the effect on the balance sheet, income statement and disclosures should in our opinion be required.

Generally, we are concerned about the tight timetable agreed with the European Commission because of the work needed to conclude on equivalence. We believe further time will be necessary.

Our responses to the questions raised in the CESR Concept paper are included in the Appendix.

On behalf of the members of EFRAG, I should be happy to discuss our comments with you, as you may wish.

Yours sincerely,

Stig Enevoldsen  
**EFRAG Chairman**

## **Appendix to EFRAG's letter to CESR on equivalence**

### **A. Objective of equivalence**

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

Yes, we agree with the proposed definition.

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

Yes, we agree with the approach taken to assess the equivalence including a review of the general principles, a technical assessment of the significant differences between accounting standards and appropriate remedies to meet investors' needs.

However, we believe that 'significance' is not clearly defined in the concept paper. We believe that 'significance' should be defined in order to be able to clearly understand what constitutes equivalence or non-equivalence. We also believe that it is important to consider not only the actual content of the IFRS/IAS standards to be included but also other mandatory EU accounting and disclosure requirements as included in Directives, etc. In this context we would mention the specific EU requirements regarding the content of the verbal Managements Report included in the annual report together with the financial statements.

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

We agree with CESR's approach that a significant difference should be one that has an impact on an investor's decision to invest or divest, but as mentioned above we believe that significant should be clearly defined. (See also our comments below.)

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

We believe that the Directors' report, interim financial statements, legal and other requirements in Europe should also form part of the assessment process. We believe too that the general objective of financial reporting in the specific country is an important factor and that it should include the history of providing transparent and relevant financial statements for investors. It could be called 'reporting culture'.

When assessing technical equivalence an important issue is the assessment of transitional provisions of accounting standards. Whether standards are applied retrospectively or prospectively is of high importance for the information provided by financial statements.

In the light of the reference in IAS 8.10 (the hierarchy) to the definition, recognition criteria, measurement concepts for assets, liabilities, income and expenses in the Framework we believe that the technical assessment should explicitly cover the Framework of IFRS and third country's GAAP and not just be considered for a proper understanding.

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

We believe that EU investors **cannot** be assumed to have good knowledge of third country GAAP. We believe that the only GAAP to be considered as the basis for comparison should be IFRS in order not to create confusion in the European market place, where investors are only now beginning to get accustomed to IFRS.

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

Yes, IAS/IFRS should be the only benchmark. (See our comment above.)

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

In our opinion CESR should **not make a** distinction between professional and individual investors in assessing equivalence. Financial statements issued by foreign filers should also be understandable for private investors. Otherwise CESR cannot claim to protect the European investors as such. Professional investors may choose to invest in third country companies listed on the third country's stock exchange provided the professional investor understands the third country's GAAP. Such a possibility is in reality not possible for private investors. Therefore we believe that for third country companies listed in the EU there should not be a distinction between professional and individual investors when evaluating equivalence.

## **B. Review of general principles**

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

Yes, we agree that it is very important that the objectives of financial statements must be the objectives as stated in the IAS Framework paragraph 12.

The overall objective should be to issue general purpose financial statements that are of benefit to investors.

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

We believe it is also important to assess the whole environment and the reporting culture of the specific country to ensure the objectives are to be of benefit to investors making investing decisions by issuing transparent and informative financial information. It is also important to

consider how GAAP is implemented and complied with including the culture and independence of the auditor profession.

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

On balance we agree with the approach; however in our opinion the “spirit” and quality of implementation and compliance should also be assessed by CESR. Even if the financial reporting standards and interpretations are equivalent between certain countries, it could be the case that they are not implemented and enforced in a comparable way and therefore the resulting information is not equivalent in reality.

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

We believe it is important that CESR also takes into consideration well known specific issues in the various third country GAAPs. For instance if US GAAP does not include a standard on share based payment it might be a major issue for equivalence in order to have a level playing field for European companies.

## **C. Technical assessment**

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

In general we agree with the proposed approach; however we are a little concerned that the proposed approach may be carried out at a too high level to ensure a proper conclusion on equivalence because significance may have different meaning for accounting treatments by different entities and in different industries.

We would expect that based on the limited analysis of the differences commonly found in practice or known to be significant as such by the financial and audit community in Europe and third countries it may not be easy to conclude on (non-) equivalence, particularly when assessing significance of differences in accounting treatment in specific industries.

We believe that the approach in paragraph 46 and 47 could be considered inconsistent. Paragraph 46 mentions the issue that the significance of a large number of GAAP differences will vary with respect to individual companies. CESR’s approach will be to limit its analysis to the differences commonly found in practice or known to be significant as such by the financial and audit community in Europe and in third countries (paragraph 47). We believe it is very important that the issue raised in paragraph 46 is considered.

Basically we believe that CESR needs to consider all differences between IAS/IFRS and third country GAAP, to conclude whether these can lead to significant differences.

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

It may be worthwhile considering how new and emerging accounting issues are resolved under third country GAAP.

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

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

Yes, we agree.

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

Yes, we agree that full audit should cover both the original third country GAAP financial statements and the additional remedies.

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

In general we agree with the three different kinds of remedies (additional disclosures, statements of reconciliation and supplementary statements).

However, we do not support the concept of a “simple” reconciliation for the income statement and equity. Full reconciliation in terms of showing the consequences of the differences identified and the effect on the income statement, balance sheet **and disclosures** should in our opinion be required. We believe that additional reconciliations should also be made in relation to the note disclosures when notes are affected by the reconciling items or when the third country GAAP does not have a specific note disclosure requirement.

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

Subject to the comments just above, we believe the remedies are sufficiently clear.

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

See our comments above.

## **E. Early warning mechanisms**

### ***Q: Do you agree with this approach?***

We support the approach for the early warning mechanisms, but question why a separate body is needed. We would expect CESR to enforce existing rules for entities listed in the European Capital Market.

### **Other issues**

In the paper it is mentioned in paragraph 10 that there are in practice cases where a third country GAAP is applied by an issuer not regulated by that third country (e.g. a non-US issuer applying US GAAP). We believe that foreign issuers should use local GAAP or IFRS if they want to file in Europe unless the issuer is also listed in the country of the GAAP used. Regarding the example we disagree that a Canadian company can use US GAAP unless the company is listed in the US.