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Dear Mr Demarigny

Draft recommendation for additional guidance regarding the transition to IFRS

We appreciate the opportunity to respond to The Committee of European Securities Regulators (CESR) draft *Recommendation for additional guidance regarding the transition to IFRS*. We also thank CESR for the opportunity to meet with CESR representatives and others to discuss the draft recommendation in the open meeting held in Paris on 12 November. This letter expresses the views of KPMG International.

CESR's draft recommendation has been very useful in highlighting the significant effort that will be required by companies, users of financial statements and auditors in preparation for the transition to International Financial Reporting Standards (IFRS) across Europe. We welcome discussion of these challenges which vary in significance and impact across individual countries and companies.

The key objective of any recommendation should be an orderly transition to IFRS for companies and capital markets in 2005 and we agree with CESR that disclosure and communication will have an important role to play in achieving this objective.

However, we believe that CESR may have underestimated the potential impact of its recommendation in practice and the consequences of companies being presumed to be able to attain a best practice benchmark that CESR has set at the highest level possible. Accordingly, we do not believe that CESR should progress all the recommendations in their current form at this time and set out below our concerns and an alternative approach.

At this time there remain uncertainties in the transition to IFRS: the 2005 standards will not be completed until March 2004, the EU endorsement process will not be completed until the last quarter of 2004 and translations of endorsed standards into the official languages of those required to apply them are not expected to be available until late 2004.

In addition, the same complexity that requires companies to start preparations for transition early also will mean that those preparations will take time to complete, for example in choosing accounting policies and in determining the approach to adopt to the options contained in IFRS 1 *First time adoption of IFRS*.

Many companies will face tension between acceleration of disclosure and the slightly later disclosure of ***reliable*** information. One result could be piecemeal disclosure of potentially less reliable information that subsequently will have to be revised. Far from adding to the orderly transition to IFRS, this could lead to market confusion and uncertainty – detracting from the very real benefits that IFRS should bring to European capital markets, investors and companies.

We expand upon these concerns in the remainder of this letter. However, at this time we do not support finalising the proposals in the recommendation and would strongly urge CESR to reconsider the most appropriate way of achieving its objective – an objective that we share.

CESR has set a very short consultation period with a tight timetable for publication of a final recommendation (by the end of 2003). We recognise that rapid action is required to finalise any recommendation for 2003 disclosures. However, we do not believe that it is necessary to finalise recommendations for all the milestones given that the second milestone (publication of the 2004 financial statements) is more than 15 months away. We believe that a considered approach is better than a hurried one. Therefore we would support an approach where CESR:

- issues a recommendation in respect of its first milestone as soon as possible. We support CESR’s recommendation encouraging companies to provide a narrative description of its progress towards a transition to IFRS. This should be provided in the narrative sections of the 2003 annual report; and
- continues its discussion, perhaps in the form of a roundtable or a longer comment period, on the costs/benefits of the draft recommendations for the remaining three milestones with a goal of issuing, perhaps in the second or third quarter of 2004, a further recommendation on the communication of the impact of the transition to IFRS.

By mid 2004 CESR, markets and preparers will have a clearer understanding of what is feasible for the majority of groups subject to the requirement to adopt IFRS from 2005 and the best practice benchmark can be set at a level that is realistic and attainable. The comments expressed from the audience at the open meeting in Paris highlighted concerns that exist that the current draft recommendation is too much, too soon.

Relevance (speed) versus reliability

In financial reporting, there is often a balance to be found between relevance (generally associated with timeliness or speed) and reliability. The IASB acknowledges the interaction (and potential conflict) of these two characteristics of financial information in its own framework. The draft recommendation emphasises the acceleration of reporting of information concerning the impact of transition to IFRS at the potential expense of the reliability of the information disclosed.

We fear that market pressure together with the over-emphasis on speed will encourage companies to disclose information on the impact of IFRS before they are prepared fully for this major change and before the uncertainties referred to below are resolved. This may be detrimental to the orderly transition to IFRS.

However, regardless of how CESR chooses to proceed, the ***reliability*** of information disclosed to the market should be given far greater emphasis.

Uncertainty, complexity and piecemeal disclosure

There remains uncertainty as to the specific requirements of the standards that will be applicable in 2005:

- The IASB will not complete its 2005 standards until the end of March 2004.
- The European Commission will need to endorse each standard published before its application is mandatory under the IFRS regulation. Whilst it is hoped that the Commission can provide early indications of its intention, this process cannot be completed until the last quarter of 2004.
- The IASB is proposing to continue to issue standards after 31 March 2004 that will not be mandatory for 2005 but which may be available for early adoption.

The complexity of standards also should be considered. Final versions of IFRS initially will be available only in English. Official translations will be available freely only following the European Commission's endorsement of the standards and the publication of the endorsed standards in the Official Journal of the European Commission.

To many companies the application of IFRS represents more than a change in a few accounting policies. For many it represents a fundamental revision of the accounting framework under which their financial statements are prepared. Accounting policy decisions should be finalised only after consideration of the entire package of standards and their interaction. Piecemeal decisions may be ill-advised. The choices are complex and will require due consideration.

Paragraph 9 of the draft recommendation proposes that companies "describe … the major differences identified to date" between their present accounting policies and IFRS. Together with the emphasis on speed, this may well encourage piecemeal disclosure of the impact of transition.

For the same reason that piecemeal decisions concerning the transition to IFRS accounting policies may be ill-advised, piecemeal disclosures may be misleading. A drip-feed of individual quantifiable impacts resulting from individual changes could result in imbalanced and potentially misleading information. Numerical information should not be provided until the ***full impact*** of the transition has been determined so that context may be provided for a discussion of any individual difference.

Consistent with an objective of reliability, CESR may wish to consider whether it should recommend that the full impact, when disclosed, be subject to some element of independent review. In the case of information provided within the financial statements themselves, CESR should have regard to Practice Note 1014 *Reporting by Auditors on Compliance with International Financial Reporting Standards* issued by the International Auditing and Assurance Standards Board (IAASB).

Whilst the uncertainty and complexity of transition should not prevent companies from beginning preparations – indeed these factors necessitate that companies advance their preparations more quickly – it will delay the completion of the transition process until the uncertainties are resolved. In light of this we believe that acceleration of the numerical disclosure of the impact of the transition may not only be impracticable but also detrimental to the orderly transition to IFRS.

Recommendation versus requirement

CESR has made clear that its paper will only be a *recommendation*. Such ‘soft law’ can be a useful guide to best practice in many circumstances. However, by issuing these recommendations CESR will alter the expectations both of companies and markets. Market expectations are a powerful force and the pressure those markets place on companies for information will be influenced by the content of the CESR recommendation. CESR risks that its ‘recommendation’ will be elevated to a ‘mandatory’ status for all companies by local regulators and/or market pressure – a status that CESR did not seem to intend in its drafting.

CESR acknowledged in the open meeting held on the 12 November that the recommendation sets the benchmark at the highest level possible. Consistent with its own objectives, we believe that CESR has a responsibility not to raise market expectations above what reasonably is achievable by a majority of companies. Had CESR intended the recommendation to be (in effect) mandatory, we believe that it would have proposed a far more realistic benchmark – one that was attainable rather than aspirational.

* * *

Within the context of our overall conclusion above, an appendix to this letter sets out our responses to the specific questions raised in the draft recommendation.

Please contact Mark Vaessen at 020 7694 8089 or David Littleford at 020 7694 8083 if you wish to discuss any of the issues raised in this letter.

Yours faithfully

KPMG

Appendix 1

Responses to invitation to comment questions 1-12

Our responses (set out below) to the specific questions posed in the Exposure Draft are provided subject to our general comments set out in our covering letter.

General

- Question 1

  Do you consider it useful that CESR Members provide recommendations to European listed companies on how to disclose financial information to the markets during the phase of transition from local GAAP to IFRS?

Yes, but those recommendations should be realistic and should not encourage companies to disclose preliminary information that has a significant risk of being changed at a later date as a result either of the finalisation of standards and / or the availability of more precise information concerning the application of standards. Further, it should not encourage the provision of incomplete piecemeal information.

As noted in our covering letter, the current proposals do not address properly the issue of incomplete, piecemeal information or reflect what we believe is the appropriate balance of relevance (speed) and reliability.

- Question 2

  Do you agree that European listed companies should be encouraged to prepare the transition from local GAAP to IFRS as early as possible?

Yes, the complexity of the changes necessitate early preparation.

- Question 3

  Do you agree that those companies should also be encouraged to communicate about this transition process? If yes, are the 4 milestones identified by CESR for such communication appropriate?

The milestones are obvious points of contact between the company and the market. However, they are not the only possible points of contact and CESR may wish to consider how to incorporate additional flexibility and the varied approaches that exist in different EU countries to communication between the companies and market participants.

We note in our covering letter and in our responses to the questions posed by CESR that we do not agree with the content of the disclosures proposed by CESR at all of these milestones.

Publication of 2003 financial statements

- Question 4

  What are your views on an encouragement to listed companies to disclose narrative information about their process of moving to IFRS and about the major identifiable differences in accounting policies this transition will bring about? Do you consider it appropriate to include such information in the 2003 annual report or in the notes to the 2003 financial statements?

We support CESR's recommendation for companies to provide a narrative description concerning the progress made towards conversion to IFRS. We consider that such disclosure should not be provided in the financial statements themselves except to the extent required by national GAAP (for example, if the circumstances of transition give rise to contingent liabilities). We consider that the unaudited narrative section(s) of the annual report that incorporates/is attached to the annual financial statements is the appropriate location for such narrative information.

However, as we note in our covering letter, we believe that piecemeal disclosure of the ***quantitative*** impact of individual differences in accounting policies may be misleading and should not be encouraged. Accounting frameworks such as IFRS provide a cohesive and coherent picture only when applied in full.

The piecemeal publication of ***qualitative*** information may be acceptable in some circumstances – for example where there are a small number of clearly understood differences – but, again, the publication of information covering less than the full impact of the transition may in some circumstances lead to confusion and market uncertainty.

Publication of 2004 financial statements

- Question 5

  Do you believe that listed companies should be encouraged not to wait until beginning 2006 for communicating about the impact of the transition to IFRS on the 2004 financial statements if such information is available earlier? Do you agree that quantified information in this regard should be given as soon as possible?

Yes, but only if ***reliable*** information concerning the ***full impact*** of the transition to IFRS is available at an earlier date. As noted in our covering letter we are concerned that CESR has not found the right balance in respect of relevance and reliability nor has it considered the drawbacks of the provision of piecemeal information.

- Question 6

  Is it appropriate to refer to the Implementation Guidance published by IASB in connection with the IFRS 1 for defining which quantified information should be disclosed as a result of the recommendations in § 11 and § 12? Do you believe other disclosures should be envisaged? Do you agree with inclusion of such information in the annual report or in the notes to the financial statements?

We believe that it is appropriate to build on the disclosure requirements of the relevant IFRS rather that developing an alternative solution. Any proposal should be based on the requirement of IFRS 1 itself (in particular, paragraphs 38-40) and should reflect the fact that the implementation guidance is merely one way of meeting the requirements of the standard.

2005 Interim information

- Question 7

  Do you agree with the principle that any interim financial information published as of 2005 by listed companies should be prepared using the accounting standards that are to be used by those companies for the 2005 year end financial reporting, i.e. IFRS, in the way indicated here under?

As explained in response to question 9 below, we do not consider that it is appropriate for CESR to seek to implement change to existing interim reporting regimes in individual EU countries until the future EU requirements resulting from the proposed Transparency Directive are clearer.

We note that while some securities regulators require use in interim financial statements of accounting policies expected to be used in future annual financial statements, others currently require interim information to be prepared using the accounting policies applied in the ***last*** financial statements. Whilst the adoption of IFRS is a different scenario, we do not believe CESR should force a change in differing national approaches. EU markets have operated on the basis of their existing national GAAPs for many years and we therefore question whether the absence of information concerning IFRS for a few more months will have a significant impact.

Subject to our comments above, we believe that this principle may be appropriate if reliable information is available on an IFRS basis. CESR should encourage IFRS information to be provided only once the transition to IFRS is complete and reliable information is available. It is not clear to us that this will be the case uniformly across the EU.

- Question 8

  Do you agree that when listed companies do not elect to apply IAS 34 for quarterly information published in 2005, they should be encouraged to prepare and disclose financial *data by applying IFRS recognition and measurement principles to be applicable at year end?*

See responses to questions 7 and 9.

- Question 9

Do you agree with the proposed encouragement for European listed companies to either fully apply IAS34 for half yearly reporting as from 2005 or, if this standard is not applied, to prepare the key half-year financial data that are to be published, in conformity with IFRS recognition and measurement principles to be applicable at year end?

No. In addition to issues of reliability (see question 7), the use of IAS 34 still is being considered by the European Council and the European Parliament as part of the transparency directive discussions. The implementation date of any EU requirements in respect of interims is uncertain but it is clearly not expected to apply in 2005.

CESR should not seek to implement change to existing interim reporting regimes in individual EU countries until the future EU requirements are clearer. In particular it should not seek to implement change at a time when the attention of reporting companies should be focussed on the requirements of the IFRS regulation in respect of their 2005 annual financial statements.

- Question 10

CESR considered different possibilities for the presentation of comparative information for the corresponding period(s), but concluded that the above proposed solution could appropriately serve users of financial information without imposing too burdensome requirements on issuers. Do you concur with the proposed solutions? In particular, do you agree with the proposals that:

A) comparative figures should be provided and restated using same accounting basis as for the current year;

B) previously published information for the previous period may be provided again;

C) explanation of restatement of comparative figures should be given;

D) in case of presentation of financial statement over 3 successive periods the restatement of the first (earliest) period could not be required;

E) indicative format ("bridge approach") for the presentation of comparative information on the face of the financial statements when the first period presented is not restated?

For the reasons set out in response to question 9, we do not agree with proposals to require that IFRS be used in 2005 interim reporting. Our further concerns on the proposed disclosures are set out in response to questions 11 and 12 concerning the annual 2005 financial statements prepared in accordance with IFRS.

2005 Annual financial statements

- Question 11

  Do you agree that, in addition to the presentation of comparative information in conformity with IFRS 1 (i.e. prepared on the basis of IFRS provisions), it could be deemed useful to present again the comparatives prepared on the basis of previously applicable accounting standards?

In respect of the annual 2005 financial statements prepared in accordance with IFRS, we are not convinced that it is appropriate to require the inclusion of non-IFRS amounts in a side-by-side presentation in a single set of primary statements. For example there will be practical difficulties for many companies in allocating amounts calculated under the recognition and measurement criteria (including definitions) of national GAAPs to primary statement headings determined under IFRS.

In addition, the recommendation for two additional columns may make the income statement unwieldy, especially if there are discontinuing activities in the three year period which would require appropriate explanation or presentation, perhaps through additional columns.

It may be possible to include previous GAAP information as part of the note envisaged in IFRS 1 explaining / reconciling the transition.

More specifically, it is unclear how paragraph 25 should be applied where a company is also an SEC registrant required to provide three years of primary financial statements for US filing purposes. Does CESR intend to recommend that the primary financial statements for the extra year under IFRS be published under all three of previous GAAP, IFRS and US GAAP? This seems excessive.

- Question 12

  Do you agree that, when presentation of financial statements over 3 successive periods is required, it would be acceptable not to require the restatement to IFRS of the first (earliest) period? If yes, do you agree with the indicative format (“bridge approach) for the presentation of comparative information on the face of the financial statements when the first period presented is not restated?

We consider that it would be very helpful if securities regulators considered whether a special exception should be made in this transition period to relieve companies from any obligation to provide IFRS information for three periods (current plus two years comparatives).

This is not simply a presentational issue as any requirement to present two full years of IFRS comparatives changes the date of transition (as defined in IFRS 1) to a date one year earlier than otherwise would be the case. In a period when the IASB is yet to finalise the 2005 standards and faced with a standard (IFRS 1) that requires retrospective application of those standards at least from the date of transition, the requirement to provide three years of IFRS information could give rise to significant practical difficulties.

If national regulators believe it important to continue to require additional comparative information, we support CESR’s suggestion for “2+2 bridging” approach to satisfy this requirement for 2005.

However, as this is currently a requirement of specific individual regulators, it is clear that regulatory action would be required by those regulators to resolve this issue. It would be helpful for CESR to discuss the issue with those regulators in order that an early decision can be taken and the position clarified. Reference to CESR views on the topic in the final recommendation without regulatory action by the individual regulators is likely to prolong the uncertainty rather than resolve the issue.

It may be helpful if CESR were to raise the issue also with non-EU regulators that require two years of comparatives. This could be done either directly or via IOSCO.