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Mr. Jonathan G. Katz
Secretary
Securities and Exchange Commission
450 Fifth Street, N.W.
Washington, DC 20549-0609
USA

19 April 2004

Dear Mr Katz

Re: File No. S7-15-04

We appreciate the opportunity to respond to the Securities and Exchange Commission's (SEC) proposed rule Release Number 33-8397 *First-Time Application of International Financial Reporting Standards*. This letter expresses the views of KPMG International and its member firms.

The International Accounting Standards Board's (IASB) efforts to develop internationally accepted accounting standards is an initiative supported by KPMG International and its member firms. Use of a single set of accounting standards should enhance transparency, improve comparability, promote efficient cross-border investment and access to capital, and facilitate merger and acquisition transactions. By providing relief to first-time adopters of International Financial Reporting Standards (IFRS), the SEC is encouraging use of IFRS, which we support.

The European Union's (EU) regulation requiring adoption of IFRS in consolidated financial statements of listed EU companies (the EU IAS Regulation) represents a significant one-time cost to the more than 7,000 listed companies across the EU affected by the regulation. This regulation will apply generally for financial years beginning on or after 1 January 2005.

The SEC's rule proposal is trying to balance the costs of restating a third year of financial information into an IFRS basis with the benefit that financial statement users may obtain from having that third year of data prepared on a consistent basis. As a result, many of the questions posed in the release are aimed primarily at financial statement users and preparers. In our comments we have focused on areas relating to our work as independent auditors, our knowledge of IFRS and generally accepted accounting principles (GAAP) in the United States (US GAAP) and differences between the two, together with our knowledge of existing SEC rules and regulations.

Need for relief

We note that the Commission has focused on the potential burden of the current SEC rules and regulations requiring companies to apply standards to 2003 transactions and circumstances when many of those standards had not been finalised. We agree that this is a valid concern as many IFRS requirements involve estimation (e.g., fair value of acquired assets; best estimates of provisions) based on circumstances at the transaction date. We note that there also is a second and potentially larger issue. IFRS 1 *First-time Adoption of IFRS* establishes the 'transition date' for adoption of IFRS as the beginning of the earliest comparative period presented on an IFRS basis. The entity's 'opening balance sheet' is its balance sheet at the transition date and it is the starting point for accounting under IFRS. The transition date can have significant recognition and measurement impacts on a company adopting IFRS.

Generally, companies adopting IFRS as a result of the EU IAS Regulation will be required for their home country and EU purposes to provide only one year of comparative financial statements on an IFRS basis. If an entity that is an SEC registrant were required to restate an additional year of financial statements on an IFRS basis, it faces the prospect of not only the cost and effort involved in restating the third year, but also of a potentially significant impact on the measurement of items in its 2004 balance sheet and therefore its financial statements in future years. These potential measurement differences could significantly reduce the comparability of 2004 financial statements between SEC registrants and others by pushing back the starting line for these entities with US listings absent the relief proposed in the release. By having two different transition dates, an entity might argue it has two sets of inconsistent first-time adoption financial statements. Alternatively, it might argue that it would only be a first-time adopter at a single date, and, if this was 1 January 2004, it could not present IFRS-compliant financial statements to satisfy a three-year SEC requirement.

Following are two examples of how the transition date has on-going impacts. For example, under IFRS 1 an entity is not required to restate business combinations that occurred prior to the transition date. If three years of financial information were required, an entity would be required to restate any business combinations that occurred in the third most recent year for its filings with the SEC even if this were not required in its local jurisdiction. Also, upon transition to IFRS an entity is permitted to deem the cumulative translation differences for all foreign operations to be zero. If this election was used an entity's cumulative translation difference may be different in its filings with the SEC as compared to its financial statements filed in its local jurisdiction for 2005 until the entity disposes of all its foreign operations present at the transition date depending on whether its transition date was 1 January 2003 or 1 January 2004.

We are not aware of any EU member states planning to require publication of financial statements prepared in accordance with IFRS for the third most recent year. Those that normally require three years of data are expected to use a "bridging approach". In other words, entities that have a calendar year end will publish reports in 2005 that contain financial statements prepared in accordance with IFRS for 2005 and 2004 and financial statements prepared in accordance with previous GAAP for 2004 and 2003.

The Commission solicited input regarding what additional information first-time adopters might need in order to provide IFRS financial statements for the third-year back that they would not already have in connection with their reconciliation to US GAAP. We have identified a number of differences between IFRS and US GAAP[1], many of which cannot be calculated from the same data. Therefore, an entity that currently produces national GAAP financial statements and a reconciliation to US GAAP would have additional cost and effort to produce IFRS-based information for a third year. Examples of the types of items we have identified include:

Fixed assets: IFRS requires use of component accounting for fixed assets (i.e., accounting separately for, including depreciation, identifiable portions of assets with different lives, for example an aircraft engine and the frame of a plane). Current requirements of US GAAP neither require nor prohibit component accounting, and the response to the Accounting Standards Executive Committee of the American Institute of Certified Public Accountants (AcSEC) proposals to require component accounting confirmed that this practice is not used widely under US GAAP[2]. Applying component accounting would require collection of extra data about the third year back if that was not the practice under national GAAP.

Deferred tax on intercompany transfers: US GAAP requires deferred tax to be calculated after elimination of intercompany items; therefore, deferred tax is calculated based on the selling entity's tax rates. Under IFRS, any intercompany gain is eliminated, but deferred tax calculations are made based on the ending location of inventory, which would be based on the buying entity's tax rates.

Hyperinflationary accounting: IFRS and US GAAP require fundamentally different approaches to accounting by entities operating in hyperinflationary economies. IFRS requires restatement for the effect of local inflation before translation to any other currency (e.g., the reporting currency of a parent) while US GAAP would require, in the same circumstance, remeasurement of each transaction into the parent's functional currency. Therefore US GAAP data would not ease the burden of restatement under IFRS in respect of the third year back.

Consolidation: IFRS requires consideration of potential voting rights of both the reporting entity and other investors when determining which, if any, entity controls or has significant influence over a subsidiary or investee. US GAAP precludes consideration of potential voting rights in most cases. This difference means that different analyses would have to be done for each period.

Impairment: the calculations of impairment under IFRS and US GAAP, especially for long-lived non-current assets, are very different. US GAAP requires a determination that the carrying amount of an asset is not recoverable on an undiscounted basis before any impairment may be recognised. Once this ‘trigger’ has been tripped, then the asset must be remeasured to a market-based measure of fair value for the asset; once an impairment has been recognised, it cannot be

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[1] KPMG’s *Implementing IAS: IAS compared with US GAAP*, September 2001
[2] AICPA proposed Statement of Position, *Accounting for Certain Costs and Activities Related to Property, Plant, and Equipment*, June 2001

reversed. Under IFRS, an impairment is recognised when the carrying amount of an asset is not recoverable on a discounted basis (i.e., considering the time value of cash flows expected to be earned with that asset). If an asset is impaired, its carrying amount is reduced by the amount that is considered not recoverable; however, the measurement of the recoverable amount is made on an entity-specific basis, which may be higher than the market-based fair value. Further, in some cases, if the circumstances giving rise to the impairment reverse, then the impairment is reversed. These differences mean that assessment and measurement of impairment on a US GAAP and IFRS basis are very different.

Eligibility requirements

The EU IAS Regulation generally requires entities covered by that regulation to adopt IFRS for financial years beginning *on or after* 1 January 2005. However, the EU IAS Regulation permits member states to defer the required effective date for certain entities up to financial years beginning *on or after* 1 January 2007. While the text of the SEC release indicates that the SEC wishes to accommodate entities that are subject to the EU IAS Regulation[3], including those who will use the 2007 delayed effective date, the phrasing of the regulation itself requires adoption of IFRS for financial years beginning *no later than* 1 January 2007[4]. It appears that entities eligible for deferral under the EU IAS Regulation that do not have a calendar year end would be excluded from the proposed relief. Also, the cut-off date will cause problems for entities adopting IFRS that have a 52-week financial year. For example, in some jurisdictions an entity's 2007 financial year may start up to five days later than 1 January 2007. If the Commission wishes to extend relief to all entities adopting IFRS pursuant to the EU IAS Regulation we recommend that the proposed regulation[5] be changed to financial years commencing before 15 December 2007.

Generally, assessing whether an entity qualifies as a first-time adopter of IFRS is relatively straightforward. However, it is possible under IFRS 1 to be a first-time adopter more than once. An entity that claimed compliance with International Accounting Standards (IAS - the predecessor to IFRS) previously can be a first-time adopter under IFRS 1 if it did not include an explicit and unreserved statement of compliance with IFRS in its most recent published annual financial statements. We believe that the IASB, when developing these requirements, may have been trying to accommodate situations where, at some point in the past, an entity claimed that, for example, its previous GAAP financial statements also complied with IAS, but dropped the assertion of IAS compliance due to subsequent changes in national GAAP and/or IAS that made dual compliance impossible. Therefore, we recommend that the SEC link eligibility for the proposed relief to an entity qualifying as a first-time adopter under IFRS 1[6].

[3] see e.g., the discussion at II.A
[4] see e.g., section I.A (including footnote 10 therein) and proposed item G(b)(1) and G(b)(2)
[5] see e.g., proposed regulation text General Instruction G(b)(1)(A) and G(b)(2)(A)
[6] see e.g., proposed regulation text General Instruction G (b)(1)(B) and G(b)(2)(B)

Condensed US GAAP financial information

The SEC solicited input regarding whether condensed US GAAP financial information, if required, should be required to include notes to the financial statements 'in addition to the required reconciliation'. It is not clear to us whether the SEC was asking about financial statement footnotes in accordance with Article 10 of Regulation S-X, in addition to the condensed balance sheet and income statement, or whether it was considering requiring full US GAAP footnote disclosures in addition to the US GAAP reconciliation. We note that requiring US GAAP footnote disclosures would be an additional requirement not imposed currently on foreign private issuers filing under Item 17.

Previous GAAP financial information

If companies are permitted or required to present information on a previous GAAP basis, we believe that it should not be presented on a "side-by-side" format. In many cases, adoption of IFRS will require introducing new line items with no comparable previous GAAP amounts. Additionally, items with similar descriptions may have different measurement bases. While IFRS 1 requires a reconciliation for the transition year that is remeasured on an IFRS basis, it does not require reconciliation of additional periods presented on a previous GAAP basis. Also, IFRS 1 does not require reconciliation of every reclassification or gross versus net presentation. We have not identified any reason to prohibit inclusion in SEC filings of previous GAAP information. However, our understanding of the nature and extent of measurement and presentation differences between national GAAPs and IFRS leads us to believe that side-by-side presentation should not be required.

Selected financial data

Generally, issuers must provide five years of selected financial data, showing information both on the basis of the primary financial statements and, if those were not prepared using US GAAP, selected US GAAP amounts. The release proposes that, while five years of US GAAP information will be required in the year of adoption, only two years of information prepared on an IFRS basis would be required in that year. Footnote 30 of the proposed release refers to the SEC's existing practice of permitting a registrant to build up a five-year history in similar situations. However, similar relief does not appear to be proposed in the draft regulation text and it appears that a full five years of data on an IFRS basis would be required in subsequent years[7]. Therefore, for a calendar year end entity adopting IFRS from 1 January 2005, its Form 20-F for 2005 could include selected financial data on an IFRS basis for only two years; however, its Form 20-F for 2006 could appear to require including selected financial data on an IFRS basis for five years (i.e., 2002-2006). At the beginning of our letter we explain the significance of the transition date to recognition and measurement under IFRS. One consequence is that, if an entity has 1 January 2004 as its transition date, there would not be a

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[7] Section II.C and proposed item G(c) of the proposed release apply only to documents where the most recent annual financial statements are those where IFRS first are adopted. See proposed General Instruction G(b) and item 8(3).

valid IFRS basis for preparing selected financial data for 2002 and 2003 under IFRS. To avoid creating conflicts with the requirements of IFRS 1, we recommend that the SEC allow an entity to build up its IFRS based selected financial data as it builds a history of IFRS based primary financial statements. This recommendation also is consistent with Instruction 2, as discussed below, that allows a new registrant to omit presentation of the earliest two periods of local GAAP data in certain circumstances.

The proposed rule requires five years of US GAAP selected financial data in the year of adoption unless Instruction 2 to Item 3.A of Form 20-F allows the omission of earlier periods[8]. Instruction 2 normally requires selected historical financial data to be presented on a US GAAP basis for the same periods that primary financial statements presented under local GAAP are required to be reconciled to US GAAP (up to a maximum of five years plus any interim periods, included in the filing). Under the proposed rule, two years of primary financial statements (prepared in accordance with IFRS) would be required in an initial registration statement. Therefore, it appears that only two years of US GAAP selected financial data might be required in an initial registration statement under the proposed rule. A two-year presentation appears to contradict the SEC's comment that they "believe that investors nonetheless find valuable three-year trend information that is prepared on a consistent basis." We request that the SEC clarify its intention in respect of requirements for presentation of selected financial data in registration statements.

We believe that issuers should be given the choice as to whether or not to include previous GAAP information in the selected financial data. We do not believe that it is necessary to include this information in an entirely separate section within the Form 20-F. For the reasons described in the previous section, we believe that a "side-by-side" disclosure format should not be required.

Financial statements and information for interim periods for the transition year

Currently, it is unclear as to what interim reporting requirements will be established by securities regulators and stock exchanges in the member states of the EU and in Australia. Early indications are that interim reporting on an IFRS basis will be required in the UK, France and Australia, while it appears unlikely that interim reporting on an IFRS basis will be required in Germany. The approach taken by different regulatory bodies varies based, in part, on whether interim financial statements are regarded as an update of the prior year annual financial statements or as a preview of the coming year-end. Those countries taking the latter approach are more likely to require reporting of interim financial information in 2005 to be on an IFRS basis.

The IASB considered whether the relevance and usefulness of interim information provided on an IFRS basis may be reduced to an unacceptable level if annual financial statements prepared on an IFRS basis have not been published before the interim financial statements are issued. Paragraph BC96 of the basis for conclusions in IFRS 1 notes the IASB's conclusion "that a first-

[8] Section II.C

time adopter's first interim financial report under IAS 34 [the standard on interim financial statements] should include sufficient information to enable users to understand how the transition to IFRS affected previously reported annual, as well as interim, figures (paragraphs 45 and 46 of the IFRS)." It is clear that the IASB agreed that some enhanced disclosure may be appropriate in cases where interim financial statements are the first presentation of IFRS based information. However the IASB concluded that interim financial statements on an IFRS basis can be presented without having published a full set of IFRS annual financial statements.

We encourage the SEC not to override a conclusion reached by the IASB in its standard setting process. Therefore, we do not support the SEC's intention to require all foreign private issuers to use previous GAAP, until a complete (i.e. not condensed) set of IFRS annual financial statements have been issued, to satisfy requirements for interim reporting of financial information. It would be a significant burden for some entities if the SEC established a uniform requirement for all foreign private issuers with respect to interim financial information in the year in which IFRS will first be used (typically 2005).

Also, we do not support the Commission's alternative two, which would permit a registrant to provide only one year of audited annual financial statements on an IFRS basis, along with IFRS interim financial statements (e.g., for a calendar year end company, 2004 restated to an IFRS basis and 2005 interim financial statements with 2004 comparative interim financial statements). As the Commission noted, alternative two conflicts with the requirements of IFRS 1 to provide comparative information. Further, as discussed in this letter under '*Need for relief*', determination of the opening balance sheet can have significant recognition and measurement impacts not only for the transition year but also for subsequent periods. It is unclear how alternative two would distinguish between (i) registrants adopting IFRS in 2005 and initially presenting restated 2004 financial statements that ultimately would be presented as comparative financial statements for 2005, and (ii) registrants adopting IFRS in 2004 but not restating their opening balance sheet at 1 January 2003, or restating but not presenting that balance sheet.

It is not unusual for entities to adopt new accounting standards for the first time in interim financial statements. Presumably, the critical issue regarding use of IFRS in interim financial statements is not *when* the shift in the basis of reporting occurs, but rather whether the condensed format and limited disclosure requirements of interim financial statements provide sufficient information to be the vehicle for presenting such a significant change in the basis of reporting. If this is the case, we encourage the SEC to focus instead on specifying what, if any, minimum disclosure requirements, for example, accounting policy or footnote disclosures, that it might require in order to address potential information gaps. Alternatively, the Commission could condition use of IFRS in interim financial statements in these circumstances to a full (i.e., not condensed) set of unaudited interim financial statements. Otherwise, the Commission may wish to have the SEC staff address this on a case-by-case basis, if relatively few of the approximately 400 registrants that are required to adopt IFRS would be in this situation. We do not believe that requiring use of previous GAAP for all interim financial reporting is the appropriate solution to this concern.

Disclosures about first-time adoption of IFRS

The SEC has proposed requiring disclosures about the impact of the application of exemptions from full retrospective application of IFRS where these exemptions are permitted or required by IFRS 1. We agree that identification of exemptions used, especially those that are optional, would enhance a user's understanding of the basis of preparation of first-time adoption financial statements. However, we expect that the disclosure of IFRS accounting policies, as well as the explanation provided as part of the required reconciliation from previous GAAP to IFRS, would identify many of the exemptions used.

If such a discussion were required we support the SEC's approach of including this in MD&A (operating and performance review) as the nature of such a discussion appears to be most similar to other narrative discussions about the comparability of financial measures of performance, resources and liquidity.

The release proposes that foreign private issuers provide an "explanation of the significance of each exception." If the SEC decides to require discussion of exemptions used, we strongly encourage this to be limited to a qualitative (narrative) discussion and not to extend to a quantification of the impact of exemptions. The IASB's work to develop IFRS 1 focused on balancing comparability of financial statements of entities reporting under IFRS with the cost of full retrospective restatement. We believe that the Board struck an appropriate balance, after considering input, as part of its due process, from preparers, users, auditors and regulators. Requiring a quantification of the impact of exemptions would impose many of the same costs as requiring full retrospective application of IFRS and would be in conflict with the IASB's conclusions in IFRS 1.

Reconciliation from previous GAAP

In Paragraph IG63 of the Implementation Guidance to IFRS 1 the IASB suggested but did not require use of a particular format for the required reconciliation of previous GAAP net income and equity to those amounts restated on an IFRS basis. Given the varying degrees of impact that the adoption of IFRS will have on issuers, a prescriptive approach may be overly rigid. Requirements consistent with IFRS 1 would seem appropriate and mean that issuers would only be presenting one reconciliation between their previous GAAP and IFRS.

Other financial statements required

The SEC's rule proposal does not currently include any discussion or guidance about applicability to financial statements of an entity other than those of the registrant. For example financial statements of a business that is the target of an exchange offer registered on Form S-4 or F-4 or included in a proxy statement; of an acquired business under Rule 3-05 of Regulation S-X; of equity method investees under Rule 3-09 of Regulation S-X; and of guarantor subsidiaries under Rule 3-10 of Regulation S-X may all be impacted if the entities for which such financial statements are required are first-time IFRS adopters. We recommend that the scope of the final rule include such financial statement requirements.

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Please contact Terry Iannaconi (212-909-5426), or Mary Tokar (+44 (0) 207 694 8288) if you wish to discuss any of the issues raised in this letter.

Yours faithfully

/s/ KPMG International

KPMG International