

**RESPONSE OF M.P. CARSCALLEN
TO A C.S.A. DISCUSSION PAPER ON
FINANCIAL REPORTING IN CANADIAN MARKETS**

Question 1

I believe that information prepared in accordance with Canadian GAAP is relevant to Canadians participating in Canadian Securities Markets. It is the basis for reporting financial information used by the vast majority of Canadian corporations and the basis with which the majority of financial statement users is most familiar. There is no logical reason to permit Canadian issuers to use any other form of accounting standards for filing in Canada. I also believe that the primary responsibility of the C.S.A. is to investors, not issuers. If issuers wish to provide additional financial information following other accounting standards, presumably those in the U.S., they should be free to do so. However, not only should the financial statements issued by Canadian corporations be in Canadian GAAP but also figures used in other information derived from the financial statements should be calculated on Canadian GAAP (MD&A, etc.)

The drive by issuers to use U.S. GAAP, or, worse yet, use U.S. GAAP for certain areas of financial accounting is in my view largely driven by self-interest and a desire to show the best picture in their particular circumstances. If elimination of pooling of interest accounting stands up politically in the U.S., there may be a considerable lessening in the pressure to use U.S. GAAP. Indeed, until Canada changes its foreign currency accounting rules, there could be an incentive to use Canadian GAAP because it is likely in the present currency markets to yield a higher income.

There may be some Canadian reporting issuers which have become very substantially owned and traded abroad. Such corporations might be permitted some relaxation of the Canadian GAAP requirement. However, I don't think it is necessary to give this relaxation by rule. The number of such corporations should be small enough that exemptions on application will suffice. The test for exemption should be fairly strict.

In principle, there is no reason why the present requirements placed on foreign issuers should change, i.e. foreign issuers should be required to present a reconciliation of their financial statements to Canadian GAAP. I don't believe we should, at this point, make an exception for financial information presented in accordance with some specific foreign GAAP. The obvious exception would be U.S. GAAP. However, I strongly suggest that this is not the time to make ourselves hostage to the U.S. standard-setting process. This is not an expression of lack of confidence in the FASB. It is rather a considerable lack of confidence in the political process in the United States. There is a history of political interference in standard-setting in the United States. The most recent example is an auditing issue where the political apparatus caused the SEC to weaken its proposed independence rules for auditors. The present administration in the U.S. has shown itself ready to step in to support special interests and has shown that it is not overly concerned with international agreements or harmonization. Specifically, whatever the views of the FASB and the SEC, I think that the political apparatus, given sufficient corporate pressure, could step in and dictate some U.S. standards.

Although I do not believe that we should agree to accept any foreign national standards in financial statement of foreign issuers without reconciliation, I believe we should give serious consideration to accepting International Accounting Standards (IAS) without reconciliation.

Question 2

As indicated, I believe foreign issuers should be given the option of filing financial statements and financial information prepared in accordance with their national standards together with a reconciliation to Canadian standards or of filing financial statements in accordance with IAS without any reconciliation requirement. I know this is radical, but I think the time has probably come for IOSCO members either to follow through on their efforts to establish acceptable IAS and to

recommend their use or to acknowledge that there has been an exercise in futility. What future developments are likely to make IAS any more acceptable internationally than they are now? We should back up our international commitments and accept IAS without reconciliation.

It is easier to make this recommendation because I do not expect that the IAS option will be much used to begin with. To use this option, most foreign issuers would first have to convert their financial statements from local GAAP to IAS. Very few now filing in Canada would be preparing IAS statements. Foreign issuers who are presently filing in Canada would already be used to preparing reconciliations to a foreign GAAP i.e. Canadian GAAP. IAS are a more prominent feature of the accounting landscape outside North America. Issuers from Europe, for example, might well decide that a single conversion to IAS without the necessity of presenting duplicate financial information was an easier road to follow than presenting financial information based on their own standards supplemented by a reconciliation to Canadian GAAP. There is a good chance that the European Community will adopt IAS as the standard for cross-border filings.

The highly desirable adoption in Canada of IAS as an acceptable, although not mandatory, basis of accounting for reporting by foreign issuers will never be something that can be instantly and painlessly adopted. There will always be a learning curve. The knowledge of Canadian accountants of IAS is, by and large, somewhat limited. In the U.S., IAS are even more exotic. Acceptance of IAS in what I believe will be a limited number of cases to begin with should make the inevitable learning exercise easier to plan and effect, particularly for regulatory staff who will be those most immediately affected.

Question 3

- (i) As indicated, I do not believe we should eliminate all reconciliation requirements for foreign issuers except possibly in the limited case of those that present their financial information based on IAS.
- (ii) & (iii) I see no point in partial reconciliations or narrative presentations of differences. Surely, if we were to adopt one of these approaches, we would want to be satisfied that the specified financial statement items to be reconciled were those where there is a material difference in result between the foreign GAAP and Canadian GAAP. Similarly, a discussion of qualitative differences should make sure that all differences having a material effect were discussed. As a practical matter, the only way to be certain that all material differences are dealt with is to do a reconciliation sufficient in scope to ensure that all differences giving rise to material differences in financial statement amounts have been identified. Put differently, it will usually be necessary to do a substantially full reconciliation to be able to present the partial reconciliation or qualitative difference discussion that has been proposed. In addition, I believe narrative discussion of qualitative differences is of little practical use. All a reader can get from it is a list of the areas about which he or she should be worried.
- (iv) As indicated above, I propose that we eliminate reconciliation requirements for foreign issuers that prepare financial statements in accordance with IAS. I do not recommend elimination of a reconciliation requirement for foreign issuers presenting financial statements under any other set of foreign standards.
 - (v) I have not thought about this issue in depth. I can conceive of a modified reconciliation requirement for foreign issuers issuing only debt in Canada. Perhaps only certain identified items would require reconciliation, or perhaps, we could accept a summary of financial statements based on Canadian GAAP or reconciled to Canadian GAAP. I don't believe the proportionate interest of

Canadian investors is likely to be a practical guide in most cases. As long as the number of Canadian investors is large enough that the foreign issuer remains a reporting issuer in Canada, I see no reason to modify the normal requirements. In a particular situation, the issuer can always apply for some sort of exemption. Such applications will likely be uncommon.

Question 4

I believe that Canadian companies should continue to be required to prepare financial statements in accordance with Canadian GAAP.

Question 5

My experience with Canadian issuers and auditors preparing financial statements under a foreign GAAP is mainly limited to the conversion of Canadian GAAP statements of subsidiaries of U.S. corporations into U.S. GAAP for the purpose of consolidation in the U.S. All the major firms have experience in this area. As U.S. standards become more and more detailed, the firms have found it necessary to identify special persons or set up special groups to review translations into U.S. GAAP. Ideally, these reviews are done before the translated financial statements are released to the U.S. auditors and issuer. Time pressure sometimes makes it necessary to do these reviews after the financial statements have been issued. This is not completely satisfactory since it may not always be possible to get any necessary adjustments made. If a significant number of Canadian issuers were to choose to use U.S. GAAP as their primary reporting basis, the profession would find it necessary to do considerable training and to beef up the existing departments. There will still be a predominance of Canadian GAAP financial statements being handled, particularly in smaller offices.

It is my recollection that the SEC has expressed reservations about the quality of many conversions and reconciliations to U.S. GAAP.

In my experience, there has been little demand for the translation of Canadian GAAP financial statements into a foreign GAAP other than U.S. GAAP. There have been occasional requests to assure an overseas auditor that the financial statements comply with IAS. These have been infrequent enough that they can be directed to the persons in the firm who have the necessary knowledge. Other foreign issuers and auditors seem prepared to accept Canadian GAAP financial statements and make their own adjustments.

Question 6

I do not believe Canadian issuers should be permitted alternatives to Canadian GAAP. If alternatives were permitted, they would almost certainly have to be limited to U.S. GAAP and perhaps IAS. Presuming these were the only two alternatives permitted, the C.S.A. would have to embark on training programs for staff to give them the necessary expertise to carry out filing reviews in accordance with the usual practice. In terms of adequacy of disclosure, there should not be a great deal of difference from what is contemplated now. In terms of compliance with accounting requirements, considerable work might be necessary. Initially, it might be necessary to employ various major accounting firms on a consulting basis.

As to necessary changes in incorporating and other statutes, there are others with more expertise in that area than I have. Considerable effort would be necessary to identify all necessary amendments and get all jurisdictions to make the necessary amendments.

Question 7

As indicated above, I do not believe that Canadian companies should be permitted to use the accounting standards of certain foreign countries or IAS.

Question 8

The responsibility of the C.S.A. is to Canadian investors and users of financial statements. The fact that an issuer may also be an SEC filer does not change that responsibility. I am sure that those issuers that are campaigning to be allowed to use U.S. GAAP are all SEC filers and that their motives are either to reduce the effort in having to in effect prepare two sets of financial statements or, more commonly than they might admit, to get access to certain U.S. accounting standards that they believe presents their financial position and results of operations more favourably. Canadian issuers are not now precluded from preparing U.S. GAAP financial statements in addition to the Canadian GAAP financial statements provided to Canadian investors.

Question 9

I believe Canadian companies should be required to produce Canadian GAAP financial statements. If they were permitted to produce financial statements on another basis, would it not be appropriate to have the courage of our convictions and not require any reconciliation? It seems ridiculous to contemplate a Canadian company doing a reconciliation to Canadian GAAP.

Question 10

If the C.S.A. were to permit an alternative to Canadian GAAP, that alternative would generally be U.S. GAAP and the issuers adopting that approach would overwhelmingly already be SEC filers. Accordingly, presuming they have been complying with Canadian requirements in the past, they should have little difficulty in converting to U.S. GAAP financial statements. If a Canadian filer were to convert its financial statements to U.S. GAAP for the first time, it seems to me there is no alternative but to require restatement of all years presented. This could be a considerable amount of work depending on the company's circumstances. As an example, if a Canadian company switched to U.S. GAAP and it had entered into a business combination in the past accounted for as a pooling of interest under Canadian rules, but could not be under U.S. rules (it happens), there would be considerable work involved in bringing the accounting for that combination forward over the years to the present date. I presume we would not want to accept balance sheets which are not prepared as if the company had always been on U.S. GAAP. To do so, would be presenting financial position determined under a hodge-podge of rules.

Question 11

As indicated by my proposal that foreign issuers be allowed to file on IAS without reconciliation, I believe that the core IAS standards provide a sufficiently comprehensive accounting framework to provide a basis to address the fundamental accounting issues encountered in a broad range of industries and a variety of transactions. If one looks through Section 1501 of the CICA Handbook, it becomes apparent that the coverage of the IAS is substantially as great as the Handbook. There are in fact matters dealt with in IAS that are not dealt with in published Canadian standards. As is the case with Canadian standards, if there are gaps in IAS auditors and issuers will bridge them through the application of general principles and concepts and experience as has frequently been necessary in the past in Canada and still is necessary from time to time.

Question 12

An issue to be addressed is the existence in IAS of benchmark standards and allowable alternatives. On the principle of "in for a penny, in for a pound", I believe we should permit the use of IAS by foreign issuers only if they follow the benchmark treatments. An apparent alternative might be for the C.S.A. to review

the benchmarks and alternatives and indicate for each standard which treatment is to be followed. By the time securities regulators around the world have done this sort of thing and arrived at different answers we will be in chaos. One must accept either only benchmarks or either benchmarks and alternatives.

The question of specialized industries is more difficult. When people refer to specialized industries, they sometimes are taking the view that a particular industry is sufficiently specialized that GAAP or IAS cannot deal with it. There is no industry in the world that specialized. The other issues that arise with so-called specialized industries are in respect of industries that, usually through more or less organized industry efforts, have adopted practices that are on the very edge of GAAP or fall outside any reasonable interpretation thereof. In these cases it has been necessary for the profession, or the regulators, to produce guidance to be followed. There will be some cases of specialized industries around the world where a local practice pushes or exceeds the bounds of local accounting rules and action has not yet been taken to deal with these anomalies. I think that we should be prepared to accept specialized industry practices, provided we are satisfied that they do not conflict with IAS generally. I don't think it is either fair or practical to say to a foreign issuer that they may use IAS to file in Canada without a reconciliation requirement but they must first investigate any special Canadian requirements that may apply to their industry. It is not a workable approach to have each host country specify the treatment for specialized topics not addressed by core IAS standards.

Question 13

I believe that IAS are of sufficiently high quality to be used without reconciliation to Canadian GAAP in cross-border filings into Canada. My experience with IAS is as a former member of the IASC, in serving on a research study group of the Canadian, U.S. and Mexican Institutes that prepared a comparison of accounting standards in the NAFTA countries and IAS and in being the author of a significant proportion of a book explaining IAS and their application prepared for international distribution by the major accounting firm with which I was formerly associated.

Question 14

I believe that the discussions of IAS in this discussion paper adequately identified the differences between Canadian GAAP and IAS and that the C.S.A. staff preparing this discussion paper have a good knowledge of IAS.

Question 15

Anyone who has been involved in standard-setting knows that whether a particular standard results in better or poorer financial reporting than another standard is in the eye of the beholder. I believe that the benchmark IAS standards provide financial reporting as good as that provided by Canadian GAAP and in some cases better. Some problems have been identified in Canadian GAAP and are in the process of being rectified, e.g. accounting for foreign currencies and accounting for financial instruments. The IAS has dealt with these problems.

Question 16

When speaking of the level of the level of guidance provided in IAS, one must remember that there is a Standards Interpretation Committee of the IASC that produces authoritative guidance. However, there is unquestionably less guidance produced by the IASC than there is by the CICA. At least some major accounting firms have produced analyses of IASs and their appropriate application around the world. I believe that there is sufficient guidance in the IAS and other available sources to make it possible to have consistent application. Certainly, the guidance is not as complete as that in Canada or the United States. A number of smaller countries have adopted IAS as their national accounting standards and I believe that outside of North America, there are a considerable number of companies that state that their financial statements have been prepared in accordance with IAS. There are obviously accountants and issuers that have found the IAS standards capable of application.

Some North American securities regulator somewhere, sometime is going to have to bite the bullet and accept IAS standards. I do not believe this is as difficult and dangerous a step as is implied by some people. Financial statements filed using IAS will undoubtedly require, at least initially, more attention from C.S.A. staff than financial statements prepared under Canadian GAAP. However, as I indicated previously, I expect that the number of foreign issuers filing financial statements in accordance with IAS would be relatively limited, at least at first.

Question 17

This question seems to be directed at the use of IAS by Canadian issuers. I do not suggest that this be permitted. The major international accounting firms do have mechanisms and structures in place to assist their clients and staff in interpreting and applying IAS.