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COMMISSION STAFF WORKING PAPER

State of play on convergence between International Financial Reporting Standards (IFRS) and third country national Generally Accepted Accounting Principles (GAAP)

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1. INTRODUCTION AND LEGAL BASES

Since 1 January 2005, companies listed on an EU regulated market[1] have to use International Financial Reporting Standards (IFRS) as adopted by the EU for preparing their consolidated financial statements.[2] The Prospectus Regulation[3] and the Transparency Directive[4] extend the requirement to produce financial reports either on the basis of IFRS or on the basis of certain third countries national accounting standards equivalent to IFRS, to third country issuers making a public offer of securities in the EU and those whose securities are traded on an EU regulated market.

A mechanism[5] to determine the equivalence of the Generally Accepted Accounting Principles (GAAP) from third countries was established in 2007. Accordingly, the Commission adopted a Decision[6] and a Regulation,[7] which identified as equivalent to IFRS the US GAAP, the Japanese GAAP, and accepted financial statements using the GAAP of China, Canada, India, and South Korea within the EU on a temporary basis, until 31 December 2011.

In accordance with the relevant EU legislation[8] the European Commission has been updating the European Parliament (EP) at regular intervals on the progress made by these countries with their respective programmes to converge their GAAP with IFRS.

In June 2010, the Commission services requested the then Committee of European Securities Regulators (CESR), now European Securities and Markets Authority (ESMA), to provide an update on changeover developments towards IFRS in the countries that had received a transitional period by the EU: China, Canada, India, and South Korea.

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1 As defined in Article 4(1), point 14, of Directive 2004/39/EC.

2 Regulation (EC) No 1606/2002 of the European Parliament and of the Council of 19 July 2002 (the "IAS Regulation").

3 Commission Regulation (EC) No 809/2004 of 29 April 2004 (the "Prospectus Regulation"). This Regulation implements Directive 2003/71/EC of the European Parliament and of the Council of 4 November 2003 (the "Prospectus Directive").

4 Directive 2004/109/EC of the European Parliament and of the Council of 15 December 2004 (the "Transparency Directive").

5 Commission Regulation (EC) No 1569/2007 of 21 December 2007 establishing a mechanism for the determination of equivalence of accounting standards applied by third country issuers of securities pursuant to Directives 2003/71/EC and 2004/109/EC of the European Parliament and of the Council (the "Equivalence Mechanism Regulation").

6 Commission Decision 2008/961/EC of 12 December 2008 on the use of third countries´ issuers of securities of certain third country's national accounting standards and International Financial Reporting Standards to prepare their consolidated financial statements, OJ L 340, 19.12.2008, p. 112.

7 Commission Regulation (EC) No 1289/2008 of December 2008 amending Commission Regulation (EC) No 809/2004 implementing Directive 2003/71/EC of the European Parliament and of the Council as regards elements related to prospectuses and advertisements, OJ L 340, 19.12.2008, p. 17.

8 Commission Regulation (EC) No 1787/2006 of 4 December 2006, and Commission Decision (EC) No 2006/891 of 4 December 2006 (the "Decision under the Transparency Directive").

The present staff paper provides an update on the progress of the abovementioned countries towards adoption of or convergence with IFRS accordingly. It takes due account of the input provided by CESR in November 2010 and the updates on China and India, received from ESMA following an on-the-spot investigation which it undertook in January 2011.

This paper presents recent developments in several other major economies such as Argentina, Brazil, Mexico, Russia, and Taiwan which have made progress towards the adoption of IFRS.

No formal decision of equivalence is needed for countries that have recently adopted IFRS (Canada and South Korea) or those which are already recognised as equivalent (the US and Japan). Before the end of 2011, the Commission will have to adopt a Decision as to whether China and India have sufficiently converged towards IFRS on the basis of the data collected by monitoring the progress achieved by these countries.

This paper is a working document of the services of the European Commission for information purposes. It does not purport to represent or pre-judge any formal position of the Commission on this issue.

2. CONVERGENCE WORK BY THIRD COUNTRIES INTENDING TO ADOPT IFRS

This section describes the Commission services' findings, which take into account CESR's report of November 2010 and the update of March 2011.

2.1. Canada

During the last year, the Canadian Authorities have continued their efforts to secure a timely transition to IFRS through various publications, on-line training courses, and concept papers.[9]

The Accounting Standards Board of Canada (AcSB) had announced that publicly accountable profit-oriented enterprises must conform to IFRS when preparing their interim and annual financial statements relating to fiscal years beginning on or after 1 January 2011. Early adoption before 2011 was permitted for some listed companies. However, Canadian public companies whose securities are registered with the US Securities and Exchange Commission are currently allowed to use US GAAP as their financial reporting framework and they will continue to have that option.[10] Moreover, a one year deferral for IFRS adoption was decided concerning entities with rate regulated activities and investment funds. Consequently, issuers currently using Canadian GAAP to prepare their financial statements will have to use IFRS for their interim and annual financial statements relating to fiscal years beginning on or after 1 January 2011, while rate-regulated activities and investment funds have the option to defer their adoption until 1 January 2012.

After carrying out a public consultation in 2010, the AcSB is expected to finalise its strategic plan for 2011-2014 in March, and begin implementing it in April 2011.

9 See for example the CICA Handbook – Accounting containing all standards to apply in the first financial statements under IFRS. The new publication "The IFRS Changeover: A guide for Users of Financial Reports" helps users of external financial reports better understand the potential impact of Canada's transition to IFRS.

10 See IAS Plus, as viewed on 14/04/2011 at: http://www.iasplus.com/country/canada.htm.

2.2. South Korea

The Korean Accounting Standards Board (KASB) has adopted IFRS as Korean IFRS (K-IFRS). K-IFRS are identical to IASB IFRS except for timing differences for newly published IFRS. K-IFRS are kept up to date as IFRS change. K-IFRS are required for all listed companies in Korea since 2011. Unlisted financial institutions and state-owned companies are also required to apply K-IFRS; other unlisted companies may choose to do so.[11] Listed companies with assets of KRW 2 trillion[12] or more will be required to report semi-annually and quarterly consolidated financial statements, while other listed companies are allowed a 2-year grace period (i.e. until 2013) for semi-annual and quarterly reports.

According to the European Union Chamber of Commerce in Korea (EUCCK) many companies have already been reporting in both the existing standards and K-IFRS in 2009 and 2010. Partly this is because most of their members are EU-based companies who had to apply IFRS for a number of years already, but also because some Korean companies have adopted IFRS earlier than the 2011 deadline.[13]

On 1 October 2010, the Korean Ministry of Strategy and Finance has introduced a bill to the National Assembly amending the Corporation Tax Law to make it compatible with IFRS. The legislation is expected to be promulgated before the end of 2011. The Korean Accounting Institute (KAI) has continued the IFRS education programme.

2.3. India

The Institute of Chartered Accountants in India (ICAI) and the Indian Government had made public commitments to adopt IFRS by 31 December 2011. The ICAI had noted that it might make modifications to IFRS (taking into consideration the legal, regulatory and economic environment, the industry preparedness, and the removal of some options permitted under IFRS) in order to reflect local circumstances. These changes were expected to be minor and the stated intention of both the ICAI and the Government was that Indian GAAP would be fully IFRS compliant by the end of the programme. Recently, the ICAI has published a new version of the Indian converged standards, having as its starting point the relevant IFRS modified for the purpose of their application in India.

ESMA has made a classification in four categories on the basis of the differences identified between Indian standards and IFRS. The groups are: i) Standards for which there is no equivalent under Indian converged standards; ii) Indian standards with significant departures from IFRS; iii) Standards for which an option (alternative treatment) has been removed; iv) Standards for which there are minor changes.

At the same time, India has stated its intention to try to further reduce or even to eliminate the differences, mainly by addressing the issues to the IASB and asking it to take them into account when amending or revising the relevant IFRS standards. In February 2010, the Ministry of Corporate Affairs of India (MCA) adopted a plan for a phased transition to "notified Indian standards that have been converged with IFRS" by listed and large Indian

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11 See IAS Plus as viewed on 14/04/2011: http://www.iasplus.com/country/korea.htm.

12 Approx. 1 EUR = 1,555.37 KRW (South Korean Won).

13 Information provided by the Delegation of the European Union to the Republic of Korea.

companies,[14] other than banks and insurance companies. Non-listed companies with a net worth of Rs 500 crores[15] or less and whose shares or other securities are not listed on stock exchanges outside India as well as Small and Medium Companies would not be required to follow the notified accounting standards which would be converged with IFRS.

The adoption of the company law appears to have been delayed by the Indian Parliament but should soon take place.

However, despite these indications of goodwill, latest developments introduce ambiguity about the country's commitment towards an IFRS-compliant financial reporting system. Indeed, there is significant uncertainty as to whether India would adopt the IFRS or otherwise come up with a country-specific version with numerous modifications and carve-outs in some important areas, such as agriculture, financial instruments, negative goodwill, and real estate.

On 25 February 2011, the MCA notified the near-final exposure drafts of 35 Indian GAAP following their publication by the ICAI. MCA states in the press release that the date of implementation of the GAAP will be confirmed subsequently which was previously expected to be 1 April 2011. Phased transition would take place only after a number of issues are resolved to ensure smooth convergence. Thus, the question remains whether companies complying with these Indian GAAP would be able to make an unreserved statement of compliance with IFRS.[16]

As there are no issuers in India who have taken advantage of the voluntary early application of IFRS, there is no experience regarding IFRS enforcement.

3. CHINA

In the case of China, Commission services requested ESMA advice on the practical application of the Accounting Standards for Business Enterprises (ASBE). Using information gathered during meetings with representatives of the Chinese Ministry of Finance (MoF) and the Chinese Securities Regulatory Commission (CSRC), ESMA confirmed that China has taken further steps in pursuit of its convergence programme.

ASBE became mandatory for all listed Chinese enterprises from 1 January 2007 upon incorporation of IFRS into Chinese legislation whilst, in certain cases, making amendments to take into account local circumstances.

In a statement entitled "Roadmap for Continuing Convergence of the ASBE with the IFRS", issued in April 2010, the MoF reassured that it intended to continue the convergence process, with relevant improvement projects to the ASBE to be accomplished by the end of 2011. The revised ASBE system would still consist of three parts: Basic Standard, Specific Standard and Implementation Guidance. To our knowledge,[17] as of October 2010, except for IFRS 9, all other standards and interpretations issued by IASB have been implemented in the ASBE. There are some remaining differences relating to the removal of alternative treatments or

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[14] See http://www.pib.nic.in/release/release.asp?relid=57220 as published on 22 January 2010; last viewed 23/02/2011.

[15] Approx. 1 crore= 10 million. Rs (rupies) 500 crore= EUR 80,000,000. Rs 1000 crore= EUR 160,000,000.

[16] See http://www.iasplus.com/asia/1103intrackingifrs9.pdf, viewed on 07/03/2011.

[17] Evidence collected by the European Commission.

some missing requirements in cases where the particular type of transaction does not exist in China but the level of convergence could be considered to be satisfactory and the differences are not significant.

The MoF believes that the converged ASBE are both making the Chinese market more attractive to overseas issuers and putting Chinese issuers in a better position to access international markets. Promotion and training are being conducted to ensure that all companies gain an understanding of the changes to relevant accounting standards and apply them effectively.

In terms of enforcement, ESMA has noted that both the MoF and the CSRC have undertaken significant steps to better monitor companies which has led to improvements in the application of the ASBE.

At present, the convergence between the Chinese ASBE and IFRS has substantially been achieved and Chinese authorities are committed to completely removing any remaining residual differences.

4. DEVELOPMENTS IN OTHER THIRD COUNTRIES

In addition to the countries already discussed in the previous sections, there are several other major countries moving towards IFRS. Even though the latter have not made an official public commitment under the Equivalence mechanism, due to their G20 membership and the significance of these economies, it is important to monitor their position regarding IFRS. This section provides general information on recent developments that Commission services are aware of based on publicly available information.

4.1. Argentina

In December 2009, Argentina's National Securities Commission (CMV) adopted a requirement that all companies that publicly offer equity or debt securities must prepare their financial statements using IFRS, beginning with financial statements for the year ending 31 December 2012. Companies may voluntarily file their financial statements in accordance with IFRS starting in January 2011.

4.2. Brazil

In July 2007, the Brazilian Central Bank and the Brazilian Securities and Exchange Commission (CVM) defined 2010 as the deadline for adoption of IFRS for the consolidated financial statements of listed companies and financial institutions.

Thus, listed companies and banks, both domestic and foreign owned, are required to publish their consolidated financial statements according to IFRS as from reporting periods ending in 2010. All other Brazilian companies are required to prepare financial statements according to the new Brazilian accounting standards (BR GAAP) that are based on IFRS.

BR GAAP are to a very high extent aligned with IFRS. The new standards are the result of the efforts between the IASB, the Brazilian Federal Council of Accounting (CFC), the Brazilian Accounting Pronouncements Committee (CPC), and the Brazilian Securities and Exchange Commission (CVM) to eliminate significant differences between BR GAAP and IFRS.

4.3. Mexico

In November 2008, the Mexican Securities and Banking Commission (CNBV), together with the Mexican Accounting Standards Board (CINIF), announced that Mexico would adopt IFRS for all non-financial listed entities in 2012. Early adoption for some entities has been permitted from 2008 subject to requirements established by the CNBV.

During the last two years, the Mexican Authorities have continued their efforts to secure a timely transition to IFRS through regulation, the establishment of the Mexican IFRS Committee, and various publications. For instance, CNBV amended its Provisions for Listed Companies to require them to prepare their financial statements in accordance with IFRS, as issued by the IASB. In addition, they are compelled to obtain an auditor opinion, on their financial statements, based on the International Standards on Auditing issued by the International Auditing and Assurance Standards Board. Listed companies are required to send CNBV their IFRS implementation plan which must include a preliminary identification of the major impacts associated with IFRS implementation.

Foreign listed companies can prepare their financial statements in accordance with IFRS. Alternatively, they can use US GAAP or their domestic accounting standards but in these cases an explanatory note disclosing the most significant differences between accounting standards and methodologies must be attached.

4.4. Russia

According to publicly available information, the use of IFRS is permitted for consolidated financial statements following the adoption of a new Law on consolidated financial statements on 27 July 2010. This legislation formally requires that all consolidated financial statements should be prepared in accordance with IFRS. These developments do not affect standalone financial statements of Russian entities.[18] According to the law, IFRS statements will supplement statements under the Russian Accounting Standards (RAS) and will not replace them (preparing consolidated financial statements under IFRS will only be required for companies with publicly traded securities, banks and insurance companies).[19]

On 25 February 2011, the Russian government signed a decree on IFRS endorsement procedure according to which IFRS should be endorsed for use in Russia by the Ministry of Finance. The decree has been reported not to contain any implementing dates but the Minister of Finance has stated that he expected endorsement of the existing IFRS before the end of 2011 in which case the date of transition to IFRS for first-time adopters would be 1 January 2012, with the first full set of IFRS financial statements covering 2013 calendar year. An experts' committee is to be set up to advice the Ministry in this process, together with the Central Bank and the Federal Committee on Financial Markets.[20]

4.5. Taiwan

In May 2009, the Financial Supervisory Commission (FSC) of Taiwan announced its roadmap for the full adoption of IFRS in Taiwan. Phase I companies, which are all listed companies

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[18] As explained at: http://www.pwc.com/us/en/issues/ifrs-reporting/country-adoption/index.jhtml ; viewed on 22/02/2011.

[19] See IAS Plus as viewed on 18/03/2011: http://www.iasplus.com/country/russia.htm#1008.

[20] See http://www.iasplus.com/country/russia.htm#1103 as viewed on 18/03/2011.

and financial institutions supervised by the Financial Supervisory Commission (except for credit cooperatives, credit card companies, and insurance intermediaries), will be required to apply IFRS starting from 1 January 2013. Voluntary adoption of IFRS will be permitted starting from 1 January 2012 for all listed companies in which case the companies should indicate this in advance in their preceding financial reports, propose an IFRS adoption plan and disclose the impact of adoption. Phase II companies, which are unlisted public companies, credit cooperatives and credit card companies, will be required to apply IFRS starting from 1 January 2015 (optional starting from 1 January 2013).

5. CONCLUSIONS

According to ESMA's report, the four countries that were found equivalent to IFRS on a temporary basis until 31 December 2011 (China, Canada, India, and South Korea) have taken further steps in pursuing their convergence or adoption. The actions undertaken by each country have been presented above in the specific sections. China has already substantially converged its accounting standards with IFRS and is committed to eliminating the remaining, residual, differences. In India, the latest developments introduce uncertainty about the country's commitment towards an IFRS-compliant financial reporting system.

Other major economies have also recently announced their intention to adopt IFRS, such as Argentina, Brazil, Mexico, and Taiwan. In Russia, there have been recent developments as far as the adoption of IFRS is concerned.

Commission services will continue to monitor the situation and assesses the ongoing efforts by third countries converging to IFRS or intending to adopt IFRS, with the technical assistance of ESMA.

ANNEX

BRIEF UP-TO-DATE SITUATION OF SOME THIRD COUNTRIES CONVERGENCE OR ADOPTION OF IFRS

	Country	Remarks
China	China	Since 1 January 2009, the EC accepted financial statements using Chinese GAAPs on a temporary basis until 31 December 2011. Chinese authorities work towards full convergence by 2012.
Intend to adopt IFRS	Canada*	Since 1 January 2009, EC accepted financial statements using Canadian GAAPs on a temporary basis until 31 December 2011. Required from 1 January 2011 for all listed entities and permitted for private sector entities including not-for-profit organisations.
	South Korea	Since 1 January 2009, EC accepted financial statements using South Korean GAAPs on a temporary basis until 31 December 2011. "Early adoption of IFRS, with exception of financial institutions, is permitted from 2009. Adoption of IFRS is required for all listed companies and certain unlisted financial institutions from 2011"[21].
	India	Since 1 January 2009, EC accepted financial statements using Indian GAAPs on a temporary basis until 31 December 2011. India announced a plan to adopt IFRSs in 2011. Currently, not enough information on application and enforcement.
Other	Argentina	"For listed entities, IFRS is required for fiscal years ending on or after 31 December 2012, with early adoption permitted in 2011. For non-listed entities, IFRS is permitted, but not required, to be applied in the statutory financial statements for years ending on or after 31 December 2011 after approval is obtained from the appropriate corporate regulatory agency"[22].
	Brazil*	Required for consolidated financial statements of banks and listed companies from 31 December 2010 and for individual company accounts progressively since January 2008.
	Mexico*	Required from 2012.
	Russia*	Required for banking institutions and some other securities issuers; permitted for other companies.
	Taiwan	Listed companies and financial institutions supervised by FSC required to apply IFRS starting from 1 January 2013 (voluntary use from 1 January 2012). Unlisted public companies, credit cooperatives and credit card companies required to apply IFRS starting from 1 January 2015 (voluntary use from 1 January 2013).

* - The information summarised in this table regarding countries marked with an * can be found on the IFRS website on 22/02/2011 at:

http://www.ifrs.org/Use+around+the+world/Use+around+the+world.htm

21 See http://www.pwc.com/us/en/issues/ifrs-reporting/country-adoption/index.jhtml as viewed on 22/02/2011.

22 Publicly available information as seen on 22/02/2011 at: http://www.ey.com/GL/en/Issues/IFRS/IFRS-Status-of-implementation?country=Argentina